Institute of
International Bankers

Global Survey 2004

Regulatory and Market Developments

Banking - Securities - Insurance
Covering 37 Countries and the EU

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OVERVIEW

The Institute of International Bankers represents internationally headquartered banking/financial institutions from over 40 countries that engage in banking, securities, insurance and other financial activities in the United States. The combined banking and non-banking assets of the U.S. operations of over 200 international banks total nearly $4 trillion. This seventeenth 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, 2003 to June 30, 2004 in 37 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.

Among the most significant developments during the period under review was the June 2004 publication of the new version of the Basel capital accord (Basel II) by the Basel Committee on Banking Supervision. Implementation of the new Accord will be in two stages, with the standardized and foundation approaches scheduled to be in place by the end of 2006 and the advanced approaches by the end of 2007.

In the United States, where Basel II will be mandatory for only about the 9 largest banking companies, with another 10-20 banks expected to adopt it on a voluntary basis, U.S. federal banking agencies are embarking on a fourth Quantitative Impact Study. Plans for implementation of Basel II have been met with some concerns that Basel II's operational risk management objectives are better suited to a supervisory approach than to a quantitative measurement approach. The European Commission's proposed Directive for European Union-wide implementation of the Accord will be negotiated by the Member States in Council and by the European Parliament. Meanwhile, another noteworthy development was the extension of the Lamfalussy process to banking and insurance. The Committee of European Banking Supervisors (CEBS) was set up in January 2004 to facilitate supervisory convergence in the EU and deliver consistent implementation across Member States.

As discussed in many of the individual country chapters, the period under review saw continued efforts to combat money laundering and the financing of terrorism, including through the adoption of the revised 40 recommendations of the Financial Action Task Force (FATF). The Australian Government, for example, accepted the revised FATF recommendations in December 2003 and is also putting in place new measures to expand customer due diligence requirements for financial institutions and extend anti-money laundering obligations to non-financial businesses and professionals. Similarly, Bahrain is overhauling its anti-money laundering regulations, which have been revised in light of the revised FATF recommendations. In the U.S., the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department, has stated that money laundering through foreign shell banks continues to be a key area of concern, despite the adoption of extensive certification requirements for correspondent banking relationships that might possibly involve shell banks. Although the USA PATRIOT Act has put in place documentation requirements to ensure that U.S. banks and broker-dealers know the identity of owners of privately-held banks and other intermediaries that might possibly be shell banks, the enhanced scrutiny of possible shell bank activities continues to be a prominent regulatory focus. Finally, there has been heightened scrutiny in Congress and among bank supervisors and law enforcement agencies regarding money laundering and terrorist financing as a result of the revelations regarding the very unfavorable practices at Riggs Bank that were not corrected for a number of years, particularly in the private banking area.

A number of country chapters also highlight further developments and initiatives in regard to corporate governance, accounting and investor protection issues. In March 2004, for example, the European Parliament and Member States adopted the Directive for harmonization of transparency requirements of publicly listed companies. One of the key elements of the Commission's original proposal, published in March 2003, was mandatory quarterly reporting for all listed companies. However, Member States were divided on the value of quarterly reporting and in the final Directive companies whose home Member State does not require quarterly reporting will only be required to publish a management statement between the annual and half-yearly reports. This decision will be reviewed by the Commission five years after the implementation of the Directive. In other developments, the German government in April 2004 published an investor protection bill which translates the EU Market Abuse Directive into German rules on insider trading, ad-hoc disclosure, prohibition of manipulation of market prices and securities analysis. In addition, the bill would for the first time introduce a requirement in German law to report suspicions of insider or price-manipulating activities. In the U.K., there have been important regulatory initiatives in three areas affecting wholesale and institutional markets: analyst research and conflicts of interest, softing and bundling, and the listing review. And in Switzerland, new directives are due to enter into force on January 1, 2005 to improve the fairness and transparency of the allocation process for both the primary market (IPOs) and capital increases.

A matter selected for special attention in this year's Global Survey concerns how various countries around the world fund the activities of their bank supervisory authorities, i.e., through assessments paid by the regulated institutions or as part of the government/central bank's budget (see table beginning on page 1).

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 are taking to implementation of Basel II, 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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[5] The treatment of smaller banking institutions (e.g. restricted license banks and deposit-taking companies) has yet to be decided, pending further industry consultation on implementation proposals after the New Accord is finalized. Options include allowing them all to stay on Basel I (or more likely a variant thereof, incorporating an operational risk charge) or allowing them to adopt the Standardized Approach on a voluntary basis.

[6] 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.

[7] In Romania, the central bank, as banking supervisory authority, intends to adopt all elements of Basel II; at least initially, it is expected that smaller banks will adopt the simpler Basel approaches, while the larger ones will adopt the advanced Basel approaches. Local branches of foreign banks are permitted to apply the parent institution's approach.

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

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

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 Romania[10] Singapore[11] United Kingdom	Czech Republic Denmark[12] Germany Norway Turkey	Israel

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[6] Funds must be invested in Portugal.

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

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

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

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

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

[12] Branches of non-domestic banking organizations 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 Hong Kong[1] Philippines[1] Romania[2] Singapore Switzerland[1]	Argentina Austria Belgium Czech Republic 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]
	Canada	Romania	
	Czech Republic	Singapore[7]	
	Denmark	South Africa	
	Finland	Spain	
	France	Sweden	
	Germany	Switzerland	
	Hong Kong[4]	United Kingdom	
	Ireland	Venezuela	

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MARKET RISK CAPITAL REQUIREMENTS

Banks subject to Risk-based capital Requirements for market risk	Nonbank financial institutions (such as securities or insurance firms) subject to risk-based capital requirements for market risk	Banks permitted to use Internal models to Measure market risk for risk-based capital adequacy requirements
Argentina	Australia (securities and insurance firms)	Australia
Austria	Austria (securities firms)	Austria
Australia	Belgium (securities firms)	Bahrain
Bahrain	Bermuda (securities and insurance firms)	Belgium
Belgium	Brazil (securities firms)	Canada
Bermuda	Czech Republic (securities and insurance firms)	Cayman Islands
Brazil	Denmark (securities firms)	Colombia
Canada	European Union (securities firms)	Czech Republic
Cayman Islands	Finland (securities firms)	Denmark
Colombia	France (securities firms)	Estonia[3]
Czech Republic	Germany (securities firms)	European Union[4]
Denmark	Greece (securities firms)	Finland
Estonia	Ireland (securities firms)	France
European Union	Italy (securities firms)	Germany
Finland	Korea (securities firms)	Hong Kong
France	Latvia (securities firms)	Indonesia
Germany	Luxembourg (securities firms)	Ireland
Greece	Mexico (securities firms)	Israel
Hong Kong	Norway (securities firms)	Italy
Indonesia	Philippines	Japan
Ireland	Poland (securities firms)	Korea
Israel	Portugal (securities firms)	Latvia[5]
Italy	Singapore (securities firms; futures brokers)	Luxembourg
Japan	South Africa (securities firms)	Netherlands
Korea	Spain (securities firms)	Norway
Latvia[1]	Sweden (securities firms)	Pakistan
Luxembourg	Switzerland (securities firms)	Poland
Mexico	United Kingdom (securities firms)	Singapore
Netherlands	Venezuela (securities firms)	South Africa[6]
Norway		Spain
Peru		Sweden
Philippines		Switzerland
Poland		Turkey
Portugal		United Kingdom
Romania[2]		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 capital requirement for fx risk applies from July 1, 2000, while for other market risks it applies from January 1, 2000.

[2] In Romania, market risk capital requirements will be issued by the end of the first semester of 2004 and will be implemented beginning with 2005.

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

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

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

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

PERMISSIBLE ACTIVITIES[4] FOR BANKING ORGANIZATIONS IN VARIOUS FINANCIAL CENTERS

Country	Securities[5]	Insurance[6]	Real Estate[7]	Bank Investments in Industrial Firms[8]	Industrial Firm Investments in Banks
Argentina	Permitted	Permitted, but only with regard to pension fund affiliates	Limited; based on bank capital and investment	Limited	Permitted but subject to prior approval of authorities
Australia	Permitted	Permitted through subsidiaries or sister companies, subject to controls under the insurance laws	Limited	Permitted; a bank (and its consolidated banking group) is required to deduct equity investments in non-subsidiary entities that are not operating in the field of finance in excess of 0.25% of consolidated Tier 1 capital for an individual investment of 5% of consolidated Tier 1 capital in aggregate, from the bank's (and the group's) Tier 1 capital.	Shareholdings of more than 15% in a bank need the approval of the Treasurer. The Treasurer has signaled a willingness to consider an association between a bank and a non-financial company where a sound case can be presented. This policy will be applied conservatively.
Austria	Permitted	Permitted through subsidiaries	Permitted	Permitted, subject to capital deduction rules relating to equity investments in non-financial entities.	Permitted, but subject to notification and prohibition under certain circumstances

[4] 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.
[5] Securities activities include underwriting, dealing and brokering all kinds of securities and all aspects of the mutual fund business.
[6] Insurance activities include underwriting and selling insurance as principal and as agent.
[7] Real estate activities include real estate investment, development and management.
[8] Including investments through holding company structures, where applicable.

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

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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Czech Republic	Subject to authorization by the Securities Commission	Selling of insurance policies as an agent is permitted; other activities permitted through independent subsidiaries with the approval of the Ministry of Finance	Permitted	Controlling interests (i.e., in excess of 50%) are prohibited. "Qualified" interests (i.e., in excess of 10% but not controlling) are permitted but may not exceed (i) individually, 15% and (ii) in the aggregate, 60% of the investing bank's capital	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 10, 20, 33 and 50%
Denmark	Permitted	Permitted through subsidiaries	Permitted up to 20% of the bank's capital	Permitted with restrictions; permanent controlling holdings in industrial companies are prohibited	Not prohibited, 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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Estonia	Permitted	Permitted through affiliates	Permitted, but as of July 1, 1998 total investments in fixed assets may not exceed 60% of own funds	Permitted, but each shareholding may not exceed 15% of the bank's own funds and such holdings in the aggregate may not exceed 60% of own funds	Permitted
European Union[9]	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

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

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

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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Italy	Permitted	Limited to 10% of own funds for each insurance company and 20% aggregate investment in insurance companies	Generally limited to holding bank premises	Permitted, up to 15% of the bank's capital, subject to approval of the Bank of Italy	Permitted, up to 5% of shares of the bank, subject to the approval of the Bank of Italy
Japan	Some services (e.g., selling of government bonds and investment trusts) permitted to banks, others permitted through subsidiaries.	Some services (selling insurance policies in connection with housing loans) permitted to banks, others permitted through subsidiaries	Generally limited to holding bank premises	Limited to holding 5% interest[10]	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

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

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

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

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

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

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

ARGENTINA

During the period under review, there was a further strengthening of the country's general economic situation. The exchange rate of the peso versus the U.S. dollar stabilized at 3 pesos per dollar, production started to recover and depositors once again started making deposits in the financial system, in a scenario characterized by the gradual stabilization of financial variables and by the strengthening of banks' liquidity.

In this sense, it should be noted that financial activity offered clear signs of having commenced a normalization process. Deposit growth occurred during the year despite the substantial decline of yields and recently credits started to reverse the systematic decline which had prevailed since almost mid-2001.

Minimum Capital Requirements

The main modifications introduced by the Central Bank during last year are as follows:

Minimum Capital Requirement for Market Risk

- The minimum capital requirement was reduced from 11.5 to 8%, over the value of financing and of non-fixed assets.
- The 8% requirement shall also be applied to holdings in investment accounts and to financing granted to the non-financial public sector.
- The application of risk indicators based on loans' interest rates was temporarily suspended.
- The introduction of a new item representing an increment on account of excesses with respect to fixed assets' ratio, the limits of credit risk fractioning, financing to related clients, credit rating and the financial assistance limit to the non-financial public sector was provided for.
- The requirement calculation should take into account adjustments to CER (Reference Stabilization Coefficient) and CVS (Salary Variation Coefficient).

Minimum Capital Requirement for Interest Rate Risk

- Ratios on account of interest rates risk in pesos and in US dollars quintupled.
- The concept of market gap risk between the interest rate and CER was incorporated.
- The current value of assets adjustable to CER and CVS, net of financial intermediation charges in pesos adjustable to CER, was also introduced.

Minimum Capital Requirement for Market Risk

The US dollar was introduced in the calculation of the market risk value as a new foreign currency position. The gold position was also incorporated.

On the other hand, the temporary provisions related to the treatment contemplated for institutions that exchanged debt instruments issued by the Government for Secured Loans issued by Decree 1387/2001 were repealed.

The figure thus obtained shall then be multiplied by an adjustment factor (alpha ratio) which will determine the difference to be complied. There was an adjustment factor applicable to holdings in investment accounts and financing granted to the national non-financial public sector until 5/31/03 and to instruments received on account of the compensation and to instruments issued by the Trust Fund for Provincial Development. This factor was increased from 0.05 to 1 between 2004 and 2009. On the other hand, another factor is applicable to temporarily reduce the interest-rate risk requirement, which varies from 0.20 and 1 between 2004 and 2007.

Finally, it should be noted that the Central Bank allows financial institutions to record, as of March 2003, the differences paid on account of judicial injunctions in the assets thereof. These differences should be amortized in a 60-month term as of the activation thereof.

Government Measures and Consequences on Financial Sector

Decree 905/02 provided that financial institutions should be compensated for the damage sustained by the asymmetric pesification, i.e., damages derived from the conversion of loans into pesos at an exchange rate equal to 1 peso per dollar, while deposits were converted at 1.40 pesos per dollar plus CER adjustment, and while other liabilities such as commercial paper and foreign credit lines were maintained in foreign currency. By way of compensation, banks received public bonds denominated in pesos adjusted by CER index and dollar-denominated bonds, in the latter case, for a maximum amount equal to net liabilities in foreign currency.

Although considerable progress was made in the year 2003 in settling this compensation, by year-end various interpretation issues pending resolution had prevented most banks from disposing of the total amount of the relevant bonds.

On the other hand, the successive measures adopted by the Government released most debts pesified at 1 peso per dollar from being adjusted by CER. These changes were consolidated by Act 25,713 contemplating the exceptions to adjustments to CER, the cases in which debts had to be adjusted by CVS as well as the rate to be applied.

Whereas certain loans pesified at the exchange rate of 1 peso per dollar were exempted from the adjustment to CER, the banks' pesified liabilities were subject to such adjustments. Therefore, the application of different adjustment ratios for assets and liabilities resulted in major losses for the institutions.

In September 2003, Act 25,796 was passed by Congress, which established a compensation mechanism for losses sustained due to the different treatment applied to the adjustment of assets and liabilities. The rule provided that the compensation be effected through the delivery of "2013 Argentine Government Bonds (BODEN) in pesos at a variable rate" for a maximum amount of $2.8 billion.

However, on January 20, 2004 a Decree was published whereby the statutes above, the exemptions from the application of CER adjustments and the compensation for asymmetric indexation were regulated.

It is very important to mention that compensation granted so far only covers losses derived from asymmetric pesification. Damages derived from asymmetric indexation might be partially compensated through the mechanism provided for by law, whereas those derived from the payment of judicial injunctions at the market exchange rate have not yet been contemplated.

Judicial Injunctions

The amount paid through judicial injunctions in 2003 was lower than the amount paid in 2002, although it represents an important figure. Last year, 83,300 cases were registered, on account of which $5.4 billion was paid, which represented a difference of almost $1.7 billion with respect to the valuation of such deposits at $1.40 per dollar plus CER adjustment.

Since 2002, financial institutions have paid $19.9 billion on account of preliminary injunctions for deposits recorded at a value equal to $11.2 billion, as provided for in the regulation in force ($1.40 plus CER adjustment). The $8.7 billion peso difference represents an equity loss of about 30% for financial institutions.

Mortgage Loans Refinancing System

Act 25,798 passed in November established the creation of a Refinancing System for Mortgage Loans. This mechanism allows refinancing mortgage loans originally granted for a maximum amount of $100,000 and maturing between January 1, 2001 and September 11, 2003.

This mechanism shall be implemented through the creation of a trust fund to which all loans shall be transferred. The trustee shall be responsible for settling outstanding principal installments by means of bonds.

On the other hand, the debtor's debt shall be restructured in order to allow the debtor to pay fixed equal and consecutive monthly installments, applying the rates and adjustments in force. Besides, such installments shall be compatible with the family's income and the real estate value. A one-year grace period shall be granted and the term to be applied shall be longer as the ratio between the amount due and the restated real estate value shall be higher.

Amendments to the Central Bank's Charter and to the Financial Institutions' Act

In September 2003, Act 25,780 introduced amendments to the Financial Institutions' Act and to the Central Bank's Charter.

The Financial Institutions' Act was amended in its section 35 bis, related to the restructuring of an institution for the sake of safeguarding both credits and deposits, introducing certain changes regarding the exclusion of the assets and liabilities of the relevant institution and the transfers thereof.

On the other hand, a paragraph was incorporated to provide that the timing, merits and convenience of acts performed by the Central Bank and the Superintendence of Financial and Exchange Institutions (SEFyC) in restructuring processes shall only be revised in court in the event of manifest arbitrariness or irrationality. In addition, amendments were introduced with respect to judicial settlement provided for in section 48 and regarding the ranking of creditors for the collection of outstanding debts in the event of institutions' liquidation or winding up (section 49).

With respect to the Central Bank's Charter, the Board of Directors was vested with the power to exempt, reduce or mitigate charges in certain exceptional cases, and introduced the Board's obligation to submit to the Senate the budget required by the Charter prior to September 30 of each year.

Likewise, advance payments which the Central Bank was authorized to make to the Argentine Government were increased up to 12% of the monetary base, and, additionally, up to 10% of the cash resources obtained in the last 12 months, provided such advance payment is allocated to the settlement of obligations contracted with multilateral credit institutions. All these advance payments shall be reimbursed in the subsequent twelve-month term. Otherwise, this power shall not be exercised again until all outstanding amounts shall be paid

Funding of Bank Supervisory Authority

The Central Bank of Argentina is funded through the central bank's budget process.

AUSTRALIA

Authorized Deposit-Taking Institutions (ADIs)

As a result of earlier work showing inconsistency in the financial reporting and capital adequacy treatment of capitalized expenses, in June 2003, the Australian Prudential Regulation Authority (APRA) proposed that many of these expenses be treated as intangible assets and deducted from Tier 1 capital. These included loan origination fees and commissions paid to originators and brokers, securitization establishment costs and costs associated with debt/capital raisings. After industry consultation, the proposals were finalized in December 2003 with ADIs to adopt the changes for quarterly prudential reporting after 1 July 2004, subject to a one year transitional arrangement for some authorized deposit-taking institutions (ADIs).

Against the backdrop of sharply rising house prices for several years, over 2003 APRA completed a rigorous "stress test" to help gauge the resilience of the housing loan portfolios of 120 ADIs to a substantial housing market correction. The stress test mapped the effect of a 30 per cent fall in house prices. The results were released in the first quarter of 2004 and revealed that all 120 ADIs would remain solvent under the conditions imposed. However, 11 institutions would fall below their regulatory minimum capital levels, which in many cases are higher than eight per cent. Current default rates on residential mortgages are very low, but with tighter monetary policy and stronger signals that the housing cycle has turned, APRA has warned ADIs to proceed with caution in housing lending.

In November 2003, APRA released a discussion paper proposing the introduction of more detailed criteria for ADIs to qualify for the 50 per cent concessional risk weighting of residential mortgage lending for capital adequacy purposes. APRA's concern is that applying this concessional risk weight to loans where the borrower's servicing ability is not verified by ADIs may not adequately reflect the likelihood of increased risk. Implementation is planned for October 1, 2004.

General Insurance

In November 2003, in an additional response to the recommendations of the HIH Royal Commission, APRA released a discussion paper seeking public comment on a second round of proposed reforms to the prudential regulation of general insurers. The proposals include revisions to the existing prudential standards and guidance notes in light of recent experience and market developments. Key topics covered were governance, technical standards, the risk management framework and disclosure about the activities of general insurers, to promote market discipline. APRA is currently in the process of analyzing submissions and further refining its proposals.

From July 1, 2003, all medical indemnity cover must be offered under contracts of insurance by general insurers authorized under the Insurance Act 1973, rather than being offered on a discretionary basis by medical defense organizations, as was past practice.

Results of the ADI housing loan stress test revealed that a significant proportion of ADI counterparty default risk for housing loans is transferred to Lending Mortgage Insurers (LMIs). Consequently, in late 2003, APRA extended the stress test to LMIs and conducted a broader review of the LMI industry. This highlighted inadequacies in capital requirements and reporting to APRA, inconsistencies in prudential supervision of LMIs and ADIs, and unacceptable risk transfer arrangements within the LMI industry. Proposed amendments to prudential requirements, including a standard model for LMIs to calculate the concentration risk charge, additional reporting requirements for LMIs, and changes to the eligibility requirements for mortgage insured loans for capital concession purposes will be released in a policy discussion paper for public consultation in August 2004.

Life Insurance

Over the next few years, APRA will be seeking to harmonize the regulatory regime for life insurance with those in general insurance and banking, where appropriate. Changes will also be made where necessary to accommodate the adoption of International Financial Reporting Standards in Australia.

Superannuation

Much of APRA's work in 2003/2004 has focused on assisting the Commonwealth Government develop major reforms covering the operation and monitoring of superannuation service providers.

Comprehensive reforms to the supervision of the superannuation industry came into force on 1 July 2004 with the enactment of the Superannuation Safety Amendment Act. There is a two year transitional period. The Act places rigorous entry and risk management requirements on trustees wishing to offer superannuation services, augmented by greater scope for APRA to effectively monitor trustee activities and superannuation fund operations. The four major aspects of reform in the Act are: universal trustee licensing; compulsory superannuation fund registration;

development of effective risk management frameworks; and operating standards in key areas, including outsourcing, fitness and propriety, and adequacy of resources.

The Government has also introduced new portability regulations to allow consolidation of retirement savings and from 1 July 2005 many employees will be able to choose the fund into which their compulsory contributions are paid.

Fit and Proper Requirements

In March 2004, APRA released for consultation, proposed new prudential standards on fit and proper requirements for "responsible persons" of ADIs, general insurers, and life insurers. The proposed requirements involve regulated institutions applying explicit tests of fitness and propriety to help ensure that responsible persons have the technical competence, skills, experience, and integrity necessary to perform their roles. However, APRA will not vet or authorise responsible person appointments.

Prudential Standard for Business Continuity Management

In July 2004, APRA released for comment a draft Prudential Standard on Business Continuity Management to apply to ADIs, general insurers and life insurers. The primary objective of the requirements is to increase the resilience of regulated institutions to business disruptions arising from internal and external events. The draft Standard ensures a harmonized framework for business continuity risk management across the three APRA-regulated industries.

Resourcing Review and Restructure

In the wake of the HIH failure, APRA commissioned an independent benchmarking study which showed that compared with its international regulatory peers, APRA was under-resourced in its supervision of large and complex financial institutions. Since the beginning of 2003, with the support of additional budgetary resources, APRA has hired an additional 55 staff into frontline and supporting supervisory roles, with a further 60 hires planned over 2004/05, taking staff numbers to around 570.

On July 1 2004, APRA implemented changes to its organizational structure and decision making processes. The restructure preserves the integrated regulator model and retains two front-line supervisory divisions – Specialized Institutions and Diversified Institutions – and a Policy, Research and Statistics Division. A new division, the Supervisory Support Division, has been created to bring together those specialist areas which support the supervisory divisions on entity-specific matters, such as Industry Technical Services, Legal and Actuarial Services and Specialist Risk Services.

Financial System Guarantees

In September 2003, as part of its response to the HIH Royal Commission recommendations, the Government commissioned a technical study (led by Professor Kevin Davis) to consider the merits of introducing a limited explicit guarantee into parts of the Australian financial system and the appropriate design features of any such guarantee scheme. This decision was taken in order to consider guarantees across the prudentially regulated sectors, namely, deposit-taking, life and general insurance and superannuation, rather than in relation to the general insurance sector alone.

In May 2004, the Government released the Davis Report in full together with a Government discussion paper on financial system guarantees seeking public comment. The public consultation process is continuing, after which the Government can make an in-principle decision on whether to implement a financial system guarantee scheme and, if so, to determine appropriate design parameters.

Regulation of the Financial Services Industry

The transitional period for the introduction of the Australian Financial Services Licensing regime ended on March 11, 2004. One of the main objectives of these reforms was to introduce a common licensing arrangement across the financial services industry. The Australian Securities and Investments Commission (ASIC) issued 3738 Australian Financial Services Licenses by the end of the transitional period. The main industries represented by license holders were - general insurance (23.5%), financial advisers (20.9%), managed investments (15%), market dealers (14.3%), life insurance (12.5%), superannuation (6.4%) and deposit takers (4.4%).

Corporate Law Economic Reform Program (CLERP)

The Government's Corporate Law Economic Reform Program continues. *The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9) was assented to on 30 June 2004. CLERP 9 aims to enhance the quality of disclosure of relevant information to the market, by strengthening continuous disclosure requirements. This includes empowering ASIC to issue infringement notices to entities for breaches of the continuous disclosure requirements of the *Corporations Act 2001*.

CLERP 9 also imposes tighter controls and standards on auditor regulation and financial reporting, especially in the areas of:

- overseeing the auditing profession;
- auditors providing non-audit services for clients;
- auditor independence;
- auditor liability; and
- accounting standards.

Policy Initiatives

ASIC has issued a number of policy statements designed to give effect to legislative provisions that will assist foreign financial service providers and market operators to access the Australian market. For example, Policy Statement PS 176 Licensing: Discretionary powers – wholesale foreign financial service providers, which identifies circumstances in which ASIC may grant an exemption to a foreign financial service provider from holding an Australian Financial Services License.

Payment Systems, Electronic Commerce and Banking

In August 2002, the Reserve Bank of Australia (RBA) announced its reforms to credit card schemes. As of January 1, 2003, merchants are permitted to impose a surcharge on customers who pay with a credit card. From the end of October 2003, interchange fees have been set by a cost-based transparent benchmark. The benchmark is based on the costs incurred by card issuers in processing and authorizing transactions, fraud and fraud prevention, and funding the interest-free period. Access to the credit card schemes has been broadened to allow specialist credit card institutions, authorized and supervised by APRA, to apply to participate.

In early 2002, the RBA convened a series of meetings of industry participants to explore options for debit card reform. In July 2002, 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 (ACCC) to reduce debit card interchange fees to zero. The ACCC ruled in favor of the application in December 2003, subject to suitable access reform being agreed to. The Australian Payments Clearing Association is currently developing a new access regime for the EFTPOS system, which is due to be submitted to the ACCC for authorization by November 2004. Separately, a group of Australian retailers successfully appealed the ACCC decision to the Competition Tribunal of the Federal Court. The RBA is now considering whether it would be in the public interest for it to designate the EFTPOS system. In February 2004, the RBA designated the Visa Debit card scheme as a payment system under the *Payments System Act 1998*. This is the first step in the possible establishment of standards and/or access regimes for a payments system. Consultation is continuing with Visa and its members.

In March 2003, the industry released for public comment a proposal that interchange fees paid to ATM owners/acquirers be replaced by a regime where each ATM owner can levy charges directly on consumers. The ATM Industry Steering Group agreed on a model for reform but an application to the ACCC for authorization has not been forthcoming. The RBA is now considering whether it would be in the public interest for it to designate the ATM system. The RBA's financial stability standards for central counterparties and securities settlement facilities were implemented in March 2004. The standards seek 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

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

The new standards outlined in the FATF revised recommendations will require Australia to expand customer due diligence requirements for financial institutions and extend anti-money laundering obligations to non-financial businesses and professions such as real estate agents, dealers in precious metals and stones, accountants, trust and company service providers, legal professionals and notaries.

The Attorney-General's Department is coordinating an extensive consultation process which involves preparation of industry specific issues papers and direct consultation with industry sectors. From January 2004, issues papers covering the various industry sectors – the financial services sector, real estate dealers, dealers in precious metals and stones, the gambling industry, legal practitioners, accountants, and company and trust service providers – were released progressively.

In consultation with other Government agencies, the Attorney-General's Department has conducted consultative forums with industry representatives and members of the public. Following the round of industry sector consultation based primarily on the issues papers, a policy principles paper is to be released. This will be made available prior to the draft Exposure Bill of new anti-money laundering legislation.

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

To further assist industry understanding of the broader issue of money laundering, and particularly the current requirements within the Australian anti-money laundering environment, AUSTRAC has developed an internet based anti-money laundering E-learning application. This product is in final testing and is intended for public release shortly. The application contains 15 modules ranging from "An Introduction to Money Laundering", "Terrorist Financing", "Best Practice Risk Management" and individual modules on the specific reporting obligations within Australia. The application contains over 8 hours of learning content, each module containing approx 30 – 40 minutes of individual content.

AUSTRAC has also received funding for the July 2004 – June 2005 financial year to establish and deliver technical and information technology (IT) assistance to developing Financial Intelligence Units (FIU's) in the South East Asian region, building on the successes of the recent long-term mentoring project in Indonesia's FIU, PPATK.

To deliver the assistance package, AUSTRAC will establish a new (TA&T) team within AUSTRAC's existing International section. The new team will draw together the best of Australia's training, IT and financial intelligence technical and analytical expertise. The package will be delivered through the development and delivery of an AUSTRAC in-house training program, focusing on technical and analytical capabilities, and in-country FIU mentoring exercises aimed at technical skill consolidation and broader FIU development assistance. The IT needs of regional FIUs will also be assessed, and strategies and solutions to meet these needs developed.

AUSTRAC also continues to support multilateral training programs, technical workshops and other anti-money laundering and counter terrorist financing initiatives throughout the world, and with a particular focus in the South East Asian and Pacific regions.

Further information on Australia's anti-money laundering efforts and anti-money laundering reform, in particular, can be found at www.austrac.gov.au and www.ag.gov.au/aml.

Basel II Implementation

APRA will apply the Basel II capital requirements to all ADIs in Australia, except foreign bank branches to which capital adequacy requirements do not apply on a stand-alone basis.

Funding of Bank Supervisory Authority

APRA is funded primarily through levies paid by the industries it regulates. The amounts are set periodically based on a 3 year rolling average of the cost of supervision of each industry, with the levy for each firm based on asset size but subject to a cap or floor. The levies raised are transferred to APRA via a special appropriation of Government after some amounts are retained in the Government's Consolidated Revenue Fund to fund consumer protection, market integrity and some other activities not undertaken by APRA. For some of APRA's activities not related to its supervision functions, there can be a Government budget appropriation-however these amounts are usually small relative to levy based funds."

AUSTRIA

Regulatory Developments

A comprehensive amendment to the Austrian Banking Act includes the obligation for currency exchange offices and money transmitters to obtain a license, thus implementing the revised anti-money laundering Directive and FATF's special recommendation IV, while it also defines detailed prudential rules to combat money laundering and terrorist financing. Tighter customer identification requirements have been adopted and a number of special rules have been introduced for trustees authorized to keep third-party accounts.

Major Modifications:

- prudential rules for banks supplemented to include aspects of terrorist financing;
- irrespective of the amounts involved, identification requirements extended to include transactions suspected of terrorist financing;
- detailed rules for establishing the identity of customers and detailed criteria defining admissible identity documents;
- new rules for establishing identity in trust business and a special provision for third-party accounts held by authorized trustees;

- rules on the establishment of permanent business relations without meeting customers face-to-face (identification in distance marketing); and
- reporting requirements extended: banks now have to report suspected terrorist organizations.

Most of the changes regarding customer identification entered into force on June 15, 2003, while the new provisions on trust accounts and school savings accounts entered into force on October 30, 2003 and provisions on licensing requirements for currency exchange offices and money transmitters on January 1, 2004.

Markets and Banking Supervision
Bill on Financial Conglomerates

The European Union's Financial Conglomerates Directive is to be transposed into national law by August 2004. The fundamental idea underlying the Austrian bill is undisputed as it ensures monitoring and control of a conglomerate's overall solvency position and risk concentrations and requires the implementation of appropriate risk management processes and adequate internal control mechanisms at the level of the financial conglomerate.

Financial Sector Assessment Program

In the second half of 2003, Austria underwent a voluntary evaluation by the International Monetary Fund (IMF) under the latter's Financial Sector Assessment Program. Assessment focused, inter alia, on the banking sector, its economic environment, stress testing, organization of supervision and legal framework.

The results show:

- that the introduction of integrated supervision meets highest international standards, and that co-operation with OeNB (Austrian Central Bank) is good;
- that the Austrian system is generally up to internationally developed supervisory standards for banking, insurance and investment operations, as well as for combating money laundering;
- that the banking sector is stable and resistant to shock;
- that the financial sector's performance is satisfying; and
- that the early inroads made by domestic credit institutions in Central and Eastern Europe have helped strengthen their earnings situation. However, there are a number of areas where the IMF sees need for action, such as adopting further measures to increase profitability in the domestic market, change the structure of the deposit guarantee system, improve corporate governance and take better precautions to support any risks arising under foreign currency loans.

Funding the Activities of Banking Regulators in Austria

The Austrian Financial Market Authority FMA is an independent, autonomous and integrated supervisory authority for the Austrian Financial Market, established as an institution under public law. It is responsible for the supervision of credit institutions, insurance undertakings, pension funds, staff provision funds, investment funds, investment service providers, companies listed on the stock exchange as well as stock exchanges themselves.

Section 19 FMABG (Federal Act on the Institution and the Organization of the Financial Market Authority) regulates the calculation of the costs of all supervised natural or legal persons, i.e. the ”entities liable to pay costs“. The costs are to be reimbursed after the FMA issued a notice of payment due. To this end, the costs are to be allocated to one of the four accounting groups pursuant to section 2 paras 1 to 4 FMABG (banking, insurance, securities and pension supervision).

Pursuant to section 19 para 4 FMABG, the federal government contributes a fixed sum of EUR 3.5 million to the FMA each financial year.

BAHRAIN

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

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

Since the last survey, the BMA has embarked on a major program to enhance resources dedicated to its supervisory functions. The increase in resources reflects the continued growth in licensee numbers, as well as the growing complexity and volume of regulation, notably as a result of Basel II.

To ensure consistent and effective implementation of supervision, and to assist in the training of new staff, the BMA has embarked on a project to develop internal procedures manuals for each of its supervisory directorates. The first of these manuals is scheduled for completion by the end of the third quarter of 2004, with the remainder to be finished over the following six months.

In the meantime, significant progress has been made on the project to re-draft all of BMA's regulations in the form of a structured Rulebook, so as to move away from the current approach of issuing individual circulars on an ad-hoc basis. Volume 1 of the Rulebook, covering regulations for banks operating under conventional principles (as opposed to Islamic finance principles) is now finalized and scheduled for publication in early August 2004. Volumes 2 and 3 (covering respectively Islamic banks and the insurance sector) are scheduled for publication in October 2004. The final two volumes (covering investment firms and other specialized activities such as leasing) will be issued during 2005.

The project will significantly enhance the transparency of BMA's regulatory requirements, as well as provide a much clearer basis for identifying existing gaps or areas where existing regulations need updating. The Rulebook will be made available on the BMA's website and on CD-ROM, as well as in hard copy.

Whereas for most volumes of the Rulebook the work has been limited to reviewing and redrafting existing regulations, work for the insurance Volume has extended to creating a completely new regulatory framework, aimed at significantly enhancing the previous regime inherited by BMA in 2002.

When implemented on January 1, 2005, BMA's new insurance regulatory framework will provide a comprehensive set of regulations for insurers, compliant with the Core Principles of the International Association of Insurance Supervisors. The framework will specify requirements in areas such as capital and solvency, actuaries, governance and high level controls, risk management, conduct of business, reporting and public disclosures, and group risks.

Banking regulations continue to be kept under review, and a number of new requirements were introduced during the period 2003-04. These included new regulations regarding succession planning for senior management; an explicit obligation on licensees to disclose fraud or attempted fraud to the BMA; a "whistleblower" requirement, for staff to disclose significant concerns to the BMA; regular reporting on the operation of Boards and their committees; consumer finance; and the BMA's enforcement mechanisms.

In addition, the BMA is currently consulting on a major overhaul of its regulations relating to governance and high-level controls, and on the BMA's anti-money laundering regulations (which have been revised in the light of the FATF's revised 40 Recommendations).

Discussions with banks on Basel II have continued, including the carrying out of an impact study for the ten largest locally incorporated banks in the Kingdom. Detailed work on finalizing the Kingdom's implementation strategy and developing new regulations will start in 2005, with the target of implementing some or all of the elements of Basel II from 2008 onwards.

In the area of capital markets, the BMA has issued new regulations covering disclosure standards; the issuing, offering and listing of debt securities; and the prevention of money laundering by users of the Bahrain Stock Exchange. A major consultation on a comprehensive Securities and Exchange Regulation is also under way.

The performance of the financial sector since the last survey has remained strong. The risk-adjusted rate of return remains healthy in all the Kingdom's banking sectors. The contribution of financial corporations to Bahrain's GDP increased from 15.6% in 2002 to 19.2% in 2003.

Total assets of full commercial banks stood at US$13.3 billion in June 2004, compared to US$11.2 billion in the corresponding period of the previous year, a growth of almost 19%. Of these assets, US$ 1.6 billion were in Islamic banks in June 2004, up 33% from a year earlier.

Total assets of the offshore banking units rose to US$89.1 billion in June 2004 from $82.5 billion in June 2003, and increase of 8%. Islamic banks accounted for US$800 million of these assets in June 2004.

Total investment bank assets stood at US$5.3 billion in June 2004, recording a 15% growth over the corresponding figures of US$4.6 billion a year earlier. Islamic banks were the fastest growing part of this sector, their assets increased over the year by 38% to US$2.2 billion in June 2004.

The number of insurance companies operating in Bahrain increased to 21. There was a continuing growth in gross insurance premiums in 2003 by 16% to reach BD 79 million (approximately US$ 210 million).

Meanwhile, Bahrain's financial sector continued to grow and attract new entrants during the period. In calendar year 2003, 30 new licenses were issued. At the end of the year there were a total of 357 banks, insurance companies, securities brokers and other financial institutions were licensed by the Agency. Of the new licenses issued, 12 were banks and other financial institutions; 17 were insurers and related licensees (e.g. insurance brokers, consultants and actuaries); and 1 was a securities broker approved under the Bahrain Stock Exchange's 1988 By-law. This growth has continued into 2004, with 12 new licenses issued in the first half of the year (10 to banks and other financial institutions and 2 to insurers and related firms).

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

Funding of Banking Regulator

The BMA – as the central bank of the Kingdom of Bahrain - is funded through its own budget process. All the BMA's directorates, including its supervisory functions, are included in this budget process. Flat rate license fees are levied on certain categories of licensed institutions by BMA. However, these are not intended to meet the full costs of BMA's supervisory functions and are set at relatively low levels. Current license fees are as follows:

	Bahraini Dinar (BD)
Offshore Banking Units:	BD 10,000 / year
Investment Bank License:	BD 6,000 / year
Investment Advisory License:	BD 4,000 / year

Broker's License:	BD 1,000 / year
Leasing Company License:	BD 5,000 / year
Financing Company License:	BD 5,000 / year for first three years. Thereafter BD 10,000 / year
Representative Office:	BD 2,000 / year

BELGIUM

The two laws of August 2, 2002 on the new architecture for the prudential control of financial markets and institutions have been applied progressively as set forth in the statutes.

The two major achievements since July 2003 are as follows:

On January 1, 2004, the former banking and financial market control authority merged with the former insurance supervisor into a new 'Banking, Finance and Insurance Commission' ('Commission Bancaire, Financière et des Assurances' in French, 'Commissie voor het Bank-, Financie- en Assurantiewezen' in Dutch).

The high level committees in charge of guiding the cooperation between this new body and the central bank, the National Bank of Belgium, have been appointed. In the new organization of the supervision, the central bank also has important supervisory responsibilities (essentially with regard to the framework of the supervision applied by the Commission).

Capital adequacy requirements

Major efforts are being focused on the preparation of the national regulation which will apply the Basel framework and the relevant European directive. Important changes are being prepared as for the application of the European Directive on financial conglomerates. These changes could be applied starting from 2005.

Reporting and disclosure requirements

The authorities propose that all Belgian banks and investment firms (listed as well as non-listed) apply International Financial Reporting Standards (IFRS) for their consolidated annual accounts as of January 1, 2005. However, as for non-listed banks and investment firms, this date is still under discussion and probably will be postponed until January 1, 2006. The new consolidated annual accounts will replace the existing annual accounts according to the Belgian law.

IFRS not only will apply to the consolidated annual accounts, but also to the prudential reporting by banks on a consolidated level. In cooperation with the sector, the regulator has developed a new prudential reporting scheme which is fully compliant with IFRS. Although no final decision has been taken at this time, it looks like the first application will also start simultaneously with the reporting period beginning on January 1, 2006.

Anti-Money Laundering

In Belgium, a new anti-money laundering law has been passed, i.e. the Law of January 12, 2004 modifying the Law of January 11, 1993 on preventing the financial system from being used for money laundering practices.

This Law is a transposition of the second European Directive 2001/97/EC of December 4, 2001 on money laundering and of the 40 Recommendations of the Financial Action Task Force (FATF) adopted in June 2003 as well as the 8 special Recommendations concerning the financing of terrorism.

The major modifications introduced by this Law include extending the scope of anti-money laundering regulations to a list of new implicit offenses: financing of terrorism, serious offences affecting the environment, counterfeiting of coins or banknotes, counterfeiting of goods, piracy, misappropriation of funds or goods by civil servants, conducting the business of an investment company, foreign exchange dealing or money transferring without being registered, misuse of trust, misuse of company goods and swindling. Other modifications include:

- Extending the scope of the entire anti-money laundering regulations to the fight against the financing of terrorism.
- Extending the scope of the regulations to new professions, including lawyers.
- Putting a limit on the amount of cash payments for the sale of real estate and valuable goods sold by tradesmen: more particularly, the ban on cash payment for goods sold by tradesmen with a value of 15,000 EUR or more.
- More stringent and accurate regulations concerning the identification of customers and real beneficiaries and transactions made at a distance as well as the obligation for permanent vigilance.
- Transposition of Special Recommendation VII of the FATF concerning electronic money transfers.
- Prohibiting the opening of branches or subsidiaries in non-cooperating countries and territories.

Moreover, this Law makes several technical modifications aimed at increasing the efficiency of preventive regulations, such as increasing the period for stopping a transaction from 24 hours to two working days.

A number of the provisions are scheduled to be implemented by the supervisory authority in September 2004.

Electronic commerce and banking

SiNSYS

On September 24, 2003, it was announced that the SiNSYS joint venture would be created as the very first pan-European initiative resulting from the co-operation between 3 national electronic payment systems providers : Banksys (Belgium), Interpay Nederland B.V. and SSB (Societa per I Servizi Bancari – Italy). The aim of SiNSYS is to offer safe and efficient processing systems for international payment cards at very competitive prices. The company seat of SiNSYS is located in Brussels.

Right from the start, SiNSYS will deal with the processing of all kinds of international cards from those 3 countries, i.e. more than 18 million cards used in 500,000 shops for executing about 800 million transactions. This new company will also offer its services to other European providers of payment systems (banks and processing companies). The aim set for 2007 is to reach 30 million cards, 800,000 shops and more than 1.5 billion transactions.

Electronic Identity Card

The large-scale introduction of the electronic identity card in Belgium has an impact on the banking sector. All Belgian citizens progressively will receive an electronic identity card within the period 2004-2009. The address is not printed on the card but stored in the chip. The Belgian supervisory authority however requires that bank (and insurers') branches identify (new) Belgian customers by registering the address on their electronic identity card. Consequently, all branches have to install compatible chip card readers in order to register the address stored in the chip of the electronic identity card.

EPC Evolution

In June 2002, 50 representatives of European banks and bankers' associations created the European Payments Council (EPC) in order to help developing the Single Euro Payment Area (SEPA). In June 2004, the EPC changed its structure in order to become an International Non-Profit Making Association under Belgian Law.

The role of the EPC is to provide strategic orientation and guidance to the banking industry for this project, which will enable customers to make payments in euro across the EU with the same degree of convenience as they enjoy in their home country.

The tasks of the EPC include facilitating agreements within the banking industry to define implementation and migration plans and for monitoring progress. One of its tasks also is to discuss with and propose solutions to the Eurosystem, the European Commission and the European Parliament as well as customers. It will take decisions about allocating the collective investments needed for achieving the SEPA objectives. The EPC is active in the following fields : cash money, cards, credit transfers and pan-European direct debit.

BERMUDA

The Bermuda Monetary Authority was closely involved during the period July 1, 2003 to June 30, 2004 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.

Perhaps the most significant single development during 2003 was the International Monetary Fund's review of Bermuda's regulatory provisions. The agreed report will be published, once finalized. The BMA is confident that the result will once again confirm Bermuda's firm commitment to meeting agreed international standards. Any recommendations for further changes in Bermuda's regulatory framework will be carefully considered as part of the ongoing process of updating financial legislation that is under way. Indeed, work is already in progress to deal with a number of the expected recommendations.

Insurance

Like regulators in other jurisdictions with a substantial and dynamic insurance sector, the Authority is continually reviewing and developing its insurance supervisory regime to ensure that it remains effective, appropriate for the scope and nature of the Bermuda industry, and consistent with evolving international standards. This involves the Authority, after extensive consultation with the industry, in assessing possible legislative changes, drafting new regulations and guidelines implementing the necessary changes in its regulatory framework and approach. In developing its regime in this way, the Authority is able to draw on its extensive involvement in joint efforts with other agencies engaged relevant standard-setting, both internationally and domestically.

During the year, the Authority took further steps to develop and enhance aspects of its regulatory approach, in close liaison with industry bodies, reflecting the full commitment of all parties to ensuring and maintaining Bermuda's quality reputation. In particular, the Authority was engaged in extensive planning for, and preparation of, a number of enhancements intended to implement developments in standards that have recently been agreed and adopted internationally. Particularly noteworthy is the close involvement of the Authority in work being carried forward by the International Association of Insurance Supervisors (IAIS). The Authority was a charter member of the IAIS and continues to be closely involved with it in the development of guidelines for global insurance regulation. The proposed draft of the IAIS Revision to the Insurance Core Principles and Methodology was presented, revised and adopted at the IAIS Annual General Meeting in Singapore in October 2003. The 28 Principles cover all aspects of the supervisory framework including, but not limited to:

. guidance for the effective operation of supervisory systems worldwide;
. examining and qualifying issues such as transparency, assessment and management of risk and consumer protection; and
. anti-money laundering.

With the adoption of the new IAIS Standard of Supervision for Reinsurers, insurance regulators are now expected to supervise all reinsurers domiciled in their jurisdictions. Bermuda has had an effective framework for the supervision of reinsurance business in place for over 20 years. However, in light of the new Standard, the Authority began an assessment of its existing supervisory approach in order to identify the changes that will be necessary and to determine a program for their implementation. These preparations are now well-advanced, involving further enhancement to Authority's existing risk-based supervisory model.

Banking

No changes were made during the year in the Authority's supervisory approach under the Banks & Deposit Companies Act. Supervision continued to involve a program of regular prudential and strategy discussions with senior management, together with off-site analysis and review of prudential data and certain on-site work, conducted both in Bermuda and in substantial group operations abroad. The Authority also regularly holds bilateral meetings with members of institutions' Audit Committees, as well as trilateral meetings which involve the institution's external auditor.

The Authority also carried forward discussions with individual licensed undertakings during 2003, with a view to finalizing its approach to various of the remaining transitional issues identified as part of its initial implementation of the Act.

Investment

In 2003, the Bermuda Monetary Authority continued to build on the strong regulatory foundation for the investment business sector that has been established over the past few years.

Progress continued in bringing fully up to date the regulatory frameworks for the different areas of financial services – in particular, during 2003, with finalization of a new Investment Business Act 2003, most provisions of which came into effect early in 2004, when the Investment Business Act 1998 was repealed. The new Act is intended to clarify and update the existing provisions for regulating investment business. At the same time, it provides a formal framework for the recognition of securities exchanges, like the Bermuda Stock Exchange, and clearing houses as self-regulatory organizations under the Act. The provisions governing investment exchanges and clearing houses come into effect on September 15, 2004.

The new Act is in many respects similar to the 1998 Act. However, it includes extensive detailed changes and new material intended to clarify a number of areas of uncertainty in the predecessor provisions. In addition, the new Act corrects a number of identified weaknesses in the 1998 Act – in particular with regard to the Authority's information and intervention powers in cases where concerns may arise. It was an important objective of the Act to ensure that Bermuda's investment regulatory framework meets current international standards by providing the Authority with the range of powers necessary for effective supervision and to ensure the protection of stakeholders and of Bermuda's reputation as a safe, secure financial center. The new Act, therefore, deals fully with recommendations made by KPMG in 2000 for enhancements to the current legal framework while also being consistent with the expected outcome of the recent IMF review.

On January 30, 2004, investment providers licensed under the 1998 Act were issued investment business licences under the new Act. These new licences are for an unlimited period, instead of the 10-year limit applied to previous licences. Any other persons conducting investment business in or from Bermuda as of that date and who were not otherwise exempt from the new Act were required to apply for a licence.

Certain exemptions from the licensing requirements are provided under an Investment Business (Exemptions) Order 2004 which has replaced a similar Order under the 1998 Act. In certain cases, persons eligible for exemption under the Order are required to provide the Authority with a declaration of the grounds of their exemption. The requirement to make such a declaration also applies to persons who have previously made a declaration under the equivalent Order under the 1998 Act and who wish to continue to benefit from the exemption.

The Act includes a range of provisions intended to help provide for further protection of clients and the public. These include: auditor requirements; powers to restrict and revoke licences; Authority approval for all Controllers and officers; powers to obtain information; new provisions to deal with confidentiality of information and the Authority's ability to disclose information to other regulators for regulatory purposes; right of entry and powers to investigate; appointment of an administrator, and various disciplinary and protective measures. Breaches of the licensing and other requirements of the new Act are offences punishable by a fine and/or imprisonment.

Effective March 12, 2004, the Authority finalized the Statement of Principles and Codes of Conduct in relation to the IBA 2003, drafts of which had previously been circulated on a consultative basis. The Authority has also issued new Guidance Notes discussing the supervisory process and reporting requirements for investment providers. The Statement of Principles, Codes, Guidance Notes along with Appendices are all available on the Authority's website, www.bma.bm.

The BMA is also engaged in preparing for the introduction of a new Collective Investment Schemes (CIS) Act, which will, for the first time, also provide for the licensing of fund administrators. In parallel, various amendments to the 1998 CIS Classification Regulations will be introduced. At the same time, the Authority has been closely involved in the preparation of new provisions criminalizing insider dealing and improper price manipulation in securities markets. The relevant legislation is expected to become law later in 2006.

Proceeds of Crime Legislation

Bermuda is strongly committed to constructing and maintaining the regulatory and legislative environment necessary to prevent money laundering and to combat terrorist financing. The Legal and Enforcement areas continued to be closely involved in the review and development of Bermuda's anti-money laundering legislation and the relevant policy framework. The Authority continued to be closely involved in the work of the National Anti-Money Laundering Committee (NAMLC), a statutory body which brings together representatives of all the agencies involved. Internally, the Legal and Enforcement areas gave advice to the Authority's line supervisory Departments on the application of anti-money laundering and counter-terrorist financing procedures within licensed institutions.

During the year, the Authority undertook extensive work on behalf of the NAMLC on a full redraft of the 1998 Guidance Notes provided for in the Proceeds of Crime Regulations and which are intended to assist regulated institutions in the fulfillment of their statutory obligations. This document was subsequently released by the NAMLC in December 2003 as a basis for wide public consultation. It will be discussed with industry groups during the course of 2004, alongside detailed proposals which Government is developing for various amendments to the Proceeds of Crime Act 1997 and Regulations.

Most of the changes that are proposed reflect the enhancements introduced by the FATF to the standards prescribed internationally for anti-money laundering and terrorist financing measures to be applied by financial institutions. As such, the finalization and implementation of the necessary amendments to Bermuda's provisions represent a very important priority. Moreover, in addition to strengthening many of the requirements imposed on financial institutions, it is noteworthy that the new FATF requirements involve the extension of anti-money laundering measures to certain non-financial businesses and professions, including real estate agents, dealers in jewelry and precious metals, and company service providers, as well as to accountants and lawyers, where they are intermediating in particular types of financial activity. Government is still considering the nature of the new provisions that will be necessary in some of these areas, as well as the arrangements for monitoring compliance that will also be required.

CANADA

Over the last twelve months, the federal government has continued to release various regulations related to the Bank Act revisions made in 2001, most notably the Bank Holding Company Proposal Regulations. On the policy front, a Consultation Paper was released requesting comments on a number of issues relating to the government's merger review process and there has been considerable discussion about the possibility of a single securities regulator.

Commercial Information Technology Activities

Canada's prudential regulator, the Office of the Superintendent of Financial Institutions (OSFI), released its Instruction Guide with respect to applications by banks to engage in allowable commercial information technology activities (which were permitted by legislation in 2001 and supplemented by regulations in 2003). The Guide is important as it both outlines the criteria that will factor into a decision to approve a commercial activity and gives examples of commercial activities. Thus regulatory approval to conduct commercial activity will likely be given where a technology is inherent to the provision of financial services, e.g. encryption technology; where the commercial use is an efficient use of excess IT capacity or expertise, e.g. web-hosting; or where commercial IT services are offered as part of an integrated package of products or services, e.g. web design when offered in conjunction with account and payment processing services.

Bank Holding Company Proposals

The government published for comment its Bank Holding Company Proposal Regulations, which will provide a framework under which Canadian banks can convert to a holding company structure. Final approval of the regulations is expected in 2004. Concurrently Canada's prudential regulator has settled holding company capital requirements that may make a bank group's conversion to a holding company structure attractive. The government is also considering steps to ensure that holding company conversions can be completed on a tax-neutral basis. A "bank holding company" will be legally defined as a "regulated non-operating company that holds both regulated and unregulated legal entities". The aim of the holding company regime is to allow for lighter regulation of non-regulated entities and facilitate joint ventures between holding company subsidiaries and third party entities.

Large Bank Mergers

Since 1998, when two merger proposals were disallowed by the federal government, the issue of mergers has been subject to a number of consultations and parliamentary committee reviews. In June 2003, the government released a Consultation Paper that responded to the reports of the House of Commons Finance Committee and the Senate Banking Committee, which the government had asked to investigate the public interest components of the government's merger review process. In the June 2003 paper the government undertook further public consultations and agreed to set out its policies, including its views on cross-pillar consolidation between banks and large demutualized life insurance companies (which is currently not permitted), by June 30, 2004. The government also indicated that following the release of its new policies, there would be a three-month transition period, to September 30, 2004, which would provide financial institutions with a period to consider their options under the new environment. The government would then be prepared to consider merger proposals among large financial institutions after September 30, 2004. However, a federal election was called for June 28, 2004 with the result that the Minister of Finance has said that the statement of the government's merger policy would be deferred until sometime in the fall of 2004, with a specific date to be announced after the election.

Single Securities Regulator

The fundamental nature of Canada's securities regulatory system (i.e., 13 provincial and territorial regulators) and the need for structural reform of the securities regulatory system have been subject to considerable public policy discussion in Canada. In 2003, the government-appointed "Wise Persons' Committee" (WPC) concluded its deliberations, made public the submissions from stakeholders, completed its substantial research initiative and reported to the federal Minister of Finance in December. The WPC report called for the establishment of a cooperative federal-provincial single securities regulator for Canada, headquartered in the National Capital Region (Ottawa/Hull) with offices across the country. A notable feature of the report was the conclusion that the federal government had the constitutional authority to regulate securities.

A parallel inquiry, the "Interprovincial Securities Initiative" (ISI), a committee of provincial securities ministers, also undertook investigations over the course of the year. In launching its consultations in 2003 the ISI expressed a clear preference for a "passport" model, i.e. a mutual recognition and reliance system (even though the government of the province of Ontario at that time expressed disappointment that the single securities regulator option was not considered). Although the ISI was expected to complete its work in the fall of 2003, discussions were still under way as of June 2004 as a result of several provincial elections that took place over the course of the year and also because the provinces involved in the project have different views regarding solutions. The ISI is also considering a single regulator option in light of Ontario's support for such a model.

As the ISI discussions continue, with both a passport and a single regulator model under consideration, a number of industry stakeholders across Canada have continued to be vocal supporters of a single regulator, as have the former members of the WPC. These stakeholders have been encouraging governments to reach agreement and announce concrete steps and specific target dates to achieve substantive reform of the securities regulatory system.

Funding of Bank Regulators

The Office of the Superintendent of Financial Institutions is mainly funded by levies on the entities that it regulates, although some funding comes from general tax revenues. The Financial Consumer Agency of Canada is funded wholly by levies on the financial institutions that it regulates. The Canada Deposit Insurance Corporation of Canada is funded by premiums charged to the insured entities. Generally, the various provincial securities commissions are funded through fees.

CHILE

Signing of the FTA between Chile and the United States

Chile signed the Free Trade Agreement with the United States, in which Financial Services was addressed in a separate chapter from Service.

Acquisitions and Other Developments

During the period under review, Banco de Crédito e Inversiones purchased Banco Conosur and Banco París acquired Santiago Express, a division of Banco Santander Santiago, which is not yet operating. Also during the period, the creation of a new bank, Banco Penta, was authorized, although it is not yet operating. In other developments, Banco Sudameris stopped operating in Chile; Banco del Desarrollo bought its portfolio. In addition, Dresdner Bank Lateinamerika is ceasing operations in Chile; Banco Security bought its portfolio.

Opening Branches During Weekends

Upon request, banking institutions will be authorized by the Superintendence of Banks to keep their branches open on weekends. The goal is to grant maximum flexibility to the banking institutions and their clients regarding access to credit.

Payment System Modernization

A new payment system (LBTR – Gross Liquidation in Real Time) that governs the financial market was implemented, which incorporates gross payments in the system of high value payments. This system allows identifying and assigning the risks existing in the economy in an efficient way, which until now did not occur since the risk of other parties in Chile was a Central Bank risk. Additionally, the implementation of a protected clearinghouse is being contemplated, beginning in 2005.

Information on Debtors

Instructions relative to information on debtors was modified, in order to report the value of all the credits agreeing with the contracting conditions, without consideration relative to the situation or the valorization of creditsused by the accrediting bank for its financial and accounting information.

Commissions And Better Transparency Levels Of Information On Tariffs

The Superintendence of Banks established the norms that financial institutions must obey, in relation to the charges that affect the products and services they provide, such as time deposits, saving accounts, credit cards, consumer loans and mortgages.

In regard to the general principles that banks must take into account in relation to their clients, the following components were made the norm: The freedom to offer the authorized services and charge for them with the restrictions established by law; the full transparency of the information that must be presented to the clients; the correspondence between the commissions and the services provided; and the origin and reasonability of the charges materialized.

Liquidity Management And Interest Rate Risk

The new liquidity management and interest rate risk norm will allow institutions to generate their own policies, according to the basic feature contained in the norm, in a self-regulated scheme. Banks will be governed by their own models, if they have it, or by similar figures to the present norm.

CHINA

Significant Developments in Banking

- Starting from 2004, Hong Kong banks are allowed to gain easier access to the Chinese mainland banking market under a free-trade agreement signed between Hong Kong and the mainland government on June 29, 2003. According to the agreement, the minimum global asset requirement for a Hong Kong bank's mainland branch is US$6 billion.

- On July 2, 2003, the China Banking Regulatory Commission (CBRC) granted new licenses to 17 Chinese and foreign financial institutions for the first time under a new regulation that became effective on the same day. According to the new regulation, no annual re-examination or renewal of the license is required unless there is a change in the company title, address or restructuring.

- The CBRC said on July 8, 2003 that it would set up 31 local bureaus for the supervision of the local banking industry in each province, municipality and autonomous region in the Chinese mainland. In addition, five special CBRC bureaus will be established in Dalian, Qingdao, Xiamen, Shenzhen and Ningbo.

- According to the CBRC, both state-owned commercial banks and joint-stock commercial banks are required to implement the internationally accepted five-category loan classification system from 2004 and stop using the Chinese standard.

- The People's Bank of China (PBOC) said that from September 1, 2003, individual investors would not be allowed to withdraw cash from their stock accounts which are held at banks and managed by brokers. The investors should first transfer their money from the stock accounts into their deposit accounts.

- The CBRC announced on August 14, 2003 that a new regulation on capital adequacy standards for commercial banks would be introduced in 2004. The regulation will have a requirement of 8% minimum capital adequacy ratio plus requirements for supervision and information disclosure.

- On November 1, 2003, a regulation on the management of foreign exchange agencies issued by the PBOC took effect. According to the regulation, foreign exchange agencies are allowed only to change the convertible foreign currencies in cash or travel notes to RMB. The foreign exchange agencies refer to those domestic corporations authorized by the qualified domestic banks to have foreign exchange business by contract.

- Effective December 1, 2003, foreign financial institutions, subject to the CBRC's approval, may provide RMB services for domestic enterprises in China. Before that, foreign banks can only provide RMB business to foreign-funded companies and non-Chinese residents in Shanghai, Shenzhen, Tianjin, Dalian, Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan.

- China decided on December 1, 2003 to lift restriction of the equity share for a single foreign bank to participate a joint bank from 15% to 20%, aiming to introduce more competition as well as cooperation among Chinese banks and foreign banks.

- A draft law on banking supervision was passed by China's top legislature on December 27, 2003. The draft amendments to the Law on the People's Bank of China and the Law on Commercial Banks were also passed at the sixth session of the National People's Congress Standing Committee. Under the new law, the CBRC is authorized to oversee all banks and financial institutions in China, investigate illegal banking operations, and mete out punishments for violations of the law.

- The State Council of China has decided to choose two state-owned commercial banks, Bank of China and China Construction Bank, for pilot reform to turn them into joint-stock banks. The reform aims to turn the two selected banks into commercial banks in the real sense. Under the reform plan, the two banks are required to launch financial regrouping, quicken the pace to solve the problem of bad assets, increase the ratio of capital sufficiency, lay a solid financial foundation, and set strict financial standards.

- Financial institutions from overseas that want to open branch offices in Shanghai can now directly register at the local industry and commerce administration, according to the Shanghai Municipal Administration for Industry and Commerce. Before that, all financial institutions with overseas funds were required to go to Beijing to apply for registration or undergo annual examination, which cost much time and money.

- The CBRC has launched the country's first risk rating system targeting the country's joint-stock banks, numbering 11 so far, in a move to tighten supervision and propel the banks to improve competitiveness. The rating would cover the bank's capital adequacy, asset safety, management, profits, liquidity and sensitivity to market risks.

- The CBRC announced new regulations on capital adequacy on February 27, 2004 in a bid to enhance risk management of the banking sector. Under the new regulations, which took effect on March 1, 2004, Chinese commercial banks will have even lower capital adequacy ratios than figures calculated under the old rules. To give commercial banks more time to replenish their capital base, the CBRC has set the deadline (January 1, 2007) for meeting the new requirements. Under the new rules, the capital adequacy ratio is calculated after a full deduction of bad loan provisions. Banks are required to fully set aside reserves only after 2005.

- China's banking authorities on March 8, 2004 published a new supervisory regulation for foreign banks in a bid to get a more comprehensive picture of their growing operations as well as risk levels. Starting April 2004, foreign banks are required to provide consolidated operation reports of their Chinese branches twice a year to the CBRC.

- China has issued regulations on foreign loans from foreign capital banks within China. The new regulations stipulate that the money borrowed from outside China by foreign capital banks is considered foreign loans, while the money borrowed from finance institutes in China is seen as spot exchange that can not be settled.

Significant developments in securities

- China will adopt stricter standards for applicants of initial public offerings in 2004 to ensure the better quality of its listed companies, according to the China Securities Regulatory Commission (CSRC). The new standards require domestic companies of China to finish their shareholding restructuring three years prior to sending in their listing applications, though exceptions are permitted for state-owned enterprises which transfer entirely into shareholding companies and under other situations allowed by the State Council.

- On October 28, 2003, China's securities investment fund law was passed. The law, which took effect on June 1, 2004, lowers the threshold for the establishment of the funds. The law does not stipulate whether open-ended funds can apply for short-term loans from commercial banks, which leaves space for further amendments according to the developing needs of the situation.

- The latest statistics from CSRC shows that the subscribers to China's security market exceeded 70 million by the end of 2003. And the total value of the market reached RMB4,200 billion yuan or more than US$500 billion.

- On June 10, 2004, CSRC released a new regulation on information disclosure requirements for securities investment funds. The regulation clarifies the liabilities of fund managers, custodians and other relevant parties on information disclosure before, during and after the issuing and listing of funds.

Significant developments in insurance

- The State Administration of Foreign Exchange (SAFE) said on September 17, 2003 that insurance companies, including foreign insurers operating in China, would be allowed to trade their forex funds in the interbank market starting October 1, 2003. The move will help insurance firms better manage their forex funds, which are mostly deposited in the banks, and improve their capability to settle claims.

- Newly revised regulations on China-based offices that represent foreign insurance institutions went into effect on March 1, 2004. Compared with the previous version of the regulations, the new edition contains more specific clauses on penalties for unauthorized business activities by such representative offices, including fines of RMB30,000 yuan (about US$3,660) or lower. The representative offices set up by insurance institutions in Hong Kong, Macao and Taiwan are also subject to the revised regulations.

Significant developments in other financial sectors

- China has issued follow-up rules on auto financing, detailing regulatory requirements and procedures for the establishment of auto financing companies in the country. The rules, announced by the CBRC on November 12, 2003, require such companies to have capital adequacy ratios of 10%, which is stricter than the 8% requirement for commercial banks. China issued auto financing regulations in October 2003 under its WTO commitments.

- The State Administration of Foreign Exchange (SAFE) and the Ministry of Public Security have jointly promulgated a regulation governing their co-operation in cracking down on money laundering in foreign currency-related matters. The regulation details the mechanism, procedures and the scope of co-operation between the two organizations in cracking down on money laundering, and will greatly facilitate their work.

- China will allow overseas financial institutions to issue RMB-denominated bonds, the government announced on December 4, 2003. The decision is expected to make it much easier for foreign banks to raise local currency for loans to overseas and domestic companies.

- In an effort to fight money laundering and better manage currency transactions, China has new foreign exchange regulations that took effect in March 2004. Under the new rules, non-resident individuals can hold, deposit or sell to banks the forex they bring from abroad. However, non-residents will have to show their ID when opening a forex account and other documents when depositing more than US$5,000 a day.

- SAFE recently reached a decision stipulating as of June 26, 2004, domestic foreign exchange loans issued by foreign-funded financial institutions in China are not allowed to be used for settlement with the exception of export foreign exchange guarantee.

- On June 28, 2004, China's financial authorities took a further step to complete a regulatory regime under which banking, securities and insurance are separately regulated.

CZECH REPUBLIC

The legal framework of the financial sector in its essential features (i.e. institutional structure of supervision, legal set-up of central and commercial banking, insurance and credit co-operatives, payment system and its instruments) remained unaltered during the period under review. New developments ensued partly from the accession of the Czech Republic to the European Union, which brought into force a number of provisions, stipulated in the Law on Banks, Law on the Czech National Bank and in laws regulating credit transfer, partly from a new regulation of investment and capital market, adopted by the Parliament. Partial changes became operative in the prevention against money laundering and in the cash payment regime. In addition there were significant changes in the value-added tax sphere and in personal data protection. Both have a considerable impact on the financial sector. "Harmonization amendments" were adopted to the Insurance System Law, to the Law on Insurance Contract and generally in the regulation of the insurance sector. There was a logical requirement for all harmonization adjustments, implementing the EU Directives no later than May 1, 2004, on which date the Czech Republic became a full member of the European Union.

As of May 1, 2004, accordingly, the following entered into force:

- amended rules for access of the new banks from the EU countries to the territory of the Czech Republic and vice versa, compliant with the EU single banking licence regime;
- admissibility of temporary border-transgressing business activities of banks within the EU;
- change in the regulation of the foreign bank branches (motherland control principle is applied in the regulation of branches, except for liquidity and currency rules); and
- change in the regime of participation in the deposit protection/insurance system and in the guarantee fund of securities traders (branches may refer to the protection by their motherland insurance systems, given the standard of the protection is at least equivalent to that of the host country).

Major developments took place in the legislation, regulating investment and capital market sphere. A set of new laws, consisting of a Capital Market Undertaking Act (No. 256/2004 Coll.), Collective Investment Act (No. 189/2004 Coll.) and Bonds Act (No.190/2004 Coll.) was passed in April 2004. These acts, that were and remain controversial in professional circles, were adopted by the Parliament in a short time period prior to the date of accession of the Czech Republic to the EU, from which date they are in force. These laws introduce a new structure in the regulation of the capital market sphere. The former Stock Exchange Act has been abolished and its topics are now included in the new Capital Market Undertaking Act. The Capital Market Undertaking Act also takes over the provisions of the public law, regulating securities, included so far in the Securities Act. Remaining provisions (from the civil law sphere etc.), relating to securities, are to be later incorporated into the Civil Code, replacing thus in the perspective the Securities Act. The new Collective Investment Act replaces the former Investment Companies and Investment Funds Act (No. 248/1992 Coll., as amended).

The scope of the Capital Market Undertaking Act includes - alongside the basic definitions - rules for investment services (securities trading and licensing, rendering the investment services in the EU room, public bidding and auctions of securities, securities market and settlement system, investment instruments registry, capital market and investor protection, state supervision, rating agencies). Fourteen procedural decrees, implementing the above mentioned act and determining - *inter alia* - prudential rules, brokerage regulation, quotation regime, capital adequacy calculation, public prospectus requirements, disclosure and reporting duties etc., were issued together with the act. The Collective Investment Act regulates collective investment funds (standard and special), investment companies, depositories (only banks and branches of foreign banks, domiciled in the

Czech Republic and having specific permit in the licence may serve as depositories), fund conversions etc. The Bond Act stipulates definitions, prerequisites and rules for securities, State and central bank bonds, issuance and issuers duties etc. The regulation of mortgage bonds is being transferred from the responsibility of the Securities Commission to the responsibility of the Czech National Bank.

The banking community adopts a pragmatic stance *vis-a-vis* the new capital market and investment legislation. A major shortcoming seen by banks is the legislation's failure to meet the objective of removing double supervision of banks (banks are basically supervised by the Czech National Bank, but in their activities as capital market and investment players also by the Securities Commission). Accordingly, it can be expected that the capital market regulation will be on the agenda of the legislative bodies again in the near future.

After a pilgrimage through governmental and legislative bodies lasting several years, a Cash Payments Limitation Act (No. 254/2004 Coll.) was adopted. According to this act the cash payments are admissible only up to an equivalent of 15,000 euros. Payments in excess of this limit have to be done through a financial intermediary (banks, but also through post system). A transfer of valuable commodities (precious metals, precious stones) is also considered as a "payment". The limit does not apply to reimbursement of taxes, customs, wages, salaries and other payments, due to employees on the basis of employee-employer working contract, pensions and similar social remuneration and to deposits into a notary´s custody. The law is in force from July 1, 2004 and is applicable to payments among subjects (legal and natural persons) of the Czech Republic and to transfers from these subjects abroad.

The Act on International Assistance in Recovering Some Debts has also been amended in connection with the accession to the EU. The act regulates the regime of the border transgressing recovery of financial compensations, financial subsidies, rates and fees of the EU common market for sugar, import and export customs, direct and indirect taxes etc. in relation to the EU countries and to other countries with which the Czech Republic had concluded respective agreements on the debt recovery.

In the House of Deputies of the Czech Parliament, an amendment to the Personal Data Protection Act is in its final states. Generally it seems to cultivate the existing law, which favored private data protection against financial security and prudence interests. Better balanced solutions, like cancellation of an entitlement of natural person to withdraw his/her consent (given in writing e.g. to a bank in connection with a credit contract) with use, processing and even keeping his/her personal data at any moment of time and without specifying a reason, cancellation of an obligation, imposed on data administrator, to render annually free of charge back-feed information to the data subject on the data, kept on him/her, alleviation of data transfer among the EU countries etc., are incorporated in the amendment. The Banking community expects that the amendment would establish a better equilibrium between the personal data protection interests and "Know-Your-Client" (KYC) requirements.

An amendment to the Population Registry Act (already in force) brings a new problem (postponed, however, to the beginning of the year 2006) consisting of a requirement to stop using and to remove from existing databases (led by banks and other financial intermediaries) birth code numbers of natural persons. These code numbers currently serve in financial institutions as a principal identification of clients - natural persons and cannot be replaced by other data.

An adoption of a Supplementary Supervision of Financial Conglomerates Act, transposing the Directive 2002/87 EC into the Czech legislation, is expected before the end of this year.

Czech Government approved in April 2004 - after several years of debates - a rough draft of an Integrated State Supervision of Financial Markets. Currently, banks are supervised by the Czech National Bank, but in their investment and capital market activities (i.e. as securities traders) they are double supervised by the Securities Commission. Capital markets and securities traders (brokers) are supervised by the Securities Commission. Insurance companies and pension funds are supervised by the Ministry of Finance. Credit co-operatives are supervised by an Office for Supervision of Credit Co-operatives. The above mentioned governmental concept outlines integration of supervision in two phases. In the first step it is envisaged to incorporate the supervision of credit co-operatives under the Czech National Bank to mid-year 2005 and the supervision of insurance companies and pension funds under the Securities Commission to year-end 2005. In the second step, timed to the date of accession of the Czech Republic to the EMU, the integration should be finalized by amalgamating Czech National Bank and Securities Commission supervisory powers into one single supervisory institution.

Funding of Bank Supervisory Authorities

The CNB (Czech National Bank) Banking Supervision Group is funded through the Central Bank´s Budget Process. The Securities Commission is funded through the Government´s general budget process. The Office for Supervision of Credit Co-operatives (its powers are limited to the co-operative credit institutions) is funded through the Government´s general budget process.

DENMARK

New Trading Measures in the Market for Danish Government Securities

With the purpose of enhancing the efficiency of the marketplace, the Danish Central Bank (Denmarks Nationalbank) together with the market participants in November 2003 launched electronic trading and market-making in Danish government securities. Previously, the trading took place predominantly via telephone. Now Danish government securities are traded electronically and on the same platform, MTS, as government securities from most other EU Member States. The trading of the Danish government securities opened in the wholesale market, i.e. the inter-dealer market, and the trading on the MTS platform is established in a special market segment, MTS Denmark (MTSDK), on the Belgian MTS company, MTS Associated Markets (MTSAM).

A primary dealer system has been established in connection with the transition to electronic trading. The primary dealer system obliges a number of banks, the primary dealers, to quote current bid and ask prices within predefined spreads and amounts. The Danish primary dealer system is in line with systems for the government securities in other EU Member States.

At the retail market level, new measures have also been introduced. On December 1, 2003 a price-quoting scheme took effect. A number of banks have signed an agreement with Danmarks Nationalbank, in which the banks are committed to quote bid and ask prices on an electronic trading platform on the Copenhagen Stock Exchange. The trading platform gives the members of Copenhagen Stocks Exchange's bond market as well as private and small investors the possibility of placing orders directly and executing trading in an electronic trading system.

Enforcement of Financial Information in Denmark

In June 2004 The Danish Parliament (Folketinget) adopted a new Act setting the future requirements for enforcement of financial information for companies whose securities are traded on a regulated market. The requirements are derived from high-level principles set up by the Committee of European Securities Regulators for the purpose of ensuring a sound capital market in the European Union but are also a part of the effort to create a more integrated and efficient capital market in the European Union.

Further the requirements should work to ensure a mutual recognition of enforcement activities between the European Union and the United States, making access for European companies to the American capital markets easier and likewise making access for American companies to the European capital markets easier.

The Act sets out the framework for picking companies for which financial information shall be subject of a formal examination and gives the necessary legal powers to perform a thorough examination of the entire company as circumstances require. The enforcement will be organized separately for financial and non-financial companies, which reflects the current structure of legislative powers on accounting matters. It is required that financial information for up to 20 percent of the companies is examined on a formal basis each year, and that a thorough examination of accounting matters is performed when reasonable doubt requires so. When making decisions regarding specific accounting issues the enforcers must take into consideration decisions made by other enforcement authorities in the European Union on similar matters.

It is expected that the requirements will help to continuously increase the quality of financial information in the European Union and that coordination between national enforcers will help create a uniform approach to the principles in the international accounting standards that are to be implemented in the consolidated statements of all listed companies in 2005.

Concerning financial companies in Denmark there is already a thorough examination of the activities by the financial supervisory authorities including accounting matters. The new rules add additional resources to this area, creating a very high level of enforcement of financial information for the Danish financial institutions.

Good Business Practice for Financial Undertakings

One of the changes in Danish consumer regulation that has had the most significant effect on Danish Banks has been an executive order on Good Business Practice for Financial Undertakings adopted by the Minister of Economic and Business Affairs in June 2003.

The executive order lays down general regulation regarding good practice and advice and specific regulation regarding banks, securities traders, mortgage-credit institutions and insurance companies. The executive order entered into force October 1, 2003. The specific regulation regarding securities traders, however, entered into force April 1, 2004.

The executive order has provided a basic common set of rules regarding customer relationships throughout the financial sector that is based on a high degree of consumer protection. The executive order applies to Danish and foreign financial undertakings that carry on activities in Denmark. The regulations apply to private customer relationships and - with a few exceptions - also to commercial customer relationships provided these are not significantly different from a private customer relationship.

The general regulation regarding good practice is based on a general clause stating that a financial undertaking shall act honestly and loyally towards its customers. A fundamental principle of the regulation is the requirement that all important contracts shall be entered into or confirmed on paper or on other durable medium.

The regulation regarding advice requires a financial undertaking to provide advice to a customer if the customer so requests, or at its own initiative if circumstances indicate that there is reason to do so.

Before a financial undertaking provides advice, the undertaking shall request the customer to provide information on his financial situation, his experience with the relevant financial services, his objective for having the service provided and his risk profile. Furthermore, in the event that a financial undertaking or its employee – when providing advice – has a special interest in the result of the advice beyond normal income, the said undertaking shall before giving advice inform the customer of the nature and scope of such special interest.

The special regulation regarding securities traders requires the securities traders to enter into a detailed written customer agreement when the customer relationship is established. Furthermore securities dealers are generally required to provide advice to the customer. In the case that the customer has a continuing customer relationship with the securities trader, the parties can agree on the extent to which the securities trader may offer the customer financial services without providing advice at the same time.

The executive order is expected to be changed in 2006 due to EU legislation.

Dankort – The Danish Payment Card

The most frequently debated topic in the financial sector in 2003 was undoubtedly the Dankort.

After many years of debating, the Danish Act on Payment Instruments was amended allowing banks to be compensated for parts of the operating costs associated with the Dankort system by collecting (fixed) fees from retailers receiving card payments. Danish banks will still have to live with the fact that they are among the few banks in the world that are not allowed to make a business out of payment card operations. But most importantly, the very popular Dankort prevailed.

Over the coming months Danish customers will be witnessing one of Denmark´s largest ever roll-outs of new information technology as 3.4 million Danes receive a chip-based Dankort, which is more future-oriented than payment cards in the countries we normally compare ourselves with. The card will be accepted at more than 100,000 locations, and storeowners will find that Denmark is one of the least expensive countries in which to use the card.

Danish banks recently introduced international payment cards with balance control for young people under age of 18. These cards have become an overwhelming success.

Website with Prices Offered by Banks

In terms of consumer demands The Danish Bankers Association in the spring of 2004 developed a new and more user-friendly website that sets out the prices offered by Danish banks. The general idea is that the customers – instead of having to visit all banks - can simply switch on a computer and study a single website, where he or she will be able to identify the banks that offer the service required, and see what the price will be.

The Funding of Activities of Banking Regulators

The Danish Financial Supervisory Authority (FSA) is an agency under the Ministry of Economic and Business Affairs. The Ministry comprises a department and 10 agencies. The department has the overall political responsibility for the legislation and for the function of the agencies in general.

The functions of the FSA can be divided into three segments:

- Supervision of banks, insurance companies, investments firms, mortgage credit banks etc,
- Legislation, including issuance of orders by laws etc. and
- Information.

While the functions of the department are financed by taxpayers, the operations of the FSA is exclusively financed by fees on an annual basis from the institutions under supervision by the FSA. The costs of the FSA are no burden on the national budget. For formal reasons, the budget of the FSA is included in the national budget, which means that each year the Danish Parliament approves the budget of the FSA.

The Guarantee Fund for Depositors and Investors is as well financed by the covered institutions (commercial banks, savings banks, mortgage credit institutions and investments firms) proportionally by payments and provision of guarantees.

EGYPT

The period under review witnessed a number of major events and decisions affecting the Egyptian economy, including efforts to pull the country out of recession and address liquidity bottlenecks and foreign currency shortages.

Banking

Egypt's efforts in combating money laundering were recognized on February 27, 2004, when it was deleted from the FATF list of non-cooperative countries. This deletion came after the Financial Action Task Force ascertained that Egyptian legislation and measures on anti-money laundering are serious and appropriate.

The most significant measure taken in this field was the issuance of anti-money laundering law No. 80 of 2002, which was amended by law No. 78 of 2003. The executive regulations of the law were also issued.

Requirements include establishing special departments in every financial institution to notify the Central Bank of Egypt's anti-money laundering unit of any suspected operations. All the institutions working in Egypt are also required to apply the international rules in this respect. Ahead of these rules is the principle of "Know Your Customer" in addition to the supervisory rules that the banks must adhere to.

In other developments, Law No. 88/2003 on the CBE, the Banking System and Currency was issued in view of the state's plan to modernize, regulate and develop the Egyptian banking system and the supervision thereof to avoid the loopholes of the prior laws, ensure strict application of credit policies, and establish the rules regulating ownership interests in banks. Moreover, the law sets forth the minimum capital requirements, whether issued or paid-up capital, for any banking institution.

The law supports the CBE as an independent entity reporting directly to the president and stipulates its goals, competencies and administration of the financial system. The aim of the law is to raise the banks' capital and enhance their competitiveness. The executive regulations of the banking law were also issued.

It is noteworthy that the Electronic Signature Law was also issued to regulate electronic transactions. Such transactions include typing, exchanging and storing documents. This helps reserve the dealers' rights and ensures the credibility and legality of electronic transaction. By the issuance of his law, the electronic signature becomes accepted in court.

Banks embarked on cleaning up their NPL portfolios, redefining their credit and investment policies and tailoring programs towards making best use of their resources and assets. The government and public-sector banks reached a preliminary agreement to resolve the problem of public-sector companies' NPLs.

In order to realize discipline in the foreign exchange market, the CBE established a new mechanism that allows monitoring inter-bank dealings in foreign currencies simultaneously via a database linking the CBE with both banks & exchange companies.

As part of the government's efforts to promote Egyptian exports, the Egyptian European Partnership Agreement came into effect as of June 2004. This agreement aims to reinforce relations between both sides in all fields in addition to providing increasing financial support for economic development in Egypt.

The Egyptian government enhanced the Egyptian investment environment to court foreign and Arab investments through introducing 29 amendments to Law No. 8/1997 on Investment Guarantees and Incentives to streamline investment procedures. The Egyptian government also established the Pilot Customs and Taxation Center to expedite exporting processes and eliminate obstacles.

Egypt's foreign trade sustained its positive trend in 2003/04 propelled by the growth of commodity and service exports coupled with a retreat in service payments.

According to the executive program of the great free zone area trade agreement, gradual liberalization of trade flow between Arab countries will offer various export advantages to the fourteen Arab countries that signed this agreement.

The first phase of the Arab Gas Pipeline Project between the Egyptian Taba port and the Jordanian Aqaba port was inaugurated in July 2003, to start exporting Egyptian natural gas. The second phase agreement was signed in January 2004.

In an attempt to control domestic public debt and the debt service thereof, the government is currently considering transferring its equity in some profit-making companies to the Authority of Insurance and Pension.

The Stock Exchange

A new system for securities settlements was applied by CBE. The aim of this system is to carry out the settlement of securities on the same day of trading. This may help the Egyptian Stock Exchange catch up with international standards in this field, thereby attracting more foreign investments. Net US$ inflows by foreigners into the market amounted to US$ 259 million in the first quarter of the year.

Funding the Activities of Banking Regulators

Egypt's bank supervisory activities are funded through the budget process of the Central Bank of Egypt, the sole banking supervisor in Egypt.

EUROPEAN UNION

Review of the Basel Capital Accord

Despite concerns in mid-2003 that the deadline for the completion of the Basel Accord would not be achieved, the Basel Committee published a press release on May 11, 2004 to confirm that agreement had been reached on many of the key technical issues. The Accord was published in June 2004. The implementation date for the Accord will be in two stages: the standardized and foundation approaches are to be in place by the end of 2006 whilst the date for the advanced approaches is end-2007.

The key concern for the European Banking Federation is that the Directive which will implement the Basel Accord in the EU be flexible to allow change in line with developments in the banking sector. It is also a priority that the Directive achieves parallelism with Basel (notwithstanding EU specificities). Currently the European Commission is considering the implementation date in the EU taking into account the new proposal from the Basel Committee for a two stage approach. The European Commission will publish the proposal for a Directive in July 2004. The proposal will then be negotiated by the Member States in Council and by the European Parliament.

Another important development in 2004 was the extension of the Lamfalussy process to banking and insurance. The Committee of European Banking Supervisors (CEBS) which will be the Level 3 Committee for banking was set up in January. It is hoped that the work of CEBS will facilitate supervisory convergence in the EU and deliver consistent implementation across Member States. The Committee has already begun work on identifying national discretions in the Basel Accord which could be eliminated in the EU and has published a set of High Level Principles on the application of the Supervisory Review Process.

The Transparency Directive

In March 2004 the Directive for harmonization of transparency requirements of publicly listed companies was adopted by the European Parliament and by the Member States. The final Directive differs substantially in some areas from the original proposal published by the Commission in March 2003. The European Banking Federation believes that the final Directive will bring European financial markets significantly closer to the transparency needed to deliver sound investor protection.

One of the key elements of the Commission's proposal was mandatory quarterly reporting for all listed companies. However, Member States were divided on the value of quarterly reporting. In the final Directive companies whose home Member State does not require quarterly reporting will only be required to publish a management statement between the annual and half-yearly reports. This decision will be reviewed by the Commission five years after the implementation of the Directive.

There are a number of issues still to be resolved through the Level 2 implementing measures. In July 2004 the Commission set this process in motion by issuing a mandate to CESR to develop principles on equivalence between third countries' application of GAAP and IAS/IFRS.

Financial Markets Regulation

The first key development in the period was the adoption in July 2003 of the EU's Prospectus Directive, which establishes "a single passport" for issuers in the primary markets and harmonizes the disclosure rules for public offers and admission to trading. The final version of the legislation incorporated a key improvement supported by the FBE (which allows issuers to retain their current flexibility with respect to choice of competent authority for non-equity securities above a minimum threshold of Euro 1000 or USD equivalent).
The FBE carried out its lobbying activities related to the Prospectus Directive in close partnership with other associations and institutions, in particular the International Primary Market Association (IPMA).

The period was also quite busy in terms of clearing and settlement of securities. In August 2003, the CESR-ESCB Joint Working Group on Standards for Clearing and Settlement of Securities published a consultation document for comments by October 2003. The objective of the work was to apply the IOSCO recommendations on the same subject to the EU. The banking sector was generally critical of the proposed standards, for various reasons: First of all, IOSCO's work, of a "best practice" nature, was being effectively converted into hard law. Banks, whose role in the area of clearing and settlement of securities did not give rise to systemic risk, were being asked to assume new requirements that did not match their activities and were faced with the potential of double regulation, since any risks arising from their activities were in any event covered under banking supervision rules. The CESR-ESCB Joint Working Group issued in May 2004 a revised version of their standards and invited comments by the third week of June. The intention was to adopt the rules in July. The FBE has participated in the consultation on both versions of the standards and continues to urge for a cautious approach aimed at avoiding double regulation of banks and establishing a coherent and competitive framework.

In November 2003, having received the relevant technical advice from CESR, the Commission started its work on the implementing measures (so called "Level 2") for the Prospectus Directive as well as for the Market Abuse Directive (adopted in December 2002). In the former case, the implementing measures covered all aspects of the Directive, including the detailed disclosure schedules by issuer and by investor. In the latter case, a first set of implementing measures had already been adopted (October 2003) but a second and final set needed to be prepared, covering subjects such as the "accepted market practices" (a legal defence against a charge of market manipulation if the activity having the effect of market manipulation can be shown to be in line with such a practice); the notification of "suspicious" transactions by the bank to the authorities; the insiders' lists that have to be kept to reflect who has access to insider information; and disclosure of transactions by senior management within an issuer. Both sets of implementing measures were published by the Commission unofficially in November 2003 with the intention of allowing the industry to provide comments. Then the revised versions were sent to the European Securities Committee (ESC) in January 2004.

The FBE lobbied for improvements in both texts, both before and after the texts were submitted to the ESC. Among its achievements regarding the Market Abuse Directive measures, the FBE counts the fact that the relevant Market Abuse measure was changed to introduce a satisfactory anti-liability provision in cases of notification of "suspicious" transactions. Without this provision, reporting banks would have been subject to insurmountable liabilities emerging from clients' losses, criminal charges, and bank secrecy. With respect to the implementing measures of the Prospectus Directive, the FBE lobbying was instrumental in improving the requirements for offering programs, mutual recognition system, and accounting standards for 3rd country issuers.

The cornerstone of the creation of the EU Single Market, the Investment Services Directive, was adopted in April 2004, after an agreement reached by the European Parliament and Council on the debated issue of pre-trade transparency requirements for in-house matching of client orders. The final result involved a regime aimed at striking a compromise between the need for maintaining liquidity and that for allowing effective competition among execution venues. Other questions of importance to the FBE were conduct of business rules on which the final text is generally satisfactory, even if certain important aspects will be need to be clarified by the implementing measures. Having asked CESR to start work on a first set of subjects (e.g. best execution) in January 2004, the Commission submitted a second mandate for advice (e.g. in-house matching and non-advisory services) in June 2004 which will form the basis of the Commission's work on the draft implementing measures for the Directive, expected in the course of 2005.

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

In June 2004 the EPC was incorporated as an International non-profit association (a.i.s.b.l.) under Belgian law. Changes made to the internal structure are reflected in the new EPC Charter. Associations of the new Member States that joined the European Union in May this year will also become EPC members during June 2004. The mission of building a true, market driven 'single euro payments area ("SEPA")' will thus be taken to a higher level of commitment and efficiency.

The work of the whole banking industry (small and large banks) joining forces with the 3 European Credit Sector Associations (ECSAs) has continued along the initially established roadmap.

After the successful implementation of the **'Credeuro' convention** and the '**Interbank Charging Practices – ICP' convention**, work continues in the development of a **pan-European direct debit scheme.** The EPC closely co-operates with the European Central Bank in developing a model that will allow customers to pay their bills all over Europe by debiting their accounts in favor of the creditors, located in their country or in other member states.

The **pan-European automated clearing house (PE-ACH)** has become a reality with its first provider, STEP 2, which was launched by the Euro Banking Association (EBA) in April 2003. The number of banks participating in the system had increased considerably since then and in the future STPE2 will also process "domestic" payments. The model of PE-ACH is open to all banks in the EU (small & large).

Integration of the European Payments Clearing Infrastructure

On 1 April 2004, the European System of Central Banks officially launched the TARGET2 project, presenting the General Functional Specifications (GFS) of the Single Shared Platform (SSP). The document is a catalogue of principles governing the design of the future TARGET2 system.

The EPC TARGET Working Group is currently reviewing the specification in order to provide the European Central Bank with an assessment of the proposal. TARGET2 is due to start operations by January 1, 2007.The SSP will be built by 3 National Central Banks (Bundesbank, Banque de France and Banca d'Italia). The TARGET Working Group of the EPC will be closely involved in the next phases of the project i.e. the detailed functional specifications, the test & training and the migration phases (together with the national banking communities).

A New Legal Framework for Payments in the Internal Market

The European Commission launched a consultation on a 'New Legal Framework on Payment in the Internal Market' in December 2003. Since then the FBE has not only provided feedback on the document, but also participated in workshop meetings with the European Commission, aimed at clarifying the Directive text and providing the Commission with detailed comments. As a result a fourth Directive proposal will be published in August, for discussion with governments and the market in September. The final text is proposed to be delivered for inter-service consultation during the first quarter of 2005.

Fiscal Matters - Taxation of Savings Directive

In the absence of any coordination of national tax systems in the field of savings income, the European Commission and the EU Council have been concerned that EU residents were able to avoid any form of taxation in their Member State of residence on interest paid by a paying agent established in another Member State. The authorities believed that this situation created distortions in the capital movements between Member States.

After 14-year discussions, the EU Finance Ministers adopted on June 3, 2003 a Directive (Council Directive 2003/48/EC), which is aimed at ensuring effective taxation of savings income in the form of interest payments. In this respect, the Directive provides that Member States will automatically exchange information, so that intra-Community interest payments are taxed according to the laws of the Member State of residence of the investor. By derogation, Austria, Belgium and Luxembourg will levy a withholding tax during a transitional period, at 15% until 2007, then at 20% until 2010 and at 35% thereafter. These withholding tax countries will convert to automatic information exchange if and when the countries identified as key third countries, i.e. Switzerland, Lichtenstein, Monaco, Andorra and San Marino, agree on information exchange upon request along the OECD recommendations, which provide for information exchange on a wider basis than simple cases of criminal offenses.

Member States were requested to transpose the Directive into national law by January 1, 2004. According to a so-called "big bang" principle, all relevant countries (Member States, key third countries and dependant territories) should have applied the Directive and the related agreements from January 1, 2005 onwards. However, the implementation of the Directive in Member States on January 1, 2005 was contingent on the application, from that same date, of equivalent measures by the key third countries and on the fact that all agreements or other arrangements are in place to provide that all relevant or associated territories apply the information exchange or the withholding tax from that same date. The Council decided in June 2004 that these two conditions were not exactly met and adopted a new implementation date, 1st July 2005, on a proposal made by the Commission.

Environmental Liability

The European Commission presented in 2002 a proposal for a Directive on environmental liability with regard to the prevention and remedying of environmental damage, based on the "polluter pays" principle. The Commission's initial definition of the key concept of "operator" as "any person who directs the operation of an activity covered by the Directive" was a positive step to ensure legal certainty.

The greatest concerns for European banks related to lender liability-legal certainty and mandatory financial security. The chain of liability must be clearly understood. By the same token, the imposition of compulsory financial security should be avoided as it can result in limiting the range of available security schemes only to nominal ones, for the sake of complying with legal requirements.

Despite the Commission's balanced proposal, the European Parliament broadened the definition of the operator to include financiers and introduced mandatory financial security for environmental damage, much to the displeasure of the industry. One of the successes of the Greek Presidency of the EU (July 2003) was the achievement of a Council compromise. The Council definition of the operator, albeit allowing Member States to define as operator anyone "*to whom decisive economic power over the technical functioning of such an activity has been delegated*" was significantly narrower than the one proposed by the European Parliament, and no mandatory financial security is envisaged, at least until 2010.

The FBE has, in cooperation with other industry associations, frequently addressed the European Parliament and the Council during all three readings of the text (04.2003-03.2004), alerting them on the potential negative consequences of their resolution (risk aversion of banks, lack of funding for SMEs and companies perceived as potential polluters).

The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary - Directive on Financial Collateral Arrangements

The Commission proposed late in 2003 that the EC sign the abovementioned Hague Convention. This will, according to the Commission, trigger a revision of article 9 of the abovementioned Directive (containing a private international law rule based on *lex rei sitae*), to be brought in line with the Convention (embracing PRIMA, the Place of the Relevant Intermediary Approach). In the Council, the competent Working Group is examining the Commission's proposal with a view to give a mandate for signature. After the signature, the Convention must be ratified by the EC and Member States. The Commission hopes that ratification can be completed in late 2004 or early 2005.

The delayed Explanatory Memorandum to the Convention is expected before autumn 2004. No assessment study has been conducted up to now regarding the impact of PRIMA on European financial services legislation.

European Commission Working Party on Data Protection

Commenting on a working document on Corporate Codes enabling groups of companies to transfer data internationally, the FBE welcomed the Working Party's recognition that in-house rules and procedures applying to undertakings within a group can provide a mechanism for ensuring that personal data are adequately protected when they are transferred to group companies outside the EU by data controllers located in it. The FBE urged however the Working Party to consult the industry more extensively and to adopt a more flexible and less legalistic approach regarding authorization requirements and onward transfers.

Commission Action Plan on a More Coherent European Contract Law

Despite its name, the Action Plan neither intends to "harmonize civil law", nor to create a "European Civil Code". It shall elaborate on a common frame of reference (CFR), establishing common principles and terminology in the area of European contract law; it may also serve as a "toolkit" of ready made and coherent definitions, rules etc, to be used by the Commission when converting minimum harmonization directives to maximum harmonization ones. Eventually, CFR may also be forged into an optional instrument, providing parties to a contract with a modern body of rules particularly adapted to cross-border contracts in the EU internal market. The instrument will have to have mandatory rules, in the sense that businesses, when opting in, will not be able to *selectively* do so. In 2004, a Commission Conference on the CFR has been organized with participants from the industry, Member States and Academia, where the methodology of CFR was presented. It is a long term project: the Commission envisages final adoption of the CFR for 2009. Given that financial services are also contracts, the industry concern for the Action Plan is self-evident.

Rome Convention on the Law Applicable to Contractual Obligations

The FBE duly responded (autumn 2003) to the Commission's consultation on transforming the Rome Convention to a Community legal instrument. The Rome Convention indicates the law applicable to contractual obligations and is thus of crucial importance for the provision of banking services cross border. The FBE is in favor of transforming the Convention into a Regulation, if its general principle of contractual freedom is maintained and reaffirmed, even to cross-border contracts between banks and consumers. In this context the FBE proposed by majority that art. 5 of the Rome Convention (submitting certain consumer contracts to the law of the consumer's country of residence) could cease to apply in substantially harmonized sectors, because EU common standards are deemed to give consumers adequate protection under any and all national legal systems, to the benefit of contractual freedom. The FBE participated in the Commission Conference in the Convention early in 2004 and developed the industry's views. The Commission is expected to publish a proposal after summer 2004.

Directive of the European Parliament (EP) and of the Council on Takeover Bids

2003 has been a long year of deadlock in the Council of Ministers and cautious progress in the European Parliament for this proposal. In the Commission's text, 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) did not extend to securities carrying double or multiple voting rights, allegedly due to potential constitutional problems in Member States. Multiple voting rights are of extreme importance for Scandinavian countries. Complex negotiations in Council and Parliament were the main reason for the delay in the legislative procedure; certain Member States also delayed this proposal as a bargaining chip for other EU legislative initiatives. After months of negotiations, during which many times the proposal was thought "dead and buried", late in 2003 the EU Competitiveness Council unanimously adopted (with Spain abstaining and the Commission not supporting the text) a text based on a political compromise (the Italian compromise). On the same day, the EP Legal Committee voted on a draft report reflecting the Council compromise which the Rapporteur (Mr. Lehne) was closely following. Days before 2004, the European Parliament adopted the Council Common Position with a single reading. According to the Italian compromise, Member States are allowed to decide whether to ban poison pills and multiple voting rights ("opt-out"). When Member States opt-out, individual companies are allowed to "opt-in" to the provisions banning these defences. Companies in Member States not allowing multiple voting rights and not using unapproved poison pills may be exempted by these interdictions if they become targets of a bid by a company able to use such devices. There is general doubt on whether such a proposal will be successful in promoting a level playing field for cross-border bids. This seems to be the approach of the Commission; Commissioner Bolkestein, in charge of the issue, has on many occasions sharply criticised this watered-down final text.

Bank/SME Code of Conduct Elaborated at EU Level

Access to finance is perceived as a significant barrier to growth for Small and Medium-sized Entreprises in the European Union.

A voluntary code of conduct between banks and Small and Medium-sized Enterprises (SMEs) has been drafted by a group of EU-level organizations representing banks and SMEs, under the auspices of the European Commission. It is intended to be the basis for codes which will set out principles of good practice in individual EU member states.

It seems likely that this initiative will encourage the spread of such codes, which exist so far in only a small number of EU countries.

FINLAND

Despite the weakened economic situation, the year 2003 was moderately good for the banks, and the earnings of financial and banking groups operating in Finland remained at the previous year's level. The positive development was backed by consumer confidence in their own economic development, which remained strong, by demand for housing loans maintained by low interest rates, as well as by improvement of the stock market, which resulted in more active trading. New housing loans set an almost record-breaking pace, and during the year, public debate on loan-related risks for both the borrowers and the banks was, at times, intense.

Already in the previous year, the Bankers' Association and the government had jointly created a debt settlement program aimed at helping people with excessive debt incurred during the recession in the early 1990s. In order to make the program more effective, a so-called lightened settlement procedure was developed in the spring of 2003 for the long-term unemployed and those living on income support or small pensions. Under the procedure, which was initiated in May, the debtor could become free of his or her debts in a flexible and simple way without a repayment program. By the end of 2003, the banks had signed more than 2,000 agreements in accordance with the debt settlement program. The two-year settlement program will end on August 31, 2004. The banks expect to reach an agreement with approximately 5 to 10 per cent of the targeted debtors.

At the same time, there have been several undertakings in Parliament to promote the position of debtors by means of legislation. However, these have had the unfortunate effect of decreasing interest in voluntary agreements. One of these was the Act on amending the Execution Act, enacted in 2003. The amendments entered into force on 1 April 2004. According to the Act, the time period of the enforceability of a sentence or other basis for execution is 15 years. If thecreditor is a natural person, the time period is 20 years. The new Act on the expiration of receivables shortened the general expiration period of a debt from 10 years to three years. Another difference in comparison to previous practice is that the expiration period starts on the due date of the debt. It can be suspected that at least some debtors would rather wait for the end of execution proceedings than agree with the banks on a voluntary repayment program.

The working group appointed by the Government to evaluate the competitiveness of savings, investment and life insurance products issued its final report in December. The working group proposes equal taxation for all essential savings and investment products, as well as introduction of the reforms as of the beginning of 2005. In the Bankers' Association's opinion, the preservation and proposed extension of the tax incentive is well-founded. The proposed model provides a good framework for product development and allows competition. However, a long transitional period is required for existing pension insurance policies.

Uncertainty about the Government's intentions was still causing problems in the spring of 2004. Pension saving has almost stopped, and due to the lack of decisions, the banks and other providers of long-term savings products cannot start developing the information systems and the like required for new operations. The debate has probably exaggerated the effect of the reform on pension savings volumes, for example. The reform is mostly similar to the existing system in Sweden, and experience from there indicates that the extended variety of alternatives has not brought any major change in savings volumes or the market shares of different service providers.

The European payment area was developed during the year by several parties: the European Commission and Parliament, mutual cooperation between banks, as well as the European System of Central Banks. Cooperation between banks and the ECBS became more intense. Cooperation between EU authorities and banks was still seeking its form. Work at the European Payments Council, established by banks, gained momentum, and during the year, agreements were reached on a European giro transfer procedure (credeuro) and the establishment of a Pan-European Automated Clearing House (PEACH). With regard to the development of payment card services, cooperation within the Finnish Bankers' Association focused on issues related to the introduction of EMV (Europay, MasterCard, Visa) smart cards. The banks developed electronic invoicing by specifying a suitable e-invoice standard and enabling e-invoices to be transmitted through the banks (Finvoice). The number of payments handled by the banks exceeded one billion transactions, and the degree of electronic processing increased to 94 per cent. The number of direct debit transactions increased by 18 per cent, the number of payment card transactions by 16 per cent and the number of payments transmitted through data connections for private customers by 10 per cent.

During the year, the Bankers' Association provided approximately 80 answers to requests for statements received from authorities. In addition to four Bank Reviews with a renewed appearance and layout, the Association published three publications on paper. The number of reports, agreement terms and conditions, as well as service descriptions published on the Association's Web site was more than 80. The Finnish Savings Banks' Association and Suomen AsuntoHypoPankki Oy were approved as new members of the Bankers' Association during the year. This means that at the end of the year, the Association had 14 members who represented 336 banks.

Funding of Bank Supervisory Authorities

The Financial Supervision Authority (FSA) supervises financial markets and participants. The operational objective is to promote stable conditions in the financial markets and enhance public confidence in supervision and market behavior. There are about 500 supervised entities. These include banks, brokerage firms, stock and derivatives exchanges, and management companies for mutual funds. The FSA operates in connection with the Bank of Finland but is an independent decision-making body.

In Finland, the Financial Supervision Authority (FSA) finances its operations by levying supervision and processing fees. Supervision fees consist of periodic fees and specific fees. The liability to pay the fees falls on the entities supervised by the FSA and the issuers of securities. Some FSA decisions and other measures are subject to processing fees under the FSA tariff. In 2003, the costs arising from the FSA's operations amounted to EUR 15 million, of which EUR 14.5 million was covered by periodic fees and EUR 0.5 million by processing fees.

FRANCE

The Financial Security Act n° 2003-706 of August 1, 2003, amends the procedure for transposing European directives into national law. The Minister of the Economy assumes the regulatory role of the CRBF or *comité de la régulation bancaire & financière* (the Banking and Financial Regulatory Committee) and will implement European directives through ministerial decrees, with the advice of the *Comité consultatif de la législation et de la réglementation financière* (the Financial Legislation and Regulatory Board), which was established under this Act.

After September 11, 2001, various institutions, notably the Basel Committee and the Financial Stability Forum, began to consider the need to implement plans for ensuring business continuity, even in the event of "extreme emergencies".

Now that sufficient progress in this area has been made, the *Commission Bancaire* (the French Banking Commission) would like to include business continuity plans in the annual internal control report, which until now only included IT disaster recovery plans. It therefore proposed a draft regulation to amend CRBF regulation n° 2001-01 (initially 97-02), which modified the internal control requirement accordingly and also amended the definition of operational risk – which was extended in particular to include external events – and furthermore added an annex concerning the security of payment means that banking institutions issue or process. This new regulation (2004-02) was adopted on January 15th, 2004, after review by a working group composed of banking industry representatives.

The fourth item that had been proposed for amendment, i.e. outsourcing, was not included in the present version of the regulation, since the CRBF considered that more work has to be done in this field.

The new regulation 2004-02 immediately came into effect upon publication, except for its article 1 concerning business continuity plans, which will be applicable from July 1st, 2004.

1. Business continuity plans : new regulation allows some flexibility:

- The definition of "business continuity plan" and the internal control report obligations imply an obligation of means (or due diligence), i.e. an obligation to implement a system for ensuring that essential services are maintained.

- If business continuity is interrupted, there must be a recovery plan, which can be partially realized when necessary due to difficult conditions.

- The Commission specified that its assessment of the business continuity plan was based on overall, as opposed to local, business activity.

2. Operational risk redefined:

The definition of operational risk is no longer limited to failures caused by accounting or IT systems, but now includes failure resulting from external events and from internal causes, such as procedures, staff and systems. Furthermore, the obligation of means in relation to operational risk has also been redefined to include legal risk.

3. Payment means and security: appendix added to the report:

The new regulation requires that an appendix on the security of payment means be added to the report. This annex must include the assessment, measurement and follow-up of the security of the payment means that banking institutions issue or process. It has to be attached to the 2004 internal control report.

Anti-Money Laundering Developments

The Financial Security Act of August 1, 2003 has brought two amendments:

- The extension of money-laundering obligations to UCITS, investment management firms, financial intermediaries, persons authorised to sell banking and financial services and investment advisers.

- A new obligation for companies with a parent company to provide their parent with all of the information it needs to prevent money laundering and the financing of terrorism, such that the parent will be able to provide local authorities with the most comprehensive information possible.

The Act of February 11, 2004 concerning the legal professions set up a complex legal mechanism which includes some provisions of the 2nd money-laundering directive of 2001:

- The scope of this mechanism was expanded to include chartered accountants, statutory auditors, court-appointed administrators, lawyers with the *Conseil d'Etat* and the *Cour des comptes* and lawyers in their capacity as advisers.
- The obligation to disclose suspicious activity was extended to include efforts to prevent corruption and fraudulent transactions that may be detrimental to the interests of the European Union. These provisions are not easy to enforce since there is no legal definition of the concepts of corruption and fraud against the interests of the European Union.
- The obligation to conduct checks on the identity of a new customer has been supplemented with an additional obligation to verify the identity of the actual economic beneficiary.

The Act of March 9, 2004 has made the following two amendments to the mechanism:

- It expanded the scope of money-laundering legislation to include the managers and legal representatives of casinos, gaming clubs and lotteries.

- It introduced a new obligation to notify the suspicious activity of anyone who could be involved in the financing of terrorism.

Market Developments

The European Payments Council 's (EPC) initial work dealt with payments subject to the *Credeuro Convention* and the Interbank Convention on Payments (ICP):

- Credeuro Convention : The banks that are party to this convention agree to execute €uro bank transfers in the EU up to €12,500 within three days, subject to certain conditions.
- ICP : This convention lays down various rules for invoicing services between banks:
- The first version of the ICP convention applies to transfers subject to the Credeuro Convention. It defines among other things the so-called " share option " for invoicing customers, in compliance with European regulation n° 2560/2001 of December 19th, 2001 concerning cross-border payments in €uros and which seeks to establish a single rate for cross-border and domestic bank transfers.
- This convention also does away with the "benededuct", whereby intermediary banks deduct a fee for their service directly from the transfer amount. This convention provides total transparency of invoicing methods without however dealing with the substance of customer invoicing.

- The ICP came into effect on July 1, 2003, when the bank transfer section of European regulation n° 2560/2001 came into effect.

GERMANY

German capital market law has been further modernized by a new framework for investment companies as well as measures to strengthen investor protection and the accountability of both companies and auditors. New financial products such as hedge funds and "true sales" of asset-backed securities have been introduced to the German market. In addition, income tax rates have been cut, while an amnesty scheme aims to help tax sinners to return to the path of tax honesty. EU Commission decisions and court rulings and their translation into German law are significantly eroding the competitive privileges that Germany's public-sector banks enjoy.

New Developments in the Regulation of Investment Companies and Securities Trading

On January 1, 2004 the Investment Modernization Act entered into force, creating a new regulatory framework for investment companies in Germany. First, it translates the two European directives of February 2003 on Undertakings for Collective Investment in Transferable Securities (UCITS) into German law. Second, it incorporates the rules for German investment companies and the sale of foreign investment fund certificates, which had been previously set out separately in the Investment Companies Act and the Foreign Investment Act respectively.

Third, it allows the licensing of hedge funds in Germany for the first time. Hedge funds follow legally unrestricted investment strategies that usually bring high returns but also may entail high risks. To protect investors, only funds of hedge funds (FOF) can be distributed publicly, whereas single hedge funds may only be sold by way of private placement (i.e. on demand by/addressing an individual client). A FOF has to comply with risk diversification requirements. For example, a FOF may not invest more than 20% of the fund's assets in one targeted fund. In addition, a FOF is not allowed to invest in more than two targeted funds of the same issuer or manager, or to invest in targeted funds which, in turn, are investing in targeted funds.

The introduction of hedge funds is expected to improve risk allocation by market participants and strengthen the future role of Germany as a financial marketplace. The stringent information requirements should enable investors to acquire a comparatively good knowledge of the product that will allow them to realistically assess their risk exposure.

An accompanying Investment Tax Act has largely leveled the existing differences in the taxation of domestic and foreign investment companies.

In June 2004, the German parliament approved the Retirement Income Bill. Among other things, this new law provides for changes in the promotion of private pension provision, with the aim of simplifying the so-called "Riester pension" in order to increase its acceptance. In addition, it requires that, as of January 1, 2006, it must be ensured in contracts that contributions and payments under pension insurance schemes are calculated without regard to the sex of the insured (so-called "unisex tariff"). In the case of bank and fund savings schemes, this provision has an important bearing on the partial annuitization of retirement capital that is stipulated from the age of 85. In this connection, the income tax treatment of life insurance contracts has been brought more into line with other financial products in that half of the sum paid out in excess of the contributions paid in is taxed.

In April 2004, the German government published a bill designed to improve investor protection. This bill translates the EU Market Abuse Directive (to be implemented by October 2004 at the latest) into German rules on insider trading, ad-hoc disclosure, prohibition of manipulation of market prices and securities analysis. In addition, the bill would for the first time introduce a requirement in German law to report suspicion of insider or price-manipulating activities. Finally, the bill contains amendments to the German Sales Prospectuses Act, making such prospectuses obligatory also for non-securities shares ("gray capital market").

A second bill to improve investor protection is due to be introduced later this year in order to strengthen directors' liability (see also *New Developments in Company Law*).

"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.

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. The project is open to all interested banks.

New Developments in Company Law

German legislators too are anxious to strengthen investor confidence in the integrity, stability and transparency of the financial markets, particularly by reforming the current system of corporate governance. 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 and in the Sarbanes-Oxley Act of 2002 to reform the U.S. corporate governance system. The demand made for more transparency in executive compensation – particularly with regard to stock options – is already accommodated by the modified German Corporate Governance Code of May 2003. The bill to strengthen corporate integrity presented by the Federal Ministry of Justice at the beginning of February 2004 is designed to address a "major point" in the aforementioned catalogue of measures.

The bill has been welcomed by the Association of German Banks as well as other German banking and non-banking associations, particularly the plans to curb any abuse of the right to sue and to introduce a so-called "business judgment rule". On the other hand, the plans to reduce the threshold amounts for legal action (to a quorum of only a 1% shareholding in terms of registered capital or a market value of € 100,000) and to establish a forum on the website of the German Federal Gazette for shareholders willing to sue are viewed with skepticism. These are matters of concern also because of the expected strengthening of corporate liability vis-à-vis third parties in the second bill to improve investor protection due later this year.

In addition, the Federal Ministry of Justice submitted at the beginning of April 2004 a bill on model proceedings for actions for damages by investors, based on the government's "catalogue of measures". The aim is to allow actions for damages brought by aggrieved investors to be pooled at law – something which has not been possible to date under the German Code of Civil Procedure – by conducting model proceedings. The introduction of model proceedings is designed to prevent complex, similar hearings of evidence in a large number of different actions. Unlike class action under U.S. law, one of the plaintiffs is officially designated as the model plaintiff by an upper regional court (*Oberlandes-gericht*); the other plaintiffs are invited to attend the model proceedings as well. The non-appealable model ruling is binding on the courts and, as far as the scope of its declaratory purpose is concerned, also on the other plaintiffs attending the proceedings and the model defendant.

The bill is to be merged later with the Federal Ministry of Finance's announced bill dealing with the liability of directors vis-à-vis third parties – the government's "catalogue of measures" would introduce "personal liability of directors vis-à-vis third parties for false capital market information circulated willfully or through gross negligence" – in a second bill to improve investor protection.

New Developments in Accounting

A key step in strengthening investor confidence is ensuring that company accounts are reliable. German accounting law is therefore being modernized, mainly by abolishing outdated accounting options and achieving further alignment with international accounting principles. In April 2004, a government bill to reform accounting law was published. This bill contains national provisions on the regulation on the application of International Financial Reporting Standards (IFRS/IAS) adopted at European level. Capital-market-oriented companies are already required under the IAS Regulation to prepare their group accounts in accordance with the IFRS from 2005 onwards. The national options contained in the IAS Regulation are to be used as far as possible in Germany. First, non-capital-market-oriented companies will also be given the chance to prepare their group accounts in accordance with the IFRS. Second, both capital-market-oriented and non-capital-market-oriented companies may also draw up individual IFRS-compliant accounts, but only for disclosure purposes. For assessing tax and calculating dividend payments, accounts drawn up in accordance with the provisions of the German Commercial Code are still required. Third, those bond-issuing firms without listed shares, as well as firms listed in third countries, e.g.

on the U.S. Stock Exchange, and therefore applying U.S. GAAP, are allowed to implement IAS by 2007 instead of 2005.

Besides addressing the application of the IFRS, the bill also contains numerous amendments to German accounting law resulting from the translation of European accounting directives into national law. This means that German accounting law is being brought into line with international standards, while the overall legal framework for accounting is being optimized.

In addition, the bill would amend the Commercial Code to make auditors more independent. It prohibits auditors from auditing themselves, i.e. auditors are not allowed to get into a situation where they assess the results of earlier advisory activities of their own. Tighter auditing rules are planned for capital-market-oriented companies and banks and insurance companies of a certain minimum size. Furthermore, the bill contains rules on the personal ties and financial dependence of auditors, as well as a requirement to disclose fees for auditing services and advisory services separately.

Also in April 2004, a government bill on the supervision of accounting was passed. In addition to the existing supervision of corporate accounting in Germany by the statutory auditors of the annual accounts and the courts of registration, a two-step enforcement procedure will be introduced. As a first step, a private supervisory organization will conduct checks, both in cases of suspicion and by way of random audits, on the orderly accounting of listed companies. As a second step, the Federal Financial Supervisory Authority (BaFin) will take action as a sovereign supervisor whenever companies refuse to cooperate at the first-step level or do not correct the shortcomings detected there. This two-step supervisory structure is to be financed by the companies that are to be examined, whereby concrete checks at the second-step level will have to be paid for solely by the respective company.

The creation of a privately-run enforcement office under government supervision strengthens the capital market and Germany's competitiveness as a financial center and is firmly supported by the Association of German Banks and the other large trade associations in Germany.

New Stock Market Developments

In November 2003, Clearstream, an integral part of the Deutsche Börse (German stock exchange) Group, launched a new securities settlement process in Germany in conjunction with Deutsche Bundesbank, the German central bank. This new settlement model allows participants to use their liquidity and collateral more efficiently, while at the same time greatly reducing settlement risk. In addition, it creates a level playing field in the settlement of securities transactions in Germany. In particular, domestic and foreign participants are now being granted the same access to central bank funds in cross-border transactions. The new German securities settlement system not only increases market efficiency and substantially reduces costs for customers but also sets the standard for the entire European capital market in line with international best-practice guidelines. Some other European central banks have participated in the new model from the outset and more have signaled an interest in this process.

Also in November 2003, Deutsche Börse AG shortened the trading hours for the electronic trading system XETRA: trading now closes at 5.30 p.m. instead of 8 p.m. Floor trading on the Frankfurt Stock Exchange and the other regional stock exchanges still closes at 8 p.m.

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

In accordance with the understanding reached in 2001 between the European Commission and the German government on the phasing-out of *Anstaltslast* and *Gewährträgerhaftung*, the public guarantees still furnished to savings banks and their central institutions, the Landesbanken, will be abolished in mid-2005. This will put an end to one of the most significant competitive privileges that German public-sector banks enjoy.

State aid proceedings by the Commission against various Landesbanken for integrating state housing agency assets are still pending. 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 that 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 against 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 intends to issue a decision on the WestLB case and the other six cases in autumn 2004.

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

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 (2002).

At the end of 2003, the Association of German Banks, in collaboration with the research group ipos, conducted another representative survey of online banking and e-commerce in Germany to follow up on the end-2002 survey. It revealed that six out of ten Germans already have Internet access. At the beginning of 1999 – just five years ago – the figure was just over one in ten. The proportion of Germans conducting online banking has risen steadily over the past few years, from just 11% in 2000 to 29% (or nearly one in three Germans) today. This means that around half of all Internet users also use online banking facilities, and no end to this growth is in sight: Another 13 % of Germans over 18 also intend to bank online in the future. The proportion of Germans who rate online banking as safe or very safe has virtually doubled since 1998, from 21% then to 41% today. At the same time, around a third (31 %) of respondents feel that online banking is "not so safe", while another 15% actually regard it as "not safe at all".

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.

In 2003, a so-called "Alliance for Electronic Signatures" was launched. Members are the German banking associations cooperating in the joint secretariat ZKA and representatives of the business sector and the Economics and Labor Ministry, the Ministry of the Interior and the Ministry of Finance. The aim of this alliance is to allow e-business and e-government applications via a common infrastructure.

For users, this means they will 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. The ZKA has already made available a multifunctional chip card, the SECCOS card, and issued uniform security requirements.

The Fight Against Money Laundering and the Financing of Terrorism

The laws to fight money laundering and the financing of terrorism were tightened considerably in 2001 and 2002, so that there is no need at present for additional legislation and the focus is on practical implementation of the provisions previously adopted. The new legal provisions supplementing the 2001/2002 amendments include, in particular, additional powers, established by the Second Act Amending the Customs Administration Act and Other Laws, for the Federal Financial Supervisory Authority (BaFin) to fight the financing of terrorism.

One particularly important new anti-money laundering instrument created in 2001 is automated access to bank account details (Section 24 c of the Banking Act). This technically and organizationally complex procedure can be used to very quickly identify which legal or natural persons have cash accounts or securities accounts at which banks in Germany.

At the European level, German banks are involved in the discussion on the contents of a third European Anti-Money Laundering Directive, a draft of which was presented in June 2004. They are also taking part in the consultation process on the Consolidated KYC Risk Management paper circulated by the Basel Committee on Banking Supervision.

Tax Developments

The income tax relief scheduled for 2005 has been partly brought forward to 2004. The bottom tax rate has been cut from 19.9% to 16% and the top rate from 48.5% to 45%. From 2005 onwards, these tax rates will be lowered again to 15% and 42% respectively.

Under the Act Promoting Tax Honesty, tax sinners in the past will be given the chance from January 1, 2004 to March 31, 2005 to return to the path of tax honesty by declaring previously untaxed income, thereby obtaining immunity from criminal prosecution. This income must be taxed at a flat rate allowing for deductions from the assessment basis (tax rate until December 31, 2004: 25%; where a declaration is furnished between January 1, 2005 and March 31, 2005: 35%). At the same time, the German government undertook to present “a proposal for an internationally competitive system of taxing capital income” in 2004. The Act Promoting Tax Honesty is seen as a first step in this direction. The German banking industry strongly supports a uniform overall concept for taxing private investment income on the basis of a final withholding tax that would cover not only interest but particularly also dividends and capital gains.

Funding of the Activities of German Bank Supervisory Authorities

Financial supervision in Germany has been performed since 2002 mainly by the Federal Financial Supervisory Authority (BaFin), which is funded entirely by the financial institutions (banks, investment firms and insurance companies) it supervises. Administrative acts in the field of financial supervision are issued solely by BaFin, while the Federal Ministry of Finance is responsible for legislation and for supervising the way BaFin performs its role. BaFin’s budget must be approved by an administrative board, composed of six government representatives, five members of the German parliament and ten representatives of financial institutions.

At present, a debate is taking place on whether the risk of litigation costs resulting from any failure by BaFin to perform its duties properly should also be borne by the financial institutions it supervises or whether the relevant legal basis should be amended so that the government meets these costs.

The Deutsche Bundesbank plays only a supporting role in the field of banking supervision: it is in charge of ongoing supervision of banks. How high its supervisory costs are is not publicly known. These costs are not passed on to banks but covered from the Bundesbank’s budget.

The cost of the deposit guarantee scheme operated by the private banks, including its audit association, is met by the banks participating in the scheme. A similar scheme is run by those public banks which are not savings banks. These are schemes aimed primarily at protecting depositors. The public savings banks and the cooperative banks, on the other hand, belong to guarantee schemes that are designed to protect them against failure. These schemes are operated by regional associations and lack cost transparency.

HONG KONG

Personal Renminbi Business in Hong Kong

Since February 25, 2004, licensed banks in Hong Kong (Participating Banks) were able to conduct personal Renminbi (RMB) business for individuals with a Hong Kong Identity Card to facilitate their personal spending. Individual Participating Banks are required to enter into a settlement agreement with the clearing bank (Clearing Bank) appointed by the People's Bank of China to offer clearing services for this scheme. The scope of personal RMB business includes deposit, exchange, and remittance initially while the card business was launched in late April 2004 after the requisite systems and arrangements were put in place. There are certain maximum amount requirements applied in respect of exchange and remittance transactions (e.g. the equivalent of RMB20,000 for exchange transactions conducted through RMB accounts and RMB50,000 for remittance per person per day). The Hong Kong Monetary Authority (HKMA) expects Participating Banks to have adequate policies, procedures and systems in place to manage personal RMB business, to monitor the relevant risks and to ensure compliance with the scope of business and the arrangements provided for in the Settlement Agreement signed with the Clearing Bank. The rollout of the new business initiative was smooth, with the total RMB deposits with Participating Banks standing at RMB6,298 million as at the end of May 2004.

Clearing and Settlement Systems

Hong Kong is set to introduce new legislation (Clearing and Settlement Systems Bill), which provides for important clearing and settlement systems to be subject to HKMA's statutory oversight and for the modification of Hong Kong's laws in their application to transactions effected through such clearing and settlement systems so as to ensure settlement finality of these transactions. The salient features are as follows:

(a) The overseer of clearing and settlement systems will be the HKMA, which is also the prudential supervisor of banks and other authorized institutions in Hong Kong.

(b) The HKMA may designate important clearing and settlement systems to be subject to HKMA's oversight if the system is or is likely to become a system whose proper functioning is material to the monetary or financial stability of Hong Kong or to the functioning of Hong Kong as an international financial center. Besides monitoring the general compliance of the designated systems, the HKMA will take reasonable steps to promote the general safety and efficiency of such systems in accordance with the Clearing and Settlement Systems Bill.

(c) Under the proposed legislation, if the HKMA determines that certain criteria have been met by a designated system, he shall issue a certificate of finality the effect of which will be to invoke the finality provision of the Bill regarding settlement in that system. Settlement finality refers to the abrogation of all rights otherwise existing at law that would allow the setting aside of transactions effected through such systems. The certificate could be revoked or suspended by the HKMA. The finality provisions, however, do not affect any rights arising from the underlying transaction in respect of the transaction taking place through the designated system, short of any revocation or reversal of the relevant transaction or disposition through the designated system.

Continuous Linked Settlement

Changes are being proposed to the clearing house rules relating to the Hong Kong dollar interbank clearing system to facilitate the participation of CLS Bank in the Hong Kong dollar Clearing House Automated Transfer System (CHATS) thereby enabling cross border currency transactions with one leg in Hong Kong dollars to be settled intra day simultaneously with its counter currencies under a real time, global settlement system. This is designed to eliminate the principal risk associated with the settlement of foreign exchange trades involving Hong Kong dollars across different time zones. In addition, changes are being proposed to the settlement procedures on typhoon and rainstorm days to require the settlement of CLS transactions and other CHATS payments in rainstorm and typhoon days. The inclusion of Hong Kong dollars into the CLS system is scheduled to come into effect in the fourth quarter of 2004.

Sharing Commercial Credit Data

Further steps have been taken to allow banks and financial institutions to share among themselves through a Commercial Credit Reference Agency credit data relating to small and medium-sized corporate enterprises. This system is based on obtaining consent from the relevant SME's to providing and sharing data through a Commercial Credit Reference Agency. This initiative is supported and regulated by the Hong Kong Monetary Authority. It is expected that the system would start operation in the second half of 2004.

Money Laundering Prevention Guidelines

The HKMA has developed a supplementary guideline on prevention of money laundering which incorporates the latest standards recommended in the Basel Committee paper on customer due diligence and the revised FATF Forty Recommendations. A set of Interpretative Notes which provide practical guidance on implementing the requirements of the supplementary guideline and explain the risk-based approach to be used has also been drawn up, in collaboration with the industry associations. The supplementary guideline, together with the Interpretative Notes, is expected to be effective before the end of the year. The main requirements in the supplementary guideline include the assessment of customer risk profile and the enhancement of due diligence process on corporate customers, trust, nominee and client accounts, customers introduced by intermediary, non face-to-face customers, correspondent banking customers and politically exposed persons, and the process of on-going monitoring. It also covers the relevant FATF special recommendations relating to anti-terrorist financing (such as wire transfers).

Anti-Terrorism Measures

Legislation is set to be introduced to give full effect to the requirements of the United Nations Security Council Resolution 1373 to combat international terrorism, the FATF Special Recommendations to freeze non-fund terrorist property, and to implement the requirements of other international conventions against terrorism, such as criminalizing any bombing attack against an infrastructure facility, a public place, a public transportation system and a state or government facility, enhancing investigation powers and enabling law enforcement agencies to exchange information on transactions of suspected terrorist property for the purpose of suppressing terrorist financing.

Approach to Funding the Activities of Banking Regulators

Activities of the banking regulator are funded through Hong Kong Monetary Authority's annual budget process.

IRELAND

Supervision of Financial Institutions

Regulatory Developments

A draft of the Central Bank and Financial Services Authority of Ireland Bill, 2003 is currently being considered by Parliament and it is anticipated that the Bill will be enacted in 2004. The Bill will provide for the establishment of a statutory ombudsman scheme for consumers, the establishment of Industry and Consumer Consultative Panels, the power to impose sanctions on financial service providers and the regulation of mortgage introducers and certain money transmission services. It will also provide the Irish Financial Services Regulatory Authority ("Financial Services Regulator") with additional powers in relation to requiring directors and auditors to report to the Financial Services Regulator on compliance matters.

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

From May 1, 2003 all reports of suspected breaches of the anti-money laundering legislation (Criminal Justice Act, 1994 – the "Act") made by the Financial Services Regulator and made by institutions designated under the Act must be reported to the Revenue Commissioners as well as to the Garda Bureau of Fraud Investigation (Irish police).

Revised Money Laundering Guidance Notes for Stockbrokers and for Insurance and Retail Investment Producers were approved by the Money Laundering Steering Committee, of which the Financial Services Regulator is a member, and issued in February 2004.

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 or other terrorist activities 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 of common interest. The Financial Services Regulator continued to provide assistance to the auditing profession in the development of guidance on the audit of investment businesses. Work also commenced on the development of guidance for auditors of Credit Unions.

The Financial Services Regulator has nominated a member 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. The Companies (Auditing and Accounting) Act, 2003 will establish IAASA on a statutory footing and will 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 member 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.

The Financial Services Regulator established a working Group on International Financial Reporting Standards (IFRS), with Industry bodies and accountancy bodies, with the primary objective of considering issues arising from the application of IFRS to financial institutions, with particular reference to regulatory capital requirements. The Financial Services Regulator also participated in various EU groups on auditing and accounting related matters.

Basel II Update

Work has been continuing at organization, industry and European level on preparations for the implementation of Basel II requirements by way of European Directive. Ireland is well represented at the negotiations of the Revised Codified Directive and Revised Capital Adequacy Directive due for publication in July 2004.

Client Money Rules

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

Codes of Conduct

The Financial Services Regulator issued interim Codes of conduct to Insurance Undertakings, Mortgage Intermediaries and Moneylenders in December 2003. A consultation paper on the review of the codes for Financial Service Providers was issued in March 2004. Submissions were invited from the Industry, the Public and consumer groups. Once the consultation process has been completed (closing date for submissions May 2004), revised codes will be issued towards the end of 2004.

A voluntary code on switching bank accounts, which has been developed by the Irish Bankers Federation, will form the basis for a consultation process for a statutory code on switching, to be published by the Financial Services Regulator, before the end of 2004.

All credit institutions as defined in the Consumer Credit Act, 1995 (as amended) who have notified charges under S149 of this Act to the Financial Services Regulator, were requested in May 2004 to carry out a review of their systems and charges and to make a report to the Financial Services Regulator before September 30, 2004.

Insurance companies and credit institutions providing retail financial services to customers were requested in June 2004 to carry out a review of their existing sales processes and practices, to examine in particular their policies in relation to recommending investment products to more vulnerable consumers and to make a report on the foregoing together with certain requested information to the Financial Services Regulator before 31 August 2004.

Developments in the Banking Sector

A banking licence was issued to Fortis Prime Fund Solutions Bank (Ireland) Limited. Five banking licences were revoked –Dresdner Bank (Ireland) plc, Commerzbank International (Ireland), maxblue Limited, Investment Bank of Ireland Limited and Rheinhyp Bank Europe plc, all at the request of the licence holders. At end June 2004, the number of credit institutions supervised by the Financial Services Regulator was forty-nine.

Residential lending, which accounts for approximately 80 per cent of personal sector credit, continued to grow substantially in 2003 and into 2004. The annual growth rate, adjusted for securitizations, for March 2004 is 26.9 percent, which is at its highest level since the series commenced in December 1996. Historically low interest rates, strong housing demand and rising house prices are amongst the factors underlying this strong growth.

A stress-testing exercise was undertaken simulating the effects of various economic scenarios relating, among other things, to GDP growth rate and unemployment trends. The FSR asked 12 domestically focused institutions to evaluate the effect of the scenarios on their asset base and profitability. The preliminary results of this analysis indicate that these institutions would be able to weather a serious economic shock.

Consultation papers on both capital instruments and credit derivatives were published. In the case of the later, following receipt of comments from industry, a new regulatory notice is expected to be issued shortly.

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 of the prudential directorate carry out the supervision of non-bank financial institutions: Securities and Exchanges Supervision, IFSC and Funds Supervision, Insurance Supervision, and the Consumer Directorate.

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

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

The Financial Services Regulator is also responsible for the authorization and supervision of collective investment schemes established under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 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. The Product Directive (2001/108/EC) was transposed into Irish law on May 29, 2003 and a new set of UCITS Notices were issued in December 2003 setting out the new product rules. The Management Company Directive (2001/107/EC) was implemented on October 21, 2003 and consultation with the industry on the resulting changes is nearing completion by June 2004. A draft guidance note was also issued in January 2003 providing for a standard format for the simplified prospectus.

A new type of fund vehicle, a common contractual fund, which is based on the law of contract, was introduced into the UCITS legislation in May 2003 by Statutory Instrument 211 of 2003. Legislation has also been drafted to provide for the establishment of non-UCITS common contractual funds.

Papers setting out the Authority's policy in relation to investments in derivatives by retail schemes and publication of dealing prices were published during the year together with revised Notice on investment by retail fund of funds schemes in unregulated funds.

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.

Funding

From 2004, the funding of the Financial Services Regulator will be based on partial industry funding. For the next three years (2004-2006) the Financial Services Regulator will seek to raise approximately 50% of its annual funding requirement from the industry. The balance of annual funding required by the Financial Services Regulator will be provided by the Board of the Central Bank and Financial Services Authority of Ireland. The manner in which the amount of the levy will be determined for the various industry sectors will be based on a cost allocation model, which will apportion the costs of regulation to each industry category. It is expected that invoicing for 2004 will commence in July 2004.

ISRAEL

The Israeli economy that had stagnated since 2001 started to show signs of revival in the second half of 2003, a trend that has continued and was more pronounced in 2004. The turnaround was due partly to the strong measures implemented by the government – budget cuts, lowering of transfer payments and several structural reforms. Another contributory factor was the improvement in the global economy and particularly the resumption of growth in the high tech industries whose products and services are an important component of Israel's export trade.

The decreasing budget deficit was coupled with a gradual reduction of interest rates by the Bank of Israel in response to the persistent environment of low inflation. This combination of factors had a strong impact on the financial markets. Prices in the stock market, that had reached a bottom in February 2003, started to recover even before the signs of economic recovery became apparent. The positive trend of stock prices, and the effect of the lower interest rates on the bond market, have contributed to the profitability of banks, insurance companies and other institutional investors.

But the more important developments in the Israeli financial markets, some already consummated and some still in the stage of planning, relate to reforms in the structure and the mode of operation of its various components. The reform of the pension system is in an advanced stage of execution: funds with large actuarial deficits were actually nationalized, with the government undertaking to cover the deficit in return for cuts in the benefits to the funds' members. The solvent funds will be sold to interested investors and will be required to invest most of their assets in the securities markets (in the former regime most of the assets were invested in special purpose unquoted government bonds). The active participation of pension funds in the securities markets is expected to increase their depth, and contribute to the development of the capital markets.

The insurance sector is also undergoing changes aimed at simplifying the terms of policies, lowering the costs of marketing through agents and increasing the competitiveness of the market. The compulsory vehicles insurance, that was conducted until 2003 by a tightly regulated arrangement, has been transferred to the sole management of the insurance companies. A further change that is currently explored by a committee, headed by the director general of the treasury, is to allow banks to market insurance policies, that until now are mostly marketed by insurance agents.

The most far reaching reforms, still in the stage of deliberation by the above mentioned committee, relate to the banking sector. The Israeli banking market is highly concentrated, with the two largest banks accounting for some two thirds of the business, and the five major groups accounting for more than 90%. The banks are also the most important participants in the securities markets, through subsidiaries that manage retirement funds (other than pension funds) and mutual funds as well as underwriting activities. It is claimed – though not substantiated - that the power of the banks is a hindrance to the competitiveness of the financial markets, and that a separation of the banks from their asset management and underwriting activities is essential to the efficiency of the markets. One may question some of the assumptions on which this view is based, particularly in light of the fact that concentration is typical of financial markets in small economies, but there is a strong political support for measures that will curb the banks dominance and therefore it seems that the next year will be a year of substantial reforms in the banking system.

Another issue explored by the committee is the structure of the regulation of the financial markets. Currently, the banking sector is regulated by an officer of the Bank of Israel – the Supervisor of Banks; insurance companies and retirement funds are subject to regulation by a treasury official – the Supervisor of Insurance, while the securities market , asset management firms and underwriting firms are regulated by the Securities Authority. (The Restrictive Trade Practices Authority is also involved in certain aspects of regulation, such as the approval of mergers.) How should the policies of these agencies be coordinated? One approach is to establish a coordinating body. Another is to consolidate the three agencies in a form similar to the Financial Services Authority in the U.K.

During the past year the Supervisor of Banks issued several directives relating to the required conduct of the banks' business:

- Members of a bank's board of directors are required to refrain from directly approaching officers of the bank in matters relating to new business initiatives or to specific customers' accounts;
- An accounting firm auditing the accounts of a bank should nominate a senior partner to be responsible to the audit relationship and assure rotation of the responsible partner at least every 5 years;
- The requirements relating to the credit ceiling of a group of interconnected borrowers in relation to the capital of a bank were tightened by redefining the term "a group of borrowers";
- The Basel Committee's directive on the management of liquidity risks was adopted ;
- The directive on the management of information technologies was revised in accordance with the principles of managing electronic banking, enunciated by the Basel Committee in July 2003;

- The banks were required to establish and implement a policy of rotating managers and employees in sensitive positions and of assuring that employees will take an annual leave of absence of several consecutive days.

The process of privatizing the banks whose controlling blocks of shares are still held by the government was not completed yet, but an offer for the sale of a controlling block of the Israel Discount Bank's shares was made public recently and the government announced its intention to distribute to the public options for the purchase of Bank Leumi's shares still in its disposal.

The coming year will, quite probably, witness significant changes in the structure of the Israeli financial markets and in the pattern of their regulation.

Funding the Activities of Banking Regulators

Banks in Israel are regulated and supervised by a Bank of Israel official – the Supervisor of Banks. The securities market, asset management and underwriting activities are regulated by the "Securities Authority". Accordingly, banks' activities in these areas (conducted via subsidiaries) are regulated by the Securities Authority. The Supervisor of Banks' activities are funded through the Bank of Israel's budget; supervision activities of the Securities Authority are funded through its own budget.

ITALY

Regulation and Supervision of Banks and Other Non-Bank Financial Institutions

Significant legislation during the period under review has involved banks and other financial companies organized as public limited companies, namely the entry into force of Italy's company law reform on January 1, 2004.

The reform, enacted with Legislative Decree 6 of January 17, 2003, features the broadening of the scope of corporate autonomy in the formulation of bylaws, the simplification of the rules governing companies, the regulation of corporate groups according to principles of transparency and the reconciliation of the interests involved. In practice, the reform translated into a modification of the Civil Code. It applies to unlisted and listed companies alike, save where special legislation provides otherwise.

Market Developments

As to regulatory innovations in the field of Payment Systems, Banca d'Italia issued on February 24, 2004 a regulation providing guidelines for the Oversight of Payment Systems, making operational the content of Article 146 of Testo Unico Bancario.

In particular, it sets out the scope of the Oversight function, summarized in the objective of reliability (prevention from operational and settlement risks) and efficiency (in terms of time and cost needed for the accomplishment of the whole cycle of the payment).

In the same period, Banca d'Italia also issued the Supervisory Instructions for the operation of Electronic Money Institutions, whose existence had been made possible by the EU Directive of 2000.

As to trends in payment instrument usage, payments at E-POS by means of debit cards have been the most numerous, followed by checks and direct debit.

The most interesting and innovative development in the field of retail Payment Systems was the launch of a procedure which allows BANCOMAT customers to locate by a toll free call the closest working ATM. The system, called FARO – a word meaning in Italian "lighthouse", but which is the acronym for "*Funzionamento ATM Rilevato On-line*" meaning "working ATMs controlled on-line" - has been put in place by CO.GE.BAN. in co-operation with the newly constituted bank consortium called "PattiChiari" (a system-wide project to improve bank-customer relations). It is based on the gathering in a dynamic data base of messages sent every 10 minutes by all the 35,000 machines installed in Italy. The mechanism, more advanced than normal "ATM locators" already available in some schemes, is the first one giving customers information concerning the effective capacity of an ATM to give out banknotes.

Further activity has been carried out by Italian banks inside the European Payments Council with regard to the building of the Single Euro Payments Area and, through Associazione Bancaria Italiana, inside the European Banking Federation in the ongoing discussions for the definition of the New Legal Framework for Payment Systems in the EU, a set of common rules that the Commission intends to define to achieve harmonization in the EU for payment services.

In the field of wholesale Payment Systems, banks have accomplished their activities positively in order to deploy the new real time gross settlement system operated by Banca d'Italia, called *Nuovo BIREL*. The experience gathered in setting up this new system, one of the most advanced in the Eurosystem, has allowed Banca d'Italia to participate, together with Deutsche Bundesbank and Banque de France, in the formulation of a proposal for a single, shared platform for the new Eurosystem infrastructure for the transfer and settlement of large value payments (TARGET 2).

The Italian banking system has also increased its activity in the last 12 months: the increase of quality and quantity of the services on offer to clients goes hand-in-hand with the growth in loans and in the terms of conditions available to clients.

At the end of 2003, the Italian banking system had 11.3% of the total banking assets of the 12 nations sharing the euro, lagging behind only Germany and France. At December 2003, bank loans as a percentage of Italy's gross domestic product rose to 79.9% from 77.8% in 2002. Among the largest European countries, Italian banks, whose loans in 2003 totalled 49.8% of total assets, came second only to Spain's 54%. When compared to European data, more Italian loans go to enterprises than to families, both as a proportion of the whole and on average. At the end of March 2004, loans to Italian firms were 64.4% of total credit, compared with an average of 46.1% in the euro zone. Loans to families totalled 35.6%, compared with an average of over 50% in the euro area. In the past year, however, banks have greatly increased lending for house purchases (+23% change at March 2004) and consumer credit (+15% change at March 2004).

Mergers and acquisitions have continued. At the end of April 2004, the number of Italian banks was 801, with a reduction of 16 banks with respect to the same month in 2003. On the other hand, in the last year there has been an increase in the number of branches (+576 branches at the end of 2003 with respect to the end of 2002 – from 29,926 to 30,502) and the number of POS (+76,676 – from 818,710 to 895,386). In the same period, the number of clients has also increased in home and corporate banking (+28,615 clients – from 4,845,033 to 4,873,648) and in phone banking (+789,607 clients – from 4,942,689 to 5,732,296).

JAPAN

Regulatory Developments

The capital adequacy ratio of Resona Bank fell below the Japanese standard of 4% in the year ended in March 2003. Consequently, the Financial Services Agency issued a business improvement order on May 17 of the same year and Resona Bank applied for public funds with the Deposit Insurance Corporation based on the Deposit Insurance Law. On June 10, the Japanese government decided to increase Resona's capital by a total of 1.96 trillion yen. As a result, the Deposit Insurance Corporation underwrote new shares issued by Resona Bank on July 1 and exchanged these with stock in Resona Holdings, Inc. through a stock exchange on August 7. This gave the Deposit Insurance Corporation voting rights of about 70% in Resona Holdings.

Ashikaga Bank fell into a condition of excessive debt in its settlements for the period ended September 2003. The Financial Services Agency issued a business improvement order on November 29 and the government decided to commence special public management of the bank based on the Deposit Insurance Law. In response to this decision, the Deposit Insurance Corporation obtained all stock in Ashikaga Bank on December 1.

A law that partially revises the Securities and Exchange Law was established on June 2, 2004. This law enables banks and other financial institutions the right to broker stocks and other securities transactions with securities firms and others. This revision will be implemented from December 1, 2004.

The Law on the Special Measure for Strengthening Financial Functions was established on June 14, 2004. This law enables financial institutions and others to apply to have the Deposit Insurance Corporation underwrite stocks, etc. up to the end of March 2008. The government will review the business reinforcement plans submitted by the concerned financial institution and underwrite stocks, etc. using public funds only when requirements are met. This law was implemented from August 1, 2004.

Market Developments

The Government Housing Loan Corporation began the business of supporting securitization (acquisition type) from October 1, 2003 based on the Amendment of the Government Housing Loan Corporation Law implemented in June 2003. This business involves the Government Housing Loan Corporation purchasing loan receivables for long-term, fixed interest housing loans issued by private financial institutions and issuing Government Housing

Loan Corporation bonds backed by the loan receivables (mortgage-backed securities). The Government Housing Loan Corporation also plans to start the business of supporting securitization by guaranteeing the securitization (guarantee type) from October 2004.

On April 1, 2004, Sony Financial Holdings Inc. was established. This is an interim holding company with three firms under its umbrella: Sony Life Insurance, Sony Assurance and Sony Bank. This is the first holding company with both a bank and insurance company under its umbrella established in Japan.

On April 1, 2004 the government of Tokyo acquired BNP Paribas Private Bank (Japan) and changed its trade name to New Bank Tokyo, which is scheduled to begin operations after April 2005. The government of Tokyo has decided to appropriate an investment of 10 billion yen into New Bank Tokyo within its fiscal 2004 budget.

Other Developments

The government of Tokyo issued an ordinance in April 2004 that introduced pro forma standard taxation for banks, etc. in Tokyo. Of those banks subject to the taxation, 21 banks (the number at that time), filed an administrative lawsuit against the Tokyo government and governor. In July 2003, the government of Tokyo applied for a settlement and the respective plaintiff banks agreed to settle the lawsuit in the Supreme Court on October 8. The settlement was agreed to after the banks and the Tokyo government (and governor) agreed to lower the tax rate from 3% to 0.9% and a portion of the previously paid tax was refunded to the corresponding banks.

Funding of Bank Supervisory Authorities

The Financial Services Agency is funded through the Government's general budget process.

KOREA

Legislative and Regulatory Developments

The Revision of the Bank of Korea Act (effective on Jan. 1, 2004)

The revision is aimed to promote an environment in which the Bank of Korea can formulate and implement monetary policy under less external pressures and influences. The Deputy Governor of Bank of Korea is empowered to serve *ex-officio* on the Monetary Committee which is a central body to determine the monetary policy of Korea. The inflation target system has been shifted to the intermediate range which will give the Bank of Korea more flexibility and allow it to work with a long-term view in its policy formulation and implementation to meet inflation targets. Under the new rule, Bank of Korea has become independent in its budget processes except that of the payroll of its employees.

The revision also provides for the Central Bank of Korea to assume overall responsibilities for oversight of the country's payment and settlement system.

New Asset Management Business Act

In October 2003, the Korean Parliament passed a new law called "the Indirect Investment Management Business Act," effective on January 4, 2004. The new law replaces a portion of the existing two laws, Securities Investment Trust Business Act and the Securities Investment Company Act, which governed the activities of financial institutions related to asset management. The new law expands the scope of assets to be managed by financial institutions to OTC derivatives, real estate, and even non-financial products from securities and futures traded in the regular market. Financial institutions that want to run asset management businesses are required to obtain approvals of the Financial Supervisory Committee/Service (FSC/FSS) under the new law and hold capital of more than 10 billion won. Banks and insurance companies are also granted licenses to run asset management businesses.

The Establishment of Korea Housing Finance Corporation

On March 1, 2004, the Korea Housing Finance Corporation (KHFC) began operations to offer long-term mortgage loans with the maturities of more than 10 years. This state-run corporation will provide more opportunities for home ownerships to low- and middle-income families. It will finance the loans by issuing bonds and mortgage-backed securities.

Measures of Financial Supervisory Committee/Service (FSC/FSS) for Financial Development

FSS to Take Steps to Improve Disclosure of Significant Share Acquisition and Disposition

On March 16, 2004, the FSS announced a number of steps to improve compliance with the rules about the disclosures of significant share acquisitions and dispositions. One of the measures is a stricter DART filing condition which requires a filing of correct information on profiles of related persons, prices of acquisition and disposition, and sources of funds. Another measure includes e-mail notifications by FSS to the person responsible for disclosure about changes in rules, disclosure formats, and other regulatory matters. The new enforcement guidelines are also a measure which provides a way for FSS to notify the public prosecutors in seeking criminal penalties against late disclosures and repeated violations of disclosure rules.

FSC/FSS Announces New Measures to Enhance Safety and Liquidity of Money Market Funds

To reduce the sensitivity of MMF to changes in short-term interest rates, FSC/FSS announced a new measure providing that the weighted average maturities of assets remaining in a MMF fund must be less than 90 days, being shortened from previous 120 days. In addition, it rules that credit ratings of assets in a MMF fund must fall in the top first or second grade category.

REITs to Come under Stricter FSC/FSS Supervision, Beginning in 2004

The FSC/FSS announced revisions on the Supervisory Regulations and Enforcement Rules on real estate investment trust (REIT) companies. They include the introduction of Prompt Corrective Actions and guidelines about Capital Adequacy and Liquidity Ratio.

FSC/FSS proposed plans to enhance infrastructure of capital market

FSC/FSS proposed a series of measures in late 2003 to strengthen supervision of credit rating companies (CRC) such as mono-lining of disclosure channels of rating information, stricter monitoring of consulting businesses of CRC, and revamping internal auditing systems of CRCs.

FSC/FSS also announced measures to encourage the companies to disclose their accounting information more accurately and timely. They encouraged the companies to employ more certified public accountants to perform internal audit functions and to prevent outside auditors from being engaged in preparing the financial statements of the companies.

Under the new proposal, all information on CP issuance of companies is required to be channeled into the Korea Federation of Banks (KFB) by underwriting and intermediary institutions (banks, securities companies, and merchant banks) so that the information can be consolidated at KFB. Moreover, when the yearly cumulative volume of CP issuance and redemption of a listed company exceed a certain level (fore example, 10% more than the company's capital), it should immediately disclose that information.

Financial Restructuring and M&A

On September 5, 2003, the FSC/FSS approved the application of Shinhan Financial Group (SFG) to make Chohung Bank a bank subsidiary of SFG. SFG is a dominant shareholder of Shinhan Bank and 10 other financial subsidiaries. The movement ultimately aims at the merger of Shinhan Bank and Chohung Bank which will create another mega-bank followed by Kookmin Bank and Woori Bank in the banking industry of Korea.

Other important merger developments during the period from July 1, 2003 to June 30, 2004 are three cross-border mergers initiated by the financial institutions and private equity funds. On September 26, 2003, Loan Star, a U.S.-based private equity fund, obtained the approval of the FSC/FSS for the acquisition of 51.0% of the controlling stakes in Korea Exchange Bank. On March 26, 2004, the FSC/FSS approved Citigroup's application to acquire more than 10% share of KorAm Bank. Citigroup was reported to have a plan to acquire all the voting shares which are held by the investor consortium led by JP Morgan and the Caryle Group and other remaining shareholders. Korea Exchange Bank and KorAm Bank are the constituents of 7 big city banks of Korea. On November 25, 2003, the government had reached an agreement with Prudential Financial Inc. to sell an 80% equity in Hyundai Investment & Securities Co. Ltd.(HITC) and Hyundai Investment Trust Management Co., Ltd. which is a subsidiary of HITC.

Approaches to Funding the Activities of Bank Supervisory Activities

The funding is made primarily through assessments paid by the regulated institutions and levies on securities trading activities. The funding is independent of the government's general budget process. Bank of Korea, the central bank of Korea, also makes contribution to the funding.

LATVIA

The legislative framework for financial sectors complies with the requirements of EU directives in all material aspects.

During the period from July 1, 2003 through June 30, 2004, amendments to several laws were approved by the Parliament.

The Financial Instruments Market Law (adopted by the Parliament on November 20, 2003), which replaced the Law on Securities, introduced several requirements of EU directives into the Latvian financial market regarding:

- prohibition against the use of inside information and market manipulations;
- investment services in the securities field;
- admission of securities to official listing on a stock exchange and the information required to be published on such securities; and
- as to how prospectuses that are to be published in connection with a public offer of securities should be drawn up, verified and distributed.

The said law provides that financial instruments traded publicly shall be regarded as financial instruments admitted to trading on a regulated market (for example, a stock exchange). Public issue of securities that are offered to the public but are not intended for trading on regulated markets will be subject to supervision. Credit institutions will not be required to obtain a separate license issued by the Financial and Capital Market Commission (hereinafter – the Commission) to provide investment services. The law also introduces 'the single license principle' for the establishment of branches of investment brokerage firms registered in EU Member States and European Economic Area countries (hereinafter – Member States) and provision of services. This implies that, upon Latvia's accession to the EU, investment brokerage firms registered in Latvia will be entitled to provide investment services or open branches in Member States according to simpler procedures. Likewise, investment brokerage firms registered in Member States will be entitled to provide investment services in the Republic of Latvia according to simpler procedures.

Under the latest amendments of the **Credit Institution Law**, (adopted by the Parliament on November 20, 2003) the original maturity for subordinated loans is reduced from seven to five years. This affords credit institutions better opportunities to attract subordinated capital.

Amendments to **the Law on Insurance Companies and Their Supervision** (adopted by the Parliament on November 20, 2003), were formulated for the purpose of introducing 'the single license principle' for the establishment of branches of insurance companies registered in Member States and provision of investment services in Latvia, as well as for the establishment of branches of insurance companies registered in Latvia and provision of investment services in Member States. As a result of introducing 'the single license principle', an insurance company registered in a Member State will not be required to obtain a license to provide insurance in another Member State, in which it intends to open a branch or provide services.

In order to improve the supervision of insurers, in turn, other amendments to this law provide for the right of the Commission not to allow an insurer to establish close links with third parties if such links may endanger the financial stability of the insurer and hinder the Commission in effecting its supervisory functions. Also, the amendments specify types of assets that may henceforth be accepted as cover for technical provisions, as well as lay down diversification rules to be observed in establishing categories of assets accepted as cover for technical provisions. In addition, for the protection of interests of the insured, the said law stipulates that, henceforth, insurance brokerage firms will only be entitled to carry out insurance intermediary activity as well as other types of commercial activity directly related to insurance intermediary activity.

To ensure the full implementation of requirements of the Investor Compensation Directive, amendments to the **Investor Protection Law** (adopted by the Parliament on November 20, 2003) were drafted, thereby determining the right of investment service providers registered in Latvia to join investor-protection schemes of other Member States, retaining concurrently the status of a participant in the Latvian investor-protection scheme.

During the period from July 1, 2003 through June 30, 2004, the Commission, continuing alignment of the regulatory framework with the requirements of directives and recommendations of international supervisory authorities, approved several new regulations as well as some amendments to the previously adopted ones.

Regulations on the Calculation of the Required and Available Solvency Margin for Insurance Companies (effective as of July 1, 2004), approved by the Commission's Board, have been drafted as a result of transposing requirements of EU directives. The Regulations introduced new procedures for the calculation of the required solvency margin for insurance companies as well as new procedures for the calculation of the available solvency margin for branches of third-country enterprises.

In order to ensure a more efficient procedure for the out-of-court settlement of disputes between an insurer and customers regarding insurance indemnity payments, the Commission prepared the **Recommendations for the Formulation of Efficient Procedures for the Out-of-Court Settlement of Disputes Between an Insurer and its Customers Regarding Insurance Indemnity Payments** (effective as of January 1, 2004). These Recommendations set the basic principles for a more efficient dispute settlement process than provided by the general procedures for the court settlement of disputes. Recommendations for the formulation of efficient procedures for the out-of-court settlement of disputes between a credit institution and its customers were adopted in 2002.

The amendments to the **Regulations for Calculating Capital Adequacy of Banks and Brokerage Companies and the Regulations on the Compliance with Restrictions on Exposures for Banks and Brokerage Companies** have been drafted as follows:

- List of Zone A countries has been amended to include new Member States that were Zone B countries prior to accession. Risk weightings for claims on central governments, central banks, claims secured by securities issued by central governments or central banks, or guaranteed by central governments or central banks, claims on credit institutions and claims guaranteed by credit institutions of these countries have respectively changed for capital adequacy calculation purposes;

- Claims on regional and local governments, claims guaranteed by regional and local governments or secured by securities issued by regional and local governments of Member States are assigned a 0% risk weighting where they are 0% risk weighted in their home country;

- Transactions with central governments and central banks of countries added to the Zone A list are exempt from restrictions on large exposures.

- Restrictions on exposures to regional and local governments of Member States, including Latvia, will only apply to 20% of the value of transactions.

Basel II

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.

Funding the Activities of Bank Supervisory Authorities

From July 1, 2001 to December 31, 2006, the activities of the Financial and Capital Market Commission are funded from payments made by financial and capital market participants, the State budget and the Bank of Latvia. Beginning in 2007, the activities of the Commission will be fully financed from payments by financial and capital market participants.

LUXEMBOURG

Measures to Control Money Laundering and to Fight Terrorism

At the legislative level, two new laws have been added to the Luxembourg legal arsenal in the fight against money laundering and the financing of terrorism.

The law of August 12, 2003 on the prevention of terrorism and its financing, approving the International Convention on the Prevention of the Financing of Terrorism laid open for signing in New York on January 10, 2000 has entered into force. The first purpose of this law is to transpose into domestic law the requirements set out in the framework decision of the Council of June 13, 2002 on the fight against terrorism. It introduces the offense of financing terrorism as such into the criminal code and extends the definition of the offense of laundering to include in the list of primary offenses, offenses of terrorism and financing of terrorism. The law also approves the International Convention on the Prevention of the Financing of Terrorism, which was adopted by the United Nations General Assembly on December 9, 1999.

The law of December 19, 2003 approving the International Convention on the Prevention of Terrorist Attacks using Explosives adopted by the United Nations General Assembly on December 15, 1997, and endorsed on December 17, 2003 also entered into force.

The bill of law, voted by Parliament but not yet in force, on the fight against laundering and on the prevention of the financing of terrorism deals with the transposition into Luxembourg legislation of Directive 2001/97/EC of December 4, 2001 amending directive 91/308/EEC on the prevention of the use of the financial system for the purpose of capital laundering. It also seeks to combat the financing of terrorism by using the resources put in place for the prevention of laundering.

A draft law tabled on December 19, 2003 will further supplement these provisions. It seeks to approve various international texts on corruption, including the Convention established on the basis of article K.3 of the Treaty on the European Union relating to the fight against corruption involving officials of the European Communities or officials of the Member States of the European Union signed in Brussels on May 26, 1997; the second protocol established on the basis of Article K.3 of the Treaty on the European Union to the Convention relating to the protection of the financial interests of the European Communities signed in Brussels on June 19, 1997; the criminal law Convention on corruption signed in Strasburg on January 27, 1999, together with the additional protocol to that Convention signed in Strasbourg on May 15, 2003. The main purpose of the approval of these texts will be firstly to extend the notion of corruption to corruption in the private sector; that will require an extension of the offense of money laundering. Secondly, the responsibility of legal persons in criminal law will be acknowledged.

New Categories of Financial Sector Professionals

The law of August 2, 2003 amending the law of April 5, 1993 on the financial sector introduced new categories of financial sector professionals; all the professionals in this sector are accordingly now subject to the same regime of approval and prudential supervision. The new professions concerned are those performing certain financial transactions (loan operations, security lending, cash transfer services, company incorporation and management services), mutual savings fund administrators, managers of non-coordinated UCIs, client communication agents, administrative agents of the financial sector and operators of EDP systems and communication networks of the financial sector. This text responds to a desire to attach to the financial sector a number of activities which are not a priori of a financial nature, but which become so in that they are ancillary or complementary to a financial activity. It also responds to an evolution of the financial sector associated with heightened specialization, which leads professionals to focus on certain activities and to outsource others.

Law of July 27, 2003 on Trusts and Fiduciary Schemes

The law of July 27, 2003 on trusts and fiduciary schemes approves the Hague Convention of July 1, 1985 on the law applicable to trusts and the recognition of trusts and also modernizes the legal framework for fiduciary arrangements in Luxembourg. Ratification of this Convention by our country has several consequences. In the first instance, the Convention provides our courts with rules enabling them to solve the problems of private international law, which are liable to arise when a trust produces its effects on the territory of Luxembourg. Secondly, the entry into force of the Convention will facilitate the recognition of Luxembourg fiduciary schemes abroad. Although Luxembourg law does not provide for trusts as such, the Luxembourg fiduciary scheme does have the characteristic features of a trust enumerated in the Convention. The latter therefore creates a bridge between the trust and the fiduciary scheme. This enhances the legal certainty of our own system.

The new text broadens the list of professionals who may act in a fiduciary capacity. Moreover, the absence of a compulsory link with Luxembourg opens the door to many applications of the Luxembourg law, including for operations in which neither the principal nor the trustee is established in Luxembourg. Relations between the principal, the trustee and third parties are defined. Moreover, the text makes full provision for the specific use of fiduciary schemes for guarantee purposes.

The new law creates greater legal certainty for fiduciary transactions and gives the Luxembourg fiduciary scheme greater legitimacy at the international level.

Law of March 9, 2004 on Securitization

The law of March 9, 2004 creates a highly attractive framework for securitization transactions in Luxembourg. In order to authorize the securitization of a maximum number of assets, the scope of application is deliberately kept as broad as possible. The law aims to cover not only securitization operations for claims but also operations involving any type of asset and risk. This will enhance the attractiveness at the international level of the Luxembourg securitization scheme and ensure that there will be no obstacle to the application of this same scheme to innovative securitization structures.

With a view to achieving maximum flexibility, the vehicle may take the form of an investment company or a purely contractual form with no legal personality, the securitization fund.

Governed by Luxembourg company law, the corporate purpose of the securitization company is to acquire securitizable assets and to issue securities representing these assets. The securitization fund is formed at the initiative of a management company responsible for its administration and management for the account of investors and may operate either on the model of a fiduciary scheme or on that of co-ownership.

Law of March 19, 2004 on the Restructuring and Liquidation of Credit Institutions

The law on the restructuring and liquidation of credit institutions seeks to transpose Directive 2001/24/EC into the amended law of 5 April 1993 on the financial sector. This is designed to supplement the EU provisions on restructuring and liquidation procedures since credit establishments, investment companies and insurance businesses had been excluded from the scope of application of Regulation No. 1346/2000 on insolvency procedures. The main purpose of the directive is to ensure mutual recognition of restructuring measures and liquidation procedures adopted by the Member States, to strengthen coordination between the competent authorities for these matters and to unify the rules of jurisdiction. It lays down the principle of the competence of the authorities at the place where the establishment has its registered office and the application of measures by the Member State of origin, namely the State in which the establishment has been approved. The measures adopted by this State produce full effect throughout the territory of the EU in compliance with the principles of universality and uniform provisions on bankruptcy. Thus, contrary to regulation No. 1346/2000 on insolvency procedures, the opening of secondary liquidation procedures in the Member State hosting the establishments is prohibited.

While taking over the rules laid down in the directive, the law extends its scope of application to investment companies if they hold funds or financial instruments for third parties. The Luxembourg legislator therefore sets out to fill the legal void left by the EU legislator who made no legal provisions for the restructuring and liquidation of investment companies. This unilateral extension of the scope of application of the directive may, however, have a fairly limited impact because a procedure opened in Luxembourg in respect of an investment company will only produce its effects in another State if the latter agrees to the extra-territorial effects of this procedure on its own territory. In principle, there is nothing to prevent another State from opening secondary liquidation proceedings.

This law, alongside EU regulation No. 1346/2000 on insolvency procedures, which is directly applicable, and draft law No. 5108 on the restructuring and liquidation of insurance companies transposing directive 2001/17/EC, enables full provisions to be put in place in Luxembourg to cover restructuring and liquidation procedures.

Law of May 12, 2004 on Venture Capital Investment Companies (SICAR)

The legal framework leaves great flexibility for the incorporation of a company, which may take various forms. Given the success of the SICAV, due to the absence of any formality in the event of a change in the share capital, SICARs incorporated in the form of a joint stock company, are similarly permitted to adopt a variable capital. Moreover, the share capital is only required to reach the stipulated minimum after one year and the subscribed capital must not be paid up immediately. Capital reimbursements can be made without any special formality.

The possibility of listing a SICAR on the Luxembourg Stock Exchange is one of the advantages of the new vehicle which will therefore respond to the needs of investors who, for regulatory reasons, tend to invest more readily in listed products.

The main purpose of the company must be investment in securities representing venture capital. The latter is defined as a contribution of funds to bodies with a view to their launch, subsequent development or stock market listing. The risk associated with such investments may therefore stem from the fact that the capital is made available to newly created listed or unlisted companies, earmarked for certain activity sectors with a high development potential or else because the investments lack diversification.

One of the conditions for application of the new regime is the limitation of the authorized purchases of shares to well-informed investors. The text gives eligibility to effect such investments not only to institutional or professional investors but also to an expert private clientele.

Draft law on financial collateral arrangements

The draft law on financial collateral arrangements seeks to transpose directive 2002/47/EC. Its purpose is essentially to strengthen the legal certainty of these contracts, in particular by harmonizing the conditions of validity and enforceability against third parties of financial collateral by removing these contracts from the rules relating to insolvency and by harmonising the application of the rule of lex rei sitae.

THE NETHERLANDS

A New Supervision Act for the Financial Sector

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

A New Act for Financial Services

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

Financial Compensation for Supervision

While the securities supervisor and the insurance supervisor already passed on their costs to the financial firms they supervise, the banking supervisors will now follow. Talks are in progress about the costs and the distribution of payments.

New Securities Regulation

Ahead of the Basel II rules, the Dutch supervisor implemented rules for securitizations. The rules make securitization for supervisory arbitrage purposes much less attractive.

Voluntary Code on Corporate Governance

A voluntary code on corporate governance was introduced as a reaction to incidents with listed companies. It has a big impact on listed companies including banks. Although the banks support the code, banks are of the opinion its influence should be limited because of the tight supervision on banks and their special position in relation with other listed companies.

Administrative Cost

The Dutch Minister of Finance has announced the ambitious goal to cut administrative costs resulting from governmental regulation by 25% to 35%. Administrative costs for banks are as high as € 665 million per annum. Not only would this call for a serious cut in existing regulations, it would also put pressure on policymakers to be very critical with new regulations. As The Netherlands chairs the EU in the second half of 2004, cutting administrative cost will also be a priority on the EU-level.

NORWAY

Significant Developments for the Financial Sector

The Parliament adopted in December 2003 changes in the Accounting Act which implement the fair value directive (2001/65/EF). The amendment came into force January 1, 2004.

The Solvency I Directives for life insurers and non-life insurers came into force January 1, 2004.

The Parliament adopted in 2003 changes in the Financial Institutions Act which permit securitization of loan portfolios. Furthermore, mortgage credit institutions may issue bonds secured by a loan portfolio (covered bonds). The amendments came into force January 1, 2004.

On January 1, 2004 the Ministry of Finance changed the rules on restrictions on holdings in banks and insurance companies to a system based on the EEA banking and insurance directives. The new rules replace the earlier absolute 10 per cent limit on holdings in banks and insurance companies with a discretionary test of the suitability of acquirers of qualifying holdings. Anyone wishing to acquire more than 10 per cent of the capital of a financial institution has to apply to the Norwegian authorities beforehand. Entry into option contracts is deemed to be on a par with share acquisitions. The authorities will give attention to the holder's suitability, supervisory aspects, the institution's independence in relation to individual shareholders, other commercial activity and competitive considerations.

A new law on money laundering came into force January 1, 2004. The new law is based on the second money laundering directive (2001/97/EF), and some international standards in this area, particular FATF's special recommendations concerning measures against terrorist financing. Under the new rules, auditors, accountants, estate agents and lawyers are obliged to report to the authorities if they suspect a client or customer to be involved in money laundering. So far, only banks and other financial institutions have been obliged to report to the authorities.

In December 2003 Norway's leading financial services group DnB and the banking and life-insurance group Gjensidige NOR merged and formed DnB NOR.

In February 2004 The Board of Directors of Storebrand (a life-insurance group) entered into an agreement with the Finnish company Sampo to sell all of its shares in If (a non-life insurance company) to Sampo.

Funding the activities of banking regulators

Norway's approach to funding the activities of banking regulators is as follows:

The Financial Supervisory Authority of Norway (Kredittilsynet)

Kredittilsynet's budget forms part of the government budget and is established by the Parliament. Kredittilsynet's expenses are covered by the institutions under its supervision at the start of the financial year. The Parliament therefore adopts a revenue appropriation equal to the expenditure appropriation. The Financial Supervision Act requires the expenses to be apportioned among the various institutional groups based on the extent of the supervision, and the expenses are therefore payable in arrears.

Guarantee Schemes for Banks

The members shall each year pay a fee to the guarantee fund unless the fund's own capital according to the last annual accounts exceeds the minimum requirement.

The Central Bank (Norges Bank)

Norges Bank is funded through the Central Bank's budget process.

PANAMA

Bank Regulatory Developments

The following are the most significant regulations issued by the Superintendency of Banks under the 1998 banking law, between June 2003 and July 2004, in compliance with the Basel criteria and standards for banking supervision as well as with the International Monetary Fund:

- Definition of "Electronic Banking" as any banking transaction that is made directly by a client through an electronic channel or Internet site; it involves services offered through Internet, ACH, automatic tellers and any other service that may be performed by electronic means. Any bank can offer electronic banking in or from Panama, as long as it has obtained previous authorization from the Superintendent of Banks. The bank´s Board of Directors or the General Manager must make sure to introduce in its operating manuals the procedures, policies and internal controls necessary to maintain an adequate administrative and operative infrastructure to offer electronic banking services.

  There must be a responsible unit within the bank, which can be the risk management unit previously required and regulated. Banks must make sure that periodic audits are conducted to evaluate, revise and permanently monitor the functioning and operation of electronic banking services, through an internal System Auditor. The regulation describes 10 specific operations that are considered part of electronic banking. All banks offering electronic banking services must keep a register of access and use of the system for registration and authentication of all transactions that must be kept available to the Superintendency for at least five years. Banks must inform their clients of electronic banking of all the characteristics, conditions, costs and any other determinant stipulation involved in electronic banking. Banks must assure in all transactions in electronic banking its authenticity, integrity of the transmitted information, confidentiality, segregation of responsibilities and authorization controls. Banks will employ appropriate control technologies, such as cryptography, specific protocols and other controls to guarantee privacy and confidentiality of clients´ information. Banks must also assure the prevention of the use of electronic banking services for money laundering or other crimes, with strict procedures and effective measures for identification and follow through of suspicious transactions, and must apply Know-Your-Customer and Due Diligence as required by previous regulations.

- The Superintendency issued regulations defining a Microfinance Bank as one that services micro and small firms with credit and other facilities and that must have at least 75% of its loan portfolio in that sector. It defines a micro firm as a natural or juridical person with annual gross income of not more than US$150,000, and a small firm one with annual gross income of over US$150,000 but not more than US$750,000.

- Regulations were issued for banks that issue and manage credit cards. It establishes the requirements for a credit policy that banks should adopt, minimum information required in contracts, procedure for approving a credit card, minimum information that must contain the monthly statements, authorizes the charges for commissions and other related items, issuance of additional cards to one holder, what to do in case of loss of credit card and bank´s responsibilities, prevention of illicit use of credit cards, insurance against fraud, requirement to inform holder of the effective interest rate.

- Rules and regulations for mergers or acquisitions of banks were also established that apply to banks and economic groups to which banks are part, and natural or juridical persons owning shares in banks that seek an acquisition or a transfer of shares of banking institutions that carry with it a change of control, and also apply to banks or economic groups of which banks are part that wish to merge or consolidate. Both cases require previous authorization by the Superintendent of Banks, for which a detailed list of requirements were adopted, that must be strictly followed for either case, with the Superintendency reserving for itself the right to object to the sale or transfer of shares or the merger in those cases that fall within the parameters established in the regulation.

Securities

- The National Securities Commission adopted new regulations for Investment Corporations, defined as a juridical person, trust or contractual arrangement that through the issue or sale of its own participating quotas carries on the business of receiving money from the investment public through single or periodic payments with the purpose of investing and negotiating directly or through investment managers in stocks, currencies, metals, real estate or any other type of goods or properties as the Commission establishes. Investment Managers are defined as those to whom an investment corporation authorizes or delegates the right, individually or as part of a group, to manage, invest and dispose of securities or other assets of the investment corporation. Investment managers may offer administrative services to investment corporations. The decree also regulates those persons offering custodial services.

Terrorism

- Panama also adopted new legislation making the handling of funds pertaining to any type of terrorism or its financing a serious crime, and including the financing of terrorism as part of the crime of money laundering.

PHILIPPINES

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

Regulation and Supervision of Banks

- Adoption of policy requiring universal banks and commercial banks to also measure and apply capital charges for market risks, in addition to the credit risk capital requirement in the risk-based capital adequacy framework.

- Imposition of sanctions on banks for charging allowance for probable losses to accounts other than "current operations".

- Amendment of regulation on the transfer of the "Undivided Profits – FCDU/EFCDU" to the "Surplus-Free" account in the regular books of the Bank Proper.

- Amendment on the waiver of the 60-day period of compliance with the risk based capital adequacy ratio (CAR) in evaluating a bank's eligibility to act as Public Trustee for another bank's Unsecured Subordinated Debt Tier 2 Offering, if the former bank has instituted remedial measure to its CAR deficiency by issuing Tier 2 capital.

- Adoption of policy on the conversion of foreign currency-denominated loans, and Real and Other Property Owned and Acquired (ROPOA) in the books of the Foreign Currency Deposit Unit (FCDU)/Expanded Foreign Currency Deposit Unit (EFCDU) to peso loans and ROPOA in the books of the Regular Banking Unit (RBU).

- Approval of guidelines for managing large exposures and credit risk concentrations in line with its objective of strengthening risk management in the banking system.

- Revision of accounting guidelines on the sale of NPAs to SPVs and to qualified individuals including booking of actual loss on true sale of NPAs under a "Deferred Charges" account which may be written down over the next 10 years.

Regulation of Derivatives and Securities Products

- Issuance of guidelines as well as documentary requirements for foreign exchange forwards and swap transactions.
- Approval of guidelines for the capital treatment of banks' investments in credit-linked notes (CLNs) and similar credit derivative products, such as credit-linked deposits (CLDs) and credit-linked loans (CLLs).
- Approval of Memorandum of Agreement for Cash Settled Securities Swap Transactions (CSSST) among the BSP, Bureau of Treasury, the Bankers Association of the Philippines (BAP), the Money Market Association of the Philippines (MART), and the Investment Houses Association of the Philippines (IHAP). The CSSST is an agreement among financial institutions to simultaneously buy or sell government securities spot, sell or buy comparable securities at a predetermined future date and price with the same counterparty.

Regulation and Supervision of Non-Bank Financial Institutions

- Adoption of risk-based CAR for quasi-banks covering initially capital requirements for credit risks.
- Formulation of Risk-Based Capital Adequacy Model and its Implementing Rules and Regulations for Securities Brokers and Dealers.
- Establishment of Financial Sector Forum (FSF) composed of the BSP, SEC, and the Insurance Commission, and the PDIC providing for an institutionalized framework for coordinating the supervision and regulation of financial institutions. This will be a venue for the agencies to discuss developments in their respective jurisdictions and other concerns that may have systemic repercussions. It seeks to improve the member-agencies coordination and supervision, as well as help them address the gray areas of supervisory boundaries.
- Development of Medium and Long-Term Plan for NBFIs (N.B.: Consultation with all stakeholders is ongoing).
- Strengthening of the BSP-SEC joint examination of entities under their respective regulatory jurisdiction.

Other Significant Developments

New Laws Enacted

- Approval of R.A. No. 9823 which covers the re-imposition of the Gross Receipts Tax (GRT) in lieu of the Value-Added Tax (VAT) on all financial transactions.

- Enactment of R.A. 9243, entitled "An act rationalizing the provisions of the documentary stamp tax of the National Internal Revenue Code of 1997, as amended." The law eliminated DST (Documentary Stamp Tax) on secondary trading of financial instruments, thus lowering transaction costs which should increase the volume of financial transactions in the secondary market.

- Signing into law of R.A. No. 9267, otherwise known as the Securitization Act of 2004. This sets the legal and regulatory framework for the sale of assets like loans, mortgages, receivables, etc., and transform them into marketable securities to raise funding, thus creating a favorable market environment for the development of the secondary market for these securitized assets.

- Enactment of R.A. No. 9294 which provides for the exemption of Foreign Currency Deposit Units (FCDUs) and Offshore Banking Units (OBUs) from all taxes except for the final tax of 10% on "onshore income".

- Enactment of the Revised Accountancy Act which provides regulations over the accounting profession to achieve the quality of audit that shall enhance reliability and comparability of financial information in the Philippines.

- Issuance of the Amended Implementing Rules and Regulations of the Securities Regulation Code

Mergers/Consolidation/Acquisitions

- During the period in review, four mergers and one consolidation took place. The mergers involved one commercial bank, two thrift banks and five rural banks while the consolidation involved four rural banks. One acquisition materialized as a universal bank acquired a commercial bank.

Listing of PSE Shares on the PSE Trading Board

- Approval of the revised PSE Listing Rules and the Rules Governing the Trading of PSE Shares

- Approval of the PSE's application for additional listing of 40% of the PSE shares sold through private placement.

Fixed Income Exchange

- Approval of the registration of the Philippine Dealing and Exchange Corporation (PDEX) as an Exchange with SRO (Self Regulatory Organization) status for trading of fixed income securities or instruments. The Fixed Income Exchange will provide an electronic trading platform, clearing and settlement, and a complete securities disposition capability including depository, registry and custody of fixed income instruments.

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

Alternative Trading System

- Promulgation of the rules providing for an electronic marketplace or facility bringing together buyers and sellers of innovative securities, and securities of small, medium, growth and/or venture enterprises, and technology-based ventures. The Alternative Trading System will give smaller firms access to capital, as well as provide investors with enhanced flexibility, security, transparency, and reduced trading costs.

Corporate Governance

- Revision of rules on interlocking officerships between banks or between a bank and non-bank financial intermediary to reflect that: (1) as a general rule, there shall be no concurrent officerships; and (2) the positions of President, Chief Executive Officer, Chief Operating Officer and Chief Financial Officer or their equivalent may not be held concurrently

- Issuance of rules and regulations governing the recognition and derecognition of domestic credit rating agencies for bank supervisory purposes to ensure that the reliance on credit ratings is not misplaced.

- Amendment of the rules on the Accreditation of External Auditors to cover SEC-registered companies that have been authorized to sell securities, certificates of indebtedness, and related financial instruments; and those that have been authorized to be listed in the stock exchange.

- Issuance of a circular which requires companies listed with the First Board of the PSE to have an audit committee with at least two (2) independent directors, one of whom shall be its Chairman.

- Adoption of International Accounting Standards (IAS) and International Standards on Auditing (ISA).

- Implementation of Certification Procedures for the Accreditation of Compliance Officers/Associated Persons of SEC-registered companies with secondary licenses.

Payment System

- Incorporated into the Philippine Payment System (PhilPaSS) a Payment versus Payment Sub-System (PvP) for US dollar-peso transactions, a state-of-the-art facility that allows simultaneous currency exchanges. PvP is a joint project of the BSP, BAP, Citigroup Manila, and the Philippine Depository and Trust Corporation (PDTC) that seeks to minimize payment and systemic risk since the final transfer in one currency is effected only once a final transfer in the other currency occurs.

Electronic Banking

- Allowed all domestic private banks with BSP-approved Internet banking facility to accept payment of fees/other charges of similar nature for the account of the departments, bureaus, offices and agencies of the government as well as all government-owned and controlled corporations.

Permissible Activities

- Allowed banks and non-bank financial institutions upon prior MB approval to act as securities custodian and/or registry.

Anti-Money Laundering

- Evaluation by the Financial Action Task Force (FATF) of the Philippines' amendments to the Anti-Money Laundering Act (AMLA) which were found to be at par with international standards.

- Assessment of the Philippines' anti-money-laundering regime by the Asia Pacific Group on Money Laundering (APG). The APG team conducted on-site visit/evaluation of the implementation of anti-money laundering laws in the AMLC and other relevant government agencies.

- Development of the Guidelines in the Preparation of the Revised Anti-Money Laundering Operating Manual for covered institutions of the SEC.

- Submission of the Implementation Plan (IP) of the AMLA to the FATF Regional Group. The submission of the IP is the second of three stages in the FATF's delisting from non-cooperative countries and territories. The first stage is the enactment of an anti-money laundering legislation which the Philippines has already done, and the third and final stage is the FATF's evaluation of the Philippines' implementation of the AMLA and its amendments.

- Signing of a Memorandum of Understanding (MOU) with the Korean Financial Intelligence Unit (KOFIU) and negotiations with other financial intelligence units (FIUs) pursuant to the authority given by the President of the Philippines to the AMLC Executive Director to conclude, sign, execute and deliver MOU with FIUs of other jurisdictions concerning cooperation through the exchange of financial intelligence involving money laundering activities and terrorist financing.

- Signing of extradition treaties with Spain and India and a Mutual Legal Assistance Treaty (MLAT) with Spain. The Philippine Senate has also given its concurrence to the ratification of the MLAR with Hong Kong SAR and Switzerland.

Activities of bank supervisory authorities are funded through assessments paid by the regulated institutions and funding is independent of the Government's general budget process. Under Section 28 of the Bangko Sentral Charter, banking and quasi-banking institutions which are subject to examination by the Bangko Sentral pay an annual fee in an amount equal to a percentage as may be prescribed by the Monetary Board of its average total assets during the preceding year as shown on its end-of-month balance sheets, after deducting cash on hand and amounts due from banks, Bangko Sentral and banks abroad.

POLAND

Macroeconomic Environment of the Polish Banking Sector

In 2003, Poland experienced a significant acceleration in economic growth in comparison with the previous two years. The Gross Domestic Product increased in real terms by 3.7%, while a year earlier the economic growth amounted only to 1.3%. According to the initial estimations of the Central Statistical Office, in 2003 the Gross Domestic Product was PLN 804.7 billion (after adjustment of the statistics to the European Union requirements, the GDP was PLN 815.0 billion). This acceleration of the economic growth rate has been noted continuously since the first quarter of 2002. Particularly strong acceleration took place in the second and fourth quarters of 2003.

The higher economic growth rate resulted from huge efforts undertaken by many enterprises in order to adjust the rules of conducting their activity to the difficult macroeconomic environment. The economic results of Poland in 2003 were obtained in conditions of very sluggish economic growth in the countries which are major economic partners of Poland (mainly the Eurozone countries). Also when comparing the economic growth in the past year with other countries, for the first time in several years the pace in Poland was somewhat higher than in such Central and Eastern European countries as Hungary and the Czech Republic.

The higher pace of economic growth did not lead to any improvement in the labor market. In 2003, further decrease in average employment in the enterprise sector was noted, although this decrease was slightly smaller than a year before. In 2003, the average employment in the enterprise sector was 4,724,000, down 3.8% from a year before (in 2002, a drop by 4.4% was noted). At the same time, the number of the registered unemployed was reduced, but the change was only marginal.

In contrast to the previous years, the main objective of monetary policy in 2003 was not to cut down further the rate of inflation. Poland's average annual rate of inflation in 2003 was 0.8% -- lower than other Eurozone countries.

Better economic results contributed to the development of the capital market in Poland. In 2003, the index of share prices on the Warsaw Stock Exchange (GPW) increased by 45% to 20,820 points. Turnover amounted to almost PLN 80 billion, up 25% from a year earlier. On the other hand, the number of companies listed on GPW S.A. was reduced (from 216 to 203 companies), but at the same time the first floating of a foreign company on the Warsaw Stock Exchange was noted. Moreover, the turnover of bonds intensified. A high increase in turnover was noted also on GPW S.A. in futures contracts concluded (by 50%), and almost all such transactions concerned the WIG 20 index. Futures contracts for other instruments were concluded on the stock exchange only occasionally.

Development in the Polish Banking Sector

The current structure of the banking sector is a consequence of numerous mergers. At the end of 2003, 60 commercial banks existed in Poland, versus 83 at the beginning of 1998. As part of the consolidation process, which was particularly intensive from 1998 - 2002, 29 commercial banks combined or were taken over by other banks. This led to the creation of large and strong institutions (in the organizational and capital aspect) able to compete with foreign banks and to meet the expectations of Polish enterprises.

The process of consolidation in the Polish banking sector has been similar to that of other Member States, and the concentration of banking services is now at the average European level.

In 2003 two new banks became operational: Nykredit Bank Hipoteczny SA- mortgage bank and HSBC Bank Polska SA.

Altogether, investors from 15 countries held stakes in the banking sector at the end of 2003. Their share in the capital of the commercial banking sector was 63.3%. The largest investors are: Germany, USA, Belgium, Holland and Ireland.

Foreign investors control 46 commercial banks. In Poland, as in other CEE countries, the proportion of banks controlled by foreign investors is much higher than in most EU countries.

Forty-two commercial banks distribute their products by a network of 3,119 branch offices as well as nearly 6,000 sub-branches and other customer service outlets. The remaining banks-subsidiaries of foreign institutions operate only through the head offices.

In comparison with other EU countries, the Polish branch network with 340 bank offices per million inhabitants lies in the middle of the range. The traditional bank offices (large branches with back office functions) are being replaced by small front office branches.

The decline in number of personnel has been continuing since 1999. At the end of 2003, commercial banks had 131,878 employees. Some large banks aiming to reduce their costs are planning group layoffs for the current year.

The number of cooperative banks decreased by 4 and was 601 at the end of 2003. 599 of them were members of 3 structures: Mazowiecki Bank Regionalny S.A. (78 banks), Gospodarczy Bank Wielkopolski S.A. (157 banks) and Bank Polskiej Spółdzielczości S.A. (364 banks). Two cooperative banks operated outside the existing associations.

Commercial banks carried out their business through a total of 2,914 branches and 6,355 sub-branches, branch agencies, and other facilities. In comparison with the end of 2002, the number of domestic units of commercial banks decreased by 639, of which by 2 headquarters, 126 branches, and 511 other units. At the same time, the creation of many smaller bank units, so-called bank-kiosks, was observed.

Balance Sheet of the Polish Banking Sector

As of December 31, 2003, the net balance sheet total of the banking sector (exclusive of the National Bank of Poland) was PLN 491,290.9 million. In comparison with the end of the previous year, the balance sheet total increased by PLN 22,951.4 million, which is an increase by 4.9%. The period was marked by increasing demand for bank loans and the increasing acquisition of debt securities by banks.

As in previous years, the dominant position in the structure of assets of the banking sector was receivables due from customers, which in 2003 amounted to PLN 218,633.2 million and constituted 44.5% of total assets. A rapid growth (by 7.7%) in this asset category was observed in the past year, which resulted in an increase in receivables' share of total assets of 1.1 percentage points. The increase resulted from a relatively high rate of growth of this item with the decreasing importance of receivables due from financial institutions.

At the end of 2003, securities attained the value of PLN 113,803.2 million, which was by 8.1% higher than a year earlier. If negative effects of appreciation of treasury securities as a result of an increase in value of market interest rates on these instruments had not taken place, then the increase in value of securities would have been even higher (by comparison, the increase in value of securities was 9.9% in 2002). Even in these conditions, the sum of assets kept as securities increased in 2003 more rapidly than the balance sheet total and the receivables due from customers. As a result, the share of this item of bank assets in the total assets increased in 2003 by 0.7 percentage points, attaining the level of 23.3%.

Receivables due from financial institutions decreased by 1.5% in 2003 to PLN 77,084.3 million. As a result, the importance of this item in balance sheets of the banks decreased in the past year by 1.0 percentage point, stopping at the level of 15.7%. This drop in importance of receivables due from financial institutions is a consequence of the gradual reduction in overliquidity of the banking sector, bank consolidation, and a drop in the amount of receivables due from Central Bank (caused for example by the reduction in the rate of and modification of rules of maintaining the mandatory reserve).

In 2003, the largest item in the structure of liabilities was deposits from customers, which represented 60.3% of total liabilities and amounted to PLN 296,216.0 million. The rate of increase in this item was 103.6%, and thus was lower than the average rate of increase in total liabilities. This resulted in the decrease in importance of deposits from customers in total liabilities of the banking sector by 0.7 percentage points. The increase in deposits resulted from the increase in balances on current accounts of customers (by PLN 14.1 billion, i.e. by 16.8%) and the decrease in value of term deposits (by PLN 3.6 billion, i.e. by 1.8%).

The nominal increase in deposits from customers was PLN 10,342.5 million, i.e. these deposits increased by 3.6%. However, if the effects of the change in foreign exchange rates on the structure of deposits from customers were disregarded (different for enterprises and different for households), then the increase in deposits from this sector would be lower by PLN 2.210 million and would amount to 2.8%.

The nominal increase in deposits from customers was obtained in total owing to the higher deposits from enterprises. The latter increased by PLN 14,506.7 million (i.e. by 22.2%). Such a strong growth may reflect the improvement of liquidity of at least some of the enterprises, and their abstaining from making investment expenses in 2003. However, deposits from enterprises are characterised by instability and are subject to high seasonal fluctuations. A year earlier they were reduced by almost PLN 10,000 million, but we should bear in mind the change in the methodology which was introduced in banks' reporting prepared for the purposes of the National Bank of Poland.

In 2003, a high growth in the current and term deposits from enterprises was noted.

Financial Profit of the Polish Banking Sector

The gross financial profit of the banking sector in 2003 amounted to PLN 4,620.9 million and was higher by PLN 794 million in comparison with 2002. The net profit amounted to PLN 2,481.9 million and was higher than attained in 2002 by PLN 143.6 million. The gross financial profit obtained by the banking sector was tremendously affected by the record loss suffered in the past year by one of the stock exchange-listed banks, partially generated as a result of that bank's failure to establish sufficient specific provisions in the preceding years. As a result, the profit of the banking sector in 2003 was distorted. Without taking into account the loss of the above-mentioned bank, the effectiveness ratios of the banking sector would be at a different level and, at least partially, would more accurately reflect the actual effects of operation of the banks in the past year.

The increase in the profit obtained by the banking sector resulted in an improvement of ROA. The rate of profit growth was higher (106.1%) than the rate of growth of the average level of assets of the banking sector (102.1%). Nevertheless, the increase in ROA was rather insignificant (by 0.03 percentage point). This result was to a large extent an effect of the high loss suffered by one of the stock exchange-listed banks.

In spite of the increase in the net profit, the period of lower ROE continued. A high increase in shareholders' equity caused a reduction in the ratio of profit to equity. Nevertheless, this reduction was relatively small. In the past two years ROE was markedly lower than in the earlier years. It seems that due to the higher capitalization of banks and the lower interest rates, the return to the higher level of ROE will be impossible in the future, especially in the existing difficult conditions of developing banking operations in Poland.

Opportunities and Challenges for the Polish Banking Sector

The generally positive trends in economy should become reflected in the economic results of operations of banks in Poland. The experience of past years indicates substantial influence of the macroeconomic situation in the country on the financial results obtained by banks. In conditions of the protracted period of slow economic growth, many banks noted a substantial reduction in profits, a significant group of banks suffered losses, and the share of bad debt in the loan portfolio increased. The improvement in the macroeconomic situation in 2003 has already borne fruit in the form of a certain improvement of financial results of the banks, but only in next years may banks feel the effects of such improvement. The enterprises' and households' interest in taking loans, especially of multi-annual type, should increase. The better financial condition of many enterprises should be reflected by gradual improvement of the quality of loan amounts due to the banks and by gradual enlargement of the scope of cooperation between banks and enterprises.

Poland's accession to the European Union on May 1, 2004 is both a challenge and an opportunity for the Polish economy. Certainly, changes in the Polish economy will not follow from day to day, but Poland's accession will affect the conditions of operation of the whole economy, and thus also will affect the banking sector. The creation of a single market of financial services in Europe will inevitably cause significant changes for the banks operating in Poland. For domestic banks it will entail above all the gradual increase in competition for customers. These changes will take place in the medium-term perspective. In the months directly following Poland's accession to the European Union, no significant changes in the market of banking services in Poland should occur. For years the Polish banking system has been adjusting its rules of operation to the standards in force in the highly developed countries, in some areas Polish banks are even more technologically advanced than their competitors from the European Union Member States, and therefore the opening of the borders for financial service providers should not cause any violent changes in the market.

Since January 1, 1998, the task of exercising supervision over domestic banks, their branches and the representative offices of foreign banks has been in the hands of the Commission for Banking Supervision. In addition, since January 1, 2002, banks constituting entities to which other entities are subordinated, as well as those operating within a financial or mixed-activity holding are also under the Commission's consolidated supervision.

In particular, the Commission's tasks include:

- the determining of the principles under which banks are to operate, with a view to safeguarding the money put into them by customers;
- supervision over banks in regard to their compliance with Acts, statutes and other legal provisions, as well as their heeding of financial standards which have been put in place;
- periodic assessments of the economic status of banks, as subsequently submitted to the Monetary Policy Council, as well as of the influence of monetary, fiscal and supervisory policy upon their development;
- the provision of opinions regarding the principles by which banking supervision is organized, as well as the establishment of methods by which it is to be exercised.

The Commission is made up of:

1. a Chairperson of the Commission, who is the President of the National Bank of Poland;
2. a Deputy Chairperson of the Commission, who is the Minister of Finance, or a Secretary of State/Under Secretary of State at the Ministry of Finance delegated by the Minister;
3. a representative of the President of the Republic of Poland;
4. the Chairperson of the Board of the Bank Guarantee Fund;
5. the Chairperson of the Securities and Exchange Commission or his/her deputy;

6. a representative of the Minister of Finance;
7. the General Inspector of Banking Supervision.

In addition, participating in the work of the Commission for Banking Supervision in an advisory capacity is a delegated representative of the Polish Banking Association, to the extent that matters concerning the regulation of banking supervision are concerned, or else the principles by which banks operate with a view to ensuring the security of the financial means afforded them by customers.

Decisions taken, and tasks determined, by the Commission for Banking Supervision are implemented and coordinated by the General Inspectorate of Banking Supervision, as an organizationally-distinct organ of the National Bank of Poland.

PORTUGAL

Main Developments

During the period under review, the legal framework regulating banking remained essentially unchanged. For the securities market, however, important changes were made to the existing Code, namely the adoption of the principle of free creation of financial instruments, formerly subject to previous authorization from the securities authority (CMVM). The bulk of other changes aim at introducing more flexibility to existing regulations, in line with international practice.

Late in 2003 the negotiation platform migrated to Euronext after the integration of the national Stock Exchange into that pan European organized market.

Funding of the Bank Supervisory Authorities

The situation is mixed, but supervisory authorities are increasingly being funded by the regulated institutions, as has recently been the case with CMVM (the securities supervisor and regulator body), where a supervisory fee has been imposed on all securities market intermediaries.

ROMANIA

The period under review saw good progress in strengthening the Romanian banking system. Further steps were taken to wind up insolvent banks, push privatization forward and bring the banking regulatory framework in line with EU legislation.

Harmonization of the Romanian Banking Legislation with the EU Legislation

In the banking sector, Romanian legislation is now at a high degree of alignment with the *acquis communautaire*. The rules, policies, and practices broadly follow the recommendations of the Basel Committee on Banking Supervision and the relevant EC Directives.

Continuing its path towards European Union accession, Romania has harmonized the provisions of its former banking law (Law No. 58/1998 – Banking Law, subsequently amended and supplemented), with applicable European Union Directives (such as Directives Nos. 12/2002, 28/2000, 46/2000 and 24/2001). Law No. 485/2003 (Monitorul Oficial al Romaniei No.876/10 December 2003) modifies the Romanian banking law to comply with European bank legislation. The new Banking Law is progressive in that it provides for a structure that will efficiently implement EU bank legislation upon accession, while also regulating situations not heretofore covered or insufficiently regulated by the former law. Thus, the Romanian Law on banking activity provides the specific framework for the organization and operation of banks and electronic money institutions, Romanian legal entities, as well as of branches operating in Romania of foreign credit institutions. The provisions of the said law are harmonized with the relevant acquis communautaire and ensure the reference legal framework for other credit institutions governed by Romanian legislation (credit co-operatives, savings institutions for housing), whose specific requirements are prescribed by special laws, to carry out activity.

Accordingly, the secondary legislation for the implementation of this law, issued by the NBR, has also been adopted, as follows:

- NBR Norms No. 11/2003 regarding supervision on a consolidated basis and on an individual basis of own funds;
- NBR Norms No. 12/2003 on the monitoring of solvency and control of large exposures of credit institutions;
- NBR Norm No. 14/2003 on investments allowed to electronic money institutions;
- NBR Norm No. 17/2003 on the organization and internal control of the business of credit institutions and major risk management as well as the organization and internal audit activity of credit institutions; and
- NBR Norms No.13/2003 amending and supplementing Norms No.3/2002 on “know-your-customer” standards.

In order to apply Law No.541/2002 concerning savings and lending for housing in a collective system (approved by Law No. 552/2003, amended and supplemented by Emergency Ordinance No. 99/2003) which provides the legal framework for this type of credit institution, the NBR issued specific rules regarding the licensing, operating and prudential supervision of the above-mentioned entities, such as:

Norms No 4/2003 on savings institutions for housing, amended by:

- NBR Norms No. 11/2003 regarding supervision on a consolidated basis and on an individual basis of own funds, norms that abrogated Article 2.

NBR Norms No. 5/2003 concerning specific conditions for the operation of savings institutions for housing.

Accordingly, the NBR is in the process of licensing the first savings institutions for housing.

With regard to the credit co-operatives sector, further progress has been made in the implementation of legislation approved in the previous period, by the issuance of additional regulations concerning prudential requirements, as well as the merger and splitting-up of credit co-operatives (NBR Norms No. 6/2003). Furthermore, the National Bank of Romania authorized in 2003 the functioning of a single credit co-operative network, comprising Creditcoop Central House and 565 affiliated credit co-operatives. The credit co-operatives network is under the supervision of the central bank and is covered by the deposit guarantee scheme.

The accounting regulations applicable to Romanian credit institutions are stated in the Accounting Regulations harmonized with Directive No. 86/635/EEC and the International Accounting Standards (Joint Order No.1982/5/2001, updated).

In order to provide the appropriate framework for applying the above mentioned rules, a commission was established in 2003 to analyze and sort 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. The commission has issued drafts of practical accounting guides, which address the problems concerning the specific International Accounting Standards relevant for the activity of credit institutions (IAS 21, IAS 32, IAS 37, IAS 39) in order to facilitate their proper application. These drafts shall be reviewed and completed considering the latest developments of IFRS.

As for the payment system, since July 1, 2003 the funds transfers and the settlement operations in relation with the State Treasury are no longer carried out by the National Bank of Romania, but by the National Company for Funds Transfer and Settlement (TransFonD S.A.), as the NBR's authorized agent. The Romanian legal framework for payment and settlement systems is undergoing a review process in order to adjust it to the relevant European Directives. In this respect, the NBR issued the following regulations:

- NBR Circular No. 22/2003 altering Regulation No. 1/2002 issued by the National Bank of Romania regarding the large-value funds transfer system;
- NBR Regulation No. 1/2003 on the principles and the bilateral netting for small-value payments to the State Treasury, inter-treasury payments, regardless of value, and net settlement via the National Company for Funds Transfer and Settlement – TransFonD S.A., as the NBR's;
- NBR Norm No. 10/2003 setting the maximum period for cessation in operation of the settlement and payments system, and of the foreign exchange and money markets, at four successive calendar days;
- N.B.R.Circular No. 21/2003 amending and supplementing Circular No. 9/2001 issued by the National Bank of Romania on the operation of the National Company for Funds Transfer and Settlement - TransFonD S.A., as the NBR's agent.

In order to systematize the regulations related to capital movements, the National Bank of Romania issued a new regulation on the performance of foreign exchange transactions. Regulation No. 1/2004 of the National Bank of Romania sets the foreign exchange regime in Romania, since its entry into force on April 10, 2004. The policy of the National Bank of Romania envisages moderately accelerating the liberalization of capital transactions, in compliance with its fundamental objective. According to the liberalization calendar, long-term inflows with a bearing on the real economy were liberalized until end-2003; capital transactions directly impacting monetary policy will be liberalized by Romania's joining the European Union.

The basic provisions of the new Currency Regulation are:

1.Rights of residents and non-residents

Residents and non-residents:

- may acquire, hold and use any foreign exchange financial assets ("full retention");
- may open accounts in foreign exchange and in lei in Romania, with authorized credit institutions;
- may perform freely and without restrictions current and capital transactions;
- non-residents may repatriate into their country of origin and transfer abroad financial assets held in Romania.

2. Access to foreign exchange market

- the access of residents and non-residents to purchasing/selling of foreign currency in exchange for lei is free;
- convertibility of current transactions is ensured for both residents and non-residents;
- purchasing/selling of foreign currency may be performed only by intermediaries of the foreign exchange market;
- purchasing of foreign currency by resident and non-resident legal entities is made based on documents;
- purchasing of foreign currency by resident natural entities via exchange houses and credit institutions is not limited.

3. Capital transactions

The following capital transactions are further subject to prior authorization of the National Bank of Romania unless they are of the nature of foreign public debt:

a. operations in securities normally dealt in on money market;
b. operations in current and deposit accounts opened by residents abroad;
c. operations in deposit accounts in the domestic currency (leu) opened by non-residents in Romania with credit institutions.

The provisions on authorising do not apply to credit institutions for the following capital transactions made on own behalf and account:

a. operations (acquisition) in foreign securities dealt in on money market;
b. operations in current and deposit accounts in foreign currency, opened abroad.

For statistical purposes, capital transactions causing external obligations arising out of commitments longer than one year, other than those of the nature of foreign public debt, are registered with the National Bank of Romania in "Romania's Foreign Private Debt Register".

4. Receipts and payments between residents

Receipts and payments between residents may be performed:

- in domestic currency - "leu";
- in foreign currency, as authorised by the Currency Regulation:
  - credit institutions - for operations provided in the authorization;
  - legal entities - for operations arising out of trade contracts and provision of external services based on agency contracts; sub-contracts arising out of international economic co-operation contracts, export contracts featuring complex units and long manufacturing cycle products;
  - individuals - for foreign currency operations between natural entities, having an incidental nature;
  - individuals and legal entities and other entities - for operations laid down by express legislative provisions; for operations arising out of provision of external services (transport, tourism); for operations arising out of external contracts under outward processing traffic arrangements; for operations arising out of trades carried out in harbors, airport "free zones", border checkpoints, international trains, aboard aircraft and ships; operations performed abroad; for operations consisting in redistribution of humanitarian aid; for operations with the implementation authority, arising out of financing from international financial institutions and bodies;
  - associates/shareholders of exchange houses - for operations arising out of credits granted to their own exchange houses.
- in foreign exchange, authorised expressly by the NBR.

5. Foreign exchange control

- Credit institutions are responsible for the appropriate application of the Currency Regulation, for the operations ordered by their customers and for the operations performed on their own behalf and account, based on the norms issued for this purpose;
- The customs authorities must be informed about the amounts exceeding:
  - EUR 10,000 (or the equivalent of this amount) in foreign currency;
  - the equivalent of EUR 1,000 in ROL;
- Residents must repatriate the amounts in foreign currency and/or in domestic currency from operations performed with foreign countries.

During the period under review, Law No.330/2003 regarding mortgage companies (approving Government Ordinance No.200/2002) was issued. The said law provides the legal framework needed for the functioning of mortgage companies. Therefore, the NBR issued Norms No. 9/2003 concerning mortgage companies (Monitorul Oficial al României No. 896/15 December 2003) which govern the transmission by mortgage credit undertakings of documents attesting establishment and registration with the Trade Register for notification to the National Bank of

Romania, as well as the reporting to the central bank of the composition of their mortgage claim portfolios. The mortgage companies are not included in the category of credit institutions; therefore they are not under the NBR's supervision.

In order to harmonize the existing legal provisions (Law No. 83/1998–Law on banks bankruptcy, subsequently amended and supplemented) with those of Directive 2001/24/EC, Government Ordinance No. 10/2004 regarding the reorganization and bankruptcy of credit institutions was issued.

Government Ordinance No.9/2004 on certain financial collateral arrangements creates the legal framework for the provision of securities and cash as collateral, in order to contribute to the integration and cost reduction in the financial markets, as well as to the stability of the financial system in the European Community, thereby supporting the freedom to provide services and free movement of capital in the single market of financial services. The act completely transposed the provisions of Directive 2002/47/EC into the Romanian legislation.

As regards the anti-money laundering legislation, Law 39/2003 on prevention and fight against organized crime amended Law No. 656/2002 on the prevention and punishment of money laundering. The new law improves the legal framework in the field by taking additional special measures in order to prevent and fight organized crime at both the national and international level. In addition, the Banking Law stipulates the obligation for banks to provide any information required by the public prosecutor in pursuing and investigating money laundering, financing of terrorist acts, illicit traffic in weapons, drug trafficking, and organized crime.

The Role of Some Banking Supervision Instruments has been Strengthened

Credit Information Bureau

The Credit Information Bureau has been operational within the National Bank of Romania since February 1, 2000. Its activity is governed by *Regulation No.1/1999 on the organization and operation of the Credit Information Bureau within the National Bank of Romania,* as amended and added by *Circular No.22/2002* issued by the National Bank of Romania.

The Credit Information Bureau is an intermediation center in charge of managing, on behalf of the National Bank of Romania the credit risk information for user needs in a formally regulated framework and conditional on observing banking secrecy.

The National Bank of Romania has taken steps with the Credit Information Bureau database by requiring additional data from credit institutions. This information will be provided in the following:

- a file containing the description of the groups of debtors, as shown by each credit institution;
- a file containing card frauds produced by owners;
- a file containing information about individuals' loans overdue more than 30 days that do not fulfil the reporting limit condition (ROL 200 million);
- integration of such information into the databases of both the Credit Information Bureau and the Payments Incident Bureau so that each debtor may be subject to full assessment.

Moreover, the Regulation on organization and operation of the Credit Information Bureau within the National Bank of Romania is to be brought in line with the new regulations in this field (e.g. credit co-operatives, mortgage companies). The new Regulation will come into force on September 1, 2004.

Depositor Protection Scheme

A draft law has been issued regarding the Bank Deposit Guarantee Fund, which is planned to enter into force in June 2004 and which is in compliance with the provisions of the Directive 94/19/EC on deposit guarantee schemes. The new law includes the credit co-operatives in the deposit-guarantee schemes, as well as the other credit institutions authorized to take deposits from individuals and legal entities. According to its provisions, the Deposit Guarantee Fund may be appointed as a liquidator in the banks' winding-up proceedings. For the time being, the Deposit Guarantee Fund is already named liquidator for Banca Romana de Scont and Banca Turco-Romana.

Bank Winding Up

The Banking Law in force provides for special proceedings for the liquidation of a credit institution upon the withdrawal of its authorization. Credit institutions are defined as: banks, credit co-operative organizations, e-money issuer institutions, or the savings institutions for housing, but only in regard to mortgages. In case of bankruptcy, the winding-up of such institutions will be made pursuant to the provisions in Government Ordinance No. 10/2004 regarding the reorganization and bankruptcy of credit institutions. In instances of the non-fulfillment of the conditions of bankruptcy for credit institutions, winding-up will follow the winding-up procedures set forth in the Romanian Company Act. The Law also contains provisions on winding-up procedures with effects outside Romania (within the European Union / European Economic Area) upon a bank operating in one or more Member States. These provisions are also applicable only upon Romania's accession to the EU.

Credit Bureau

The banking community decided to establish a Credit Bureau in order to collect and pool information on the borrowing and payment track record of consumers (one file per registered person), and issue credit reports prior to lending money. Lenders supply information to the databases of the credit bureau, and use the pooled information to help them assess the creditworthiness of a loan applicant. The credit report is used as decision support information for lenders. The Credit Bureau does not take the decision to grant or reject a loan; this is an analysis and decision to be made by the lender, based on his own files and the credit report issued by the Credit Bureau.

Market Developments

The period under review witnessed the following developments:

- the removal from the system of Columna Bank by final decision of the Bucharest Court, pursuant to which the winding-up proceedings were opened;

- the acquisition of majority stakes in of Libra Bank and Daewoo Bank by two groups of Romanian companies, which induced the 2.8 percentage point rise (to 8 percent) in the weight of domestic private capital;
- the sale of 25 percent plus two of the shares of Banca Comerciala Romana (BCR) to EBRD and IFC, with buy-back option in the case a strategic investor is identified;
- the NBR authorized the functioning of a single credit co-operative network;
- the NBR is in the process of licensing the first savings houses for housing.

Future Objectives

In the near future NBR will focus mainly on:

- the completion of the legal framework in order to implement the supervision on a consolidated basis of credit institutions;
- the creation of the credit institutions legal framework for market risk, by transposing the provisions of Directive 93/6/EC on capital adequacy;
- the creation and completion of the legal framework for banks in order to implement the standardized approach of Basel II;
- the completion of legal framework in order to set the requirements and rules for the credit institutions as players in the financial market.

Funding the Activities of Bank Supervisory Authorities

The National Bank of Romania is funded through the Central Bank's budget process.

SINGAPORE

Organization and Responsibility of the Monetary Authority of Singapore

Objective and Principle of Supervision

In April 2004, MAS issued a monograph titled "Objectives and Principles of Financial Supervision in Singapore". The monograph spells out MAS' objectives of supervision, the functions it performs, and the principles that guide its supervisory approach. It also explains what MAS can and cannot do in areas like failure prevention and consumer protection and emphasises that all stakeholders have a shared responsibility to achieve a sound and progressive financial services sector. There are no fundamental changes to MAS' approach to financial supervision. The document is intended to further enhance the transparency of MAS' operations and is the second monograph that MAS has issued. The first monograph "Monetary Operations in Singapore" was issued in January 2003.

Powers and Functions of MAS

The first phase of a two-phase initiative to fine-tune the Monetary Authority of Singapore Act (Cap 186), which sets out the powers and functions of the MAS, came into effect on January 1, 2004. Among other changes, the Act was amended to provide MAS with more operational flexibility to set aside provisions for contingencies or market volatilities, and to allow MAS greater flexibility in lending to financial entities for the purpose of managing system liquidity and safeguarding the financial system. The MAS also rationalized the scope of immunity provisions for supervisory staff, contained in the various Acts administered by it including extending immunity from legal suits to MAS itself. Provisions were also included in the Act to explicitly enable the Board and Managing Director to form committees and delegate powers to them or designated officers.

Developments in Regulation and Supervision of Banks

Anti-Commingling Policy

MAS issued regulations in May 2004 to set out the implementation details of the policy to separate financial and non-financial business of a bank, and to unwind cyclical shareholdings within the local banking group. Broadly, banks are not allowed to hold major stakes (more than 10% interest) in non-financial businesses, and all such stakes have to be divested by July 2006. For purposes of determining a bank's major stake, stakes held by a bank's affiliated entities (more than 20% interest) are deemed as stakes of the bank and have to be aggregated with the bank's own direct stake. In addition, the regulations give effect to the policy on cyclical shareholding arrangements within a banking group, which restricts affiliated entities of a bank from holding in aggregate more than 2% voting power in the bank. The regulations clarify that banks will, however be permitted to manage investment properties that are owned by the banking group, properties that have been foreclosed and properties used in the business of the banking group.

Credit Card) Regulations

The Banking (Credit Card and Charge Card) Regulations 2004 (the "Credit Card Regulations") which took effect in February 2004 essentially consolidated the various guidelines and regulations on the operations of credit and charge card issuers. The objective of these regulations is to curb excessive expansion of consumer credit and to discourage individuals from spending beyond their means. Key changes introduced include lifting the limit of two supplementary cards per principal card account; and allowing issuers to issue additional cards to existing cardholders without first having to receive their applications.

The Credit Card Regulations were amended in April 2004 by introducing two further changes. First, issuers are allowed to issue a credit card or charge card to a person who does not meet the income requirements, if he has deposits in the aggregate of not less than S$10,000 with any bank, which he may use to fully secure the credit limit of the card. The other change is the removal of the requirement for the issuer to verify income before issuing additional cards to an existing cardholder.

Second Consultation Paper on Deposit Insurance Scheme

A second consultation paper was issued, covering implementation issues related to establishing and administering a proposed deposit insurance scheme in Singapore ("DI Scheme"). This follows the first consultation paper published in August 2002. The objectives of the DI

Scheme are to protect small depositors and dispel the misperception of a government guarantee for deposits with financial institutions.

Membership would be mandatory for all full banks and finance companies; wholesale and offshore banks would be excluded from deposit insurance. The proposed coverage limit would be S$20,000 per depositor per institution, and would include personal deposits only in Singapore dollars. Both residents and non-resident depositors would be covered. It is proposed that the deposit insurance fund would be funded from participating institutions; the target fund size would be 30 basis points of total insured deposits. A new public agency is proposed to be established to administer the DI Scheme, including premium collection, management of the DI fund, depositor payout and consumer education.

Capital Adequacy Requirements for Singapore-Incorporated Banks

In May 2004, MAS issued details of changes to the capital adequacy requirements for Singapore-incorporated banks. Effective from June 30, 2004, MAS will lower the Tier 1 capital adequacy ratio (CAR) requirement from 8% to 7%, and the Total CAR requirement from 12% to 10%. In addition, MAS will also adjust the rules for computing CAR. The key changes are:

(i) Banks will be allowed to include 45% of the revaluation surpluses from property assets as well as portfolio equity investments as Upper Tier 2 capital.
(ii) Banks will be required to set aside more capital for significant investments, with significant investments in non-financial companies attracting a higher capital charge than significant investments in financial companies. The new treatment for significant investments better reflects the risks commensurate with them.
(iii) Banks with insurance subsidiaries will be required to exclude these subsidiaries for purposes of meeting their CAR requirements on a banking group basis.

Banks will be allowed to use funds raised from Qualifying Preference shares and Innovative Tier 1 capital instruments to meet no more than 30% of their Tier 1 CAR requirements.

Revision of MAS 612 Credit Files and Classification of Loans

The MAS consulted the industry on proposed revised regulations on credit files, grading and provisioning. The revisions are to formalize existing practices on provisioning, valuation of collateral and 90-days arrears rule on loan classification, as well as classification requirements for consumer loans. The revised regulations are expected to be issued soon in 2004.

MAS Risk Management Guidelines

Following consultation with industry, MAS is reviewing the comprehensive set of Guidelines on Sound Risk Management Practices and incorporating industry feedback where appropriate. It has issued the finalized post- consultation guidelines on Business Continuity Management (“BCM”); and, updated guidelines on Internet Banking Technology Risk Management (“IBTRM”).

The BCM guidelines set out that boards of directors and senior management should be responsible for their institution's BCM. They focus on several key principles, notably that institutions should:

(i) embed BCM into their business-as-usual operations, incorporating sound practices;
(ii) test their business continuity plans regularly, completely and meaningfully;
(iii) develop recovery strategies and set recovery time objectives for critical business functions;
(iv) understand and appropriately mitigate interdependency risk of critical business functions;
(v) plan for area-wide disruptions;
(vi) practise a separation policy to mitigate concentration risk of critical business functions.

The updated IBTRM guidelines add six new recommended security practices:

(i) separate physical / logical environments for systems development, testing and production;
(ii) separate environments for development, testing, staging and production of internet facing web-based applications; connect only the production environment to the internet;
(iii) implementation of a multi-tier application architecture which differentiates session control, presentation logic, server side input validation, business logic and database access;
(iv) deployment of strong cryptography and sound key management techniques to protect customer PINs and user passwords as well as other sensitive data where applicable;
(v) implementation of end-to-end application layer encryption security to protect PINs and other sensitive data in communications between terminals and hosts; and
(vi) deployment of stringent user authentication in wireless local area networks and protection of sensitive data with strong encryption and integrity controls.

Consultation Paper on Guidelines on Outsourcing

The MAS released a consultation paper on guidelines on outsourcing in April 2004, setting out MAS' expectations for financial institutions that have entered into outsourcing arrangements with service providers. The main focus of the guidelines, based on international best practice, is on material outsourcing. MAS expects financial institutions to establish risk management practices commensurate with their risk profile. The guidelines complement the Internet Banking Technology Risk Management Guidelines, which address outsourcing of IT processing functions and operations.

Developments in Regulation and Supervision of Capital Market Services and Financial Advisory Services (Banks, Securities Firms, Insurance Firms, Fund Managers and Other Non-Bank Financial Institutions Providing Such Services)

Capital Market / Financial Advisory Services

Capital market activities are regulated by the Securities and Futures Act (Chapter 289) (SFA) whilst the financial advisory services are regulated by the Financial Advisers Act (Chapter 110) (FAA). In 2003, MAS embarked on a two-phase review of SFA and FAA. The first phase of legislative amendments was passed by Parliament in September 2003 and came into force in December 2003. These amendments sought to implement the recommendations made by the Company Legislation and Regulatory Framework Committee. The recommendations were aimed at reducing the cost of raising capital in Singapore, by rationalizing and simplifying the requirements in the SFA for offers of investments. They also incorporated technical amendments to the SFA and FAA taking into account industry developments and feedback since their enactment in 2001.

In September 2003, MAS issued a consultation paper on the key policy reforms that were being considered for the second phase of amendments to the SFA and FAA. The consultation covered a wide range of policy issues including changes to the regulatory framework for offers of investment, markets and clearing facilities, and the product scope of the FAA. Amongst the proposals are: retain prospectus liability for underwriters; extend prospectus liability to issue managers; allow dissemination of pre-deal research reports to institutional investors subject to conditions; to include price interaction as a key criterion for determining a market; introduce a designation approach for clearing facilities; expand the scope of the FAA to include structured deposits and OTC derivatives; and exempt provision of financial advisory services rendered to overseas investors from business conduct requirements. In March 2004, MAS published its response to the comments received from the public. The draft Amendment Bills were subsequently released for public exposure in April 2004. MAS intends to introduce these amendments for 1st reading in Parliament in the second half of 2004.

Separately, Guidelines were issued by MAS in February 2004 on the application of the extra-territorial provision (s.339) of SFA, which confers MAS with jurisdiction over financial services committed, in part or wholly, outside Singapore, where the act has a *substantial and reasonably foreseeable effect* in Singapore.

Commodities Derivatives

In the 2004 Budget, the Minister for Finance announced a new scheme to encourage the growth of the commodity derivatives market, with a view toward enhancing Singapore's position as a commodities trading hub. In April 2004, MAS issued a circular explaining the new scheme, which includes a concessionary tax rate of 5% on income derived from transactions in commodity derivatives and commodities for a period of five years, subject to certain conditions.

Insurance

Following two consultation papers in October 2003, the Insurance (Amendment) Act 2003 ("IAA") came into force in January 2004 and introduced a regulatory framework for the accident and health insurance business; a risk-based capital framework for life and general insurance companies; and an authorization framework to strengthen MAS' supervision over the cross-border supply of reinsurance services in Singapore.

Separately, on November 28, 2003, MAS released a consultation paper on the proposed risk-based capital framework for insurance companies. Based on concerns that the existing statutory framework is not sufficiently transparent or risk-focused to reflect the underlying financial condition of insurance companies, the proposed framework seeks to, among other things, amend the existing valuation methodology for assets and liabilities; establish new capital requirements; update the role of actuaries; and introduce a new set of statutory reporting standards. The proposed framework was formulated in close consultation with the insurance industry and is based on international standards and good practices in developed countries.

Consistent with the MAS' moves toward risk-based supervision, on October 1, 2003, it was announced that the MAS would be reducing the minimum paid-up capital requirements of S$25 million for direct insurers to S$10 million for full-fledged insurers; and, S$5 million for mono-line insurers writing selected lines of business.

On 17th November 2003, MAS also issued a consultation paper on its proposed approach to regulate the distribution of traded endowment policies ("TEPs") and traded life policies ("TLPs") to Singapore investors. The MAS proposes to expand the definition of investment products to include TEPs and TLPs as a class of investment products under FAA and provide that entities distributing such products should be licensed and supervised by the MAS.

Fund Management

In April 2004, the MAS released a consultation paper on a set of proposed amendments to the Code on Collective Investment Schemes (the "CIS Code"). The proposed amendments seek to improve the operating environment, balancing market developments and investor protection concerns. Among other things, to broaden the range of collective investment schemes available to the investing public and to deepen the pool of fund management expertise in Singapore, MAS proposed to introduce guidelines for currency funds.

Separately, in March 2004, MAS issued guidelines for the valuation of collective investment schemes, formalising the use of net asset value to value CIS. The guidelines have been incorporated into the CIS Code.

Disclosure Requirements, Requirements for Listing on Exchanges and Exchange Trading Requirements

MAS issued the Guidelines on Disclosure of Financial Information in Prospectuses in September 2003, which clarify the regulatory objectives of certain provisions in the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations ("SFR") following feedback received from public consultation. The new financial disclosure framework provides guidance on the form and substance of presenting audited, pro-forma and interim financial information as well as trend / profit forecasts or estimates.

Separately, in November 2003, the Singapore Exchange Ltd ("SGX") released amendments to the Listing Manual to provide for a trading halt feature, which is intended to differentiate between short trading stoppages requested solely by issuers, and suspensions which may be requested either by an issuer or imposed by the SGX. The trading halt may be used for purposes of proper dissemination of material information by issuers during market hours.

A new set of securities trading rules took effect in December 2003 issued by SGX. Apart from aligning the new rules with the requirements of SFA, the rules also seek to enhance market transparency. One key amendment is the requirement for trading members to separate its research activities from its dealing, corporate finance and back office functions.

SGX further issued 2 new practice notes on SGX-ST listing rules for IPOs to be effective on June 1, 2004, intended to tighten the disclosure standards for companies seeking listing. The notes set out SGX's procedure in granting listing, circumstances under which it may withdraw the eligibility-to-list letter, sponsors' duty regarding due diligence, sponsorship disclosure requirements post listing, and director's training and connection in Singapore.

Treatment of Non-Domestic Financial Institutions, including Access to the Singapore Market, Powers Granted Them Under Host Country Law, and their Regulation and Supervision by Host Country Authorities

The US – Singapore Free Trade Agreement ("US / Singapore FTA") came into force on January 1, 2004. Among the key commitments are that: (i) as at June 30, 2005, there will be no restrictions on the number of US banks which may be granted Qualifying Foreign Bank privileges; (ii) as at January 1, 2006, there will be no limit on the number of service locations held by American Qualifying Foreign Banks; and, (iii) as at June 30, 2006, American qualifying Foreign Banks incorporated in Singapore may negotiate for local bank ATM networks on commercial terms; those not incorporated in Singapore may negotiate for such rights commencing January 1, 2008.

Other Significant Market Developments

Lending of Singapore Dollar to Non-Resident Financial Institutions

The policy concerning the non-internationalization of the S$ was put in place to discourage S$ speculation. Since 1998, MAS has made significant adjustments to the policy, as part of its effort to develop a vibrant capital market in Singapore.

On May 27, 2004, MAS further fine-tuned the above policy in 2 aspects –

(1) Non-resident, non-financial issuers of S$ bonds or equities will no longer be required to swap or convert their S$ proceeds into foreign currencies before remitting abroad.

(2) To facilitate straight-through processing and more efficient handling of S$ payments, any extension of temporary overdrafts of S$ vostro accounts to prevent settlement failures will be exempted from the restrictions under the policy.

With the progressive easing of the S$ restrictions over the years, the policy, at present, only limits the lending of S$ to non-resident financial institutions for the purpose of S$ speculation. The policy has thus been renamed "Lending of S$ to non-resident financial institutions".

Singapore Dollar Becomes Eligible Currency Of CLS Bank

On September 11, 2003, the Singapore dollar commenced live settlement as an eligible currency of the CLS Bank, which administers the Continuous Linked Settlement (CLS) service, supported by more than 65 of the world's largest global financial institutions. The other ten eligible currencies are: Australian dollar, Canadian dollar, Danish Krone, Euro, Japanese Yen, Norwegian Krone, Pound Sterling, Swedish Krona, Swiss Franc and the US dollar. This is a significant development for Singapore as a financial hub, making it more attractive for financial institutions to conduct their currency operations in Singapore.

Developments In Tax Framework

With effect from January 1, 2004, seven financial tax incentive schemes were merged into a single scheme known as the Financial Sector Incentive Scheme ("FSI"). Qualifying activities under the FSI are divided into two tiers. Income arising from Standard Tier ("ST") and Enhanced Tier ("ET") activities are taxed at 10% and 5%, respectively.

With effect from January 1, 2004, Singapore sourced investment income derived by individuals from financial instruments will be exempted from tax in Singapore. This measure was introduced to ensure that individuals are not biased against investments in Singapore financial instruments in view of the fact that all foreign sourced income received in Singapore by individuals is also exempted from tax with effect from the same date; and to encourage retirement planning and saving. The tax exemption does not apply to income derived by individuals through partnerships in Singapore.

Important Legislative or other Changes Expected to Occur after June 2004

Competition Bill

On April 12, 2004, the Ministry of Trade and Industry ("MTI") released its first consultation paper seeking feedback on a draft Competition Bill. The draft Bill was based on the principle that competition law in Singapore should incorporate relevant international best practices but also take into account Singapore's unique characteristics as a small open economy; and business costs should be kept to a minimum. When introduced, competition law will extend to all economic activities by private sector entities, including activities in the financial sector. It will apply regardless of the ownership of the entity, be it domestically or foreign owned or controlled; or government-linked companies.

Prohibited activities under the draft Bill include: (i) agreements and concerted practices which have as their object or effect the prevention, restriction or distortion of competition in Singapore, for example, price fixing or market allocation; (ii) conduct which amounts to abuse of a dominant market position, i.e., abusing power in ways that are anti-competitive and which work against long-term economic efficiency in any market in Singapore, for example, predatory pricing;

(iii) mergers and acquisitions that substantially lessen competition in Singapore. There are some exemptions to certain of the draft prohibitions, in particular if there are exceptional and compelling reasons of public policy that would warrant such exemptions or if there are appropriate sectoral regulatory frameworks in place that deal with competition issues.

A Competition Commission will be set up as a statutory body under the MTI to administer the competition law, and will have powers of investigation and enforcement. Following enactment of the competition law, a transition period of at least 12 months will be provided before the prohibition provisions come into force.

The Competition Bill is expected to be enacted in January 2005.

Funding the Activities of Banking Regulators

Banking regulation and supervision activities are financed from banks' license fees and income from the MAS' other operations. The MAS is self-financed and sets its own budget, that is approved by the President.

SPAIN

During the period under review, the Spanish Parliament passed two important Acts related to the financial system: one was the new insolvency law and the other was a new law on mutual funds and collective investment schemes in securities. The Insolvency Law (Law 22/2003) represents a significant modernization of the Spanish insolvency system which dates back to the end of the nineteenth century. Characteristics worth mentioning of this reform are the significant reduction of the credit privileges (thus, the traditional privilege of credits made with the participation of civil law disappears), the simplification of several types of insolvency and a balanced treatment concerning reorganization and winding-up. With respect specifically to financial institutions, certain measures are maintained which were introduced during the last few years by means of legal reforms, as the acknowledgement of netting in agreements of contractual clearing.

The new Law on Collective Investment Undertakings (Law 35/2003) has incorporated into Spanish law the latest Directives of the European Union on this subject: Directive 2001/107/EC of the European Parliament and the Council concerning management companies’ simplified prospectuses; and Directive 2001/108/EEC of the European Parliament on investments of UCITS (undertakings for collective investment in transferable securities). These Directives complete the introduction of the securities collective investment in the single market of financial services by extending the community passport to portfolio management companies and increasing the amount of assets and financial instruments in which UCITS can invest. Law 35/2003, apart from incorporating these Directives of the European Union, has also meant a generalized revision of the existing rules which will be finalized with a new regulation within the next few months. It is expected that the flexible framework of the new Law, which admits for the first time products such as the umbrella funds, will permit the development in Spain of hedge funds.

Another innovation has been the regulation, in Law 62/2003, detailed and very reasonable, of the fiscal consequences of securities loan agreements, a market which up to this date had not significantly been developed in Spain, due to the uncertainties of the enforced fiscal regime. This fiscal regime is based on the neutrality principle for the lender. It only applies to one-year securities loans, granted with the participation or mediation of a financial institution.

During this period, Royal Decree 302/2004 completed the regulation on issuance of *"cuotas participativas"* of the savings banks. Savings banks, which represent in Spain a significant amount of the financial system, are *"foundation like"* entities, with no corporate capital divided in stocks. The "*cuotas participativas*", which are considered tier one capital, intend to be securities which, although not bestowing voting rights, would permit the right to participate in the profits of the savings banks, bearing the risk of insolvency in a similar way as stocks in banks, which are public companies. The Royal Decree demands that the *"cuotas participativas"* be listed on the Stock Exchange, and emphasizes the similarity of their regime to that of the shares of public companies.

Finally worth mentioning is Royal Decree 303/2004, concerning the Commissioners of the financial services customer defense, who are three ombudsmen in the areas of banking, securities investments and insurance and pensions, linked, although autonomous, to each of the branch supervisors: "Banco de España", "Comisión Nacional del Mercado de Valores" and "Dirección General de Seguros" (Bank of Spain, National Commission of Securities Market, and National Insurance Authority). Regulation ECO/734/2004 provides that Spanish financial institutions should include a customer complaints department or ombudsman.

SWEDEN

Legislative and Regulatory Developments

Three important laws were decided in the last year and came into force on July 1, 2004.

The most important is the new banking law. In 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 market undertakings to take deposits. The deposits will be limited to 50,000 Swedish kronor (about 5,500 euro) for households but there will be no limit for deposits from companies. These "deposit institutions" will not be covered by the deposit guarantee scheme and will not be supervised by the Financial Supervisory Authority.

On the same date, July 1, 2004, a law on covered bonds came into force. The implication of the new law is that a Swedish bank or mortgage credit institution will be entitled to issue covered bonds. The rules are functional in character, which means that institutions can decide if they wish to engage solely in borrowing and lending associated with covered bonds or to engage in other banking and financing activities as well. The Financial Supervisory Authority shall exercise special supervision to ensure that the issuing house complies with the provisions of the act.

A new Financial Advice Consumers Act also came into force July 1, 2004. The law includes liabilities for banks to ensure that its employees who give advice have the necessary skills to document the advice given to consumers and to observe good advisory practices and protect the consumer's interests with care.

The government has also presented a proposal for a new law on money laundering. The main element in the law is that the obligation to report suspected cases of money laundering will include not only financial institutions but also lawyers, auditors, real estate agents and persons that deal with goods of high values. The new law will come into force January 1, 2005.

Market Developments

The profitability of the major banks has been increasing during the year. The improvement is mainly a consequence of the rising stock market, which strengthened the net commission and insurance income. Decreased costs also contributed to the better profitability.

Lending to the public from the Swedish banks and mortgage credit institutions has continued to increase during the year. The mortgage lending to households increased by 12 percent in 2003 which mainly can be explained by the low interest rates and a rapid increase in house prices in the large cities.

Households in Sweden as in many other countries, are still rapidly increasing their debts. Some of the main factors are improved disposable income, low interest rates and a high turnover in the housing market. The ratio of debts to disposable income has risen from around 90 per cent in the mid 1990s up towards 120 per cent at present. Still, on account of the low interest rates, post-tax interest payments on these loans are relatively small in relation to household income. However, the debt and the debt servicing ratios are both expected to continue to rise in the years ahead. The Riksbank pays close attention to the development and has during the year studied the indebtedness and ability to service debt of different income groups. The conclusion is that the households with debts have comfortable margins and that not even markedly higher interest rates or unemployment would affect them to such an extent that the risks in the banking system would become seriously greater.

The loan losses of the major Swedish banks decreased during the year and are accordingly still low in both a historical and a European perspective. Given the economic upswing forecasted by the Riksbank, the losses are expected to remain moderate.

The Swedish banks are continuing their expansion in the Nordic countries, in the Baltic States and in Poland and Germany. More than half of the loans to the general public from the major Swedish banks are provided to borrowers abroad. One aspect of this is that the risks and risk profiles of the banks is more complex and more difficult to overlook. A conclusion from the Financial Supervision Authority is that the development underlines the need for deeper and wider collaboration between the supervisors in these countries.

No major mergers or acquisitions have been carried out during the year. The plans of Coop, one of the major food store chains, to start a bank was interrupted during the spring because of disagreement between the owners about the way to establish the new bank.

The use of electronic and Internet banking is very important for Swedish banks. Internet services have increased rapidly since the introduction of these services in 1996. More than 40 per cent of all Swedes use their banks' internet services on a regular basis.

In November 2003 VPC, the Swedish securities depository and clearinghouse, launched a new clearing system known as NewClear. The new system allows both securities and payments to be settled in gross. In close co-operation with the Riksbank, a functionality was also developed to provide payment accounts with central bank funds. In addition, a number of settlement cycles have been set up, increased flexibility has been introduced in the registration of instructions as well as in the handling of limits for clearing members and settlement banks. In an international ranking by Thomas Murray of security and efficiency in the custody and settlement of securities in 2003, Sweden came out on the top, having been ranked third in a global perspective and first in Europe.

Funding of the Supervisory Authority

The operations of the Swedish Financial Supervisory Authority (Finansinspektionen) are financed from the national budget but the companies monitored by the Authority pay mandatory fees to the central government. There are two kinds of fees. The main part is fees for supervision of institutions and market places. Furthermore the institutions pay fees for permits and registrations.

SWITZERLAND

New National Bank Act (NBA)

The new National Bank Act (NBA) was passed by the Swiss Federal Parliament on October 3, 2003 and entered into force on May 1, 2004. Switzerland's new Federal Constitution, which entered into force on January 1, 2000, contains the new Article 99 on monetary policy which forms the constitutional basis of the Swiss currency and the activity of the Swiss National Bank (SNB). Article 99 confirms the SNB's independence, as well as its obligation to set aside adequate currency reserves from its earnings, part of them in gold. Both elements are designed to help maintain public confidence in monetary stability. As was the case previously, the central bank's mandate includes an obligation to conduct a monetary policy "in the interests of the country as a whole."

The new National Bank Act sets out in detail the central bank's constitutional mandate and its independence. Furthermore, complementary to central bank independence, the SNB's accountability and information obligation towards the Federal Council, Parliament and the public has been introduced. At the same time, the SNB's scope of business, which has hitherto been defined too narrowly, has become more flexible. This has brought considerably more room for maneuver for monetary and investment policy activities. The National Bank now also has a uniform statutory basis for the compilation of financial market statistics. Furthermore, the new

National Bank Act provides for a modern minimum reserve regulation for banks, which is guided by the cash liquidity requirements previously regulated by the Act on Banks and Savings Banks. Moreover, the new Act entrusts the SNB with the oversight of payment and securities settlement systems.

Revision of FATF 40 Recommendations

The adoption of the revised 40 recommendations at the FATF's plenary meeting in Berlin was undoubtedly the most important FATF event in 2003. Switzerland, which worked actively on reviewing the regulations, welcomed the acceptance of these revised international standards. With the adoption of the revised recommendations national legislation is also to be adapted. Compliance with the revised recommendations will be monitored within the framework of mutual evaluations among member states from the end of 2004. To this end, the Swiss authorities have set up inter-departmental working groups to accelerate the necessary changes. These changes are scheduled to be introduced in 2005.

Reform of Financial Market Regulation

In November 2000 the Zufferey Group of Experts, set up by the Finance Ministry, suggested merging both the insurance and banking supervisory authorities into one supervisory body. The Federal Council subsequently set up a new Commission of Experts, chaired by Professor Ulrich Zimmerli, and tasked it with preparing the legislative foundations for the new supervisory body. The Zimmerli Commission of Experts issued "Part One" of its report on an "Integrated Financial Market Authority" (FINMA) together with a draft of a "Federal Law on Financial Market Supervision" (FINMAG) and presented them to the Finance Ministry on July 7, 2003.

The proposed "Federal Financial Market Authority" will first of all merge the present Federal Banking Commission with the Federal Office of Private Insurance. The draft law not only lays out the organizational structure, but it also standardizes the supervisory instruments at the disposal of the future integrated regulatory body. The consultative procedure, in which the Swiss Bankers Association (SBA) also participated, terminated at the end of January 2004. In its position paper the SBA welcomed the creation of an integrated financial market authority and considers the FINMAG to be a suitable foundation for a new regulatory order.

On the other hand the SBA is critical of the FINMA's area of responsibility as it believes it is too narrow and should include the Money Laundering Control Authority as well as a new body to supervise independent asset managers. The SBA proposes that the FINMAG should be uncoupled from the discussion about a future catalogue of sanctions. In view of the current flood of new regulation the SBA stresses the necessity of coordinating the various regulatory intentions with regard to both timing and content. FINMA should also be obliged to carry out a transparent cost-benefit analysis of proposed regulations.

Following the publication of Part One of its report the Commission of Experts is now dealing with a catalogue of sanctions for the new regulatory authority. The relevant report is due to appear in summer 2004. The Commission of Experts has, for the time being, excluded examination of the question of whether the scope of the integrated financial market authority should be extended to cover other financial service providers.

SBA Directives for the New Issues Market

On June 4, 2004 the Swiss Bankers Association (SBA) promulgated allocation directives for the new issues market in order to ensure that the allocation process is as fair and transparent as possible. This self-regulatory measure on the part of the banks has been approved by the banking regulator, the Federal Banking Commission (FBC), as a minimal standard. This means that auditors recognized under regulatory law are required to monitor compliance with the directives on behalf of the FBC. The directives are due to enter into force on January 1, 2005.

The directives will improve the fairness and transparency of the allocation process for both the primary market (IPOs) and capital increases. They apply to all public issues and placements of shares, participation certificates and dividend-right certificates as well as convertible bonds and bonds cum warrant in Switzerland.

The directives define rules of conduct for the allocation process, with special emphasis being placed on verifiability and transparency. The directives continue to allow for differences in the treatment of individual clients or client groups in line with the need to balance the relative claims of parties involved. Allocations based on promises of special reciprocal compensation (laddering, quid pro quo agreements and spinning) are explicitly forbidden. Furthermore, issue prospectuses must in the future include additional information on any option for overallotment (“greenshoe”). Transparency is also required in respect of specific allocations requested by the issuer, for example to business partners or even employees (friends and family programs). Finally, nostro allocations by the underwriting banks – particularly for market making purposes – are only permitted by arrangement with the issuer and on an appropriate scale. Once the transaction has been completed, the lead bank must disclose the placement volume together with the size of allocations to any subscriber categories having special connections to the issuer as well as any greenshoe options exercised.

In sum, the prime focus is on requirements relating to the objectivity and transparency of the allocation process. The new directives represent another example of the SBA’s approach of effective and practice-oriented self-regulation.

The Financing of Banking Regulation

To finance its activities, the Swiss Federal Banking Commission (SFBC - Switzerland’s banking regulator) levies an annual supervisory fee on the institutions which are subject to its supervision. The supervisory fee is levied on the basis of the costs which the SFBC incurred in the previous year. The activities of the SFBC are thus financed independently from the country’s finance budget on the principle of cost covering.

TURKEY

Banking Sector Restructuring

Following the banking sector restructuring program that has taken place over the past three years, the sound functioning of the Turkish banking system, which is of vital importance for the whole economy, has been ensured by the support and participation of all relevant institutions and organizations.

The main remaining issues for the Savings Deposit Insurance Fund (SDIF) and Banking Regulatory and Supervisory Authority (BRSA) include the resolution of Pamukbank, which was taken over by the SDIF in July 2002 and is still in the process of sale. The other bank under the SDIF's management, namely Bayındırbank A.Ş. has been restructured as a transition bank.

Efforts regarding the privatization of the state banks have continued. Within the framework of operational restructuring of the state banks, Emlak Bankası was transfered to Ziraat Bank.

Financial Restructuring Program: "Istanbul Approach"

Within the framework of the Financial Restructuring Program, the number of signed restructuring agreements was 275 as of April 2004. The total amount of signed contracts has reached USD 5.6 billion. Of this amount, 77 small-scale companies accounted for USD 0.6 billion and 198 large-scale companies accounted for of USD 5 billion.

Accounting Practices

The Law on the taxation of net income according to the principle of inflation accounting has been accepted by the parliament in February 2004, to be applied as from 2005.

Measures Against Informal Economy

A new regulation was put in place to require payments above a certain amount to be made through the financial sector.

Savings Deposit Insurance Scheme

According to the resolution of the Banking Regulation and Supervisory Board no. 1084, dated July 3I, 2003, the full guarantee scheme applied to savings deposit accounts opened with the deposit banks and foreign bank branches in Turkey will be terminated, and up to 50 billion Turkish lira, savings deposit accounts, which are opened or renewed after July 4,2004 will be subject to insurance.

A new regulation on calculation of insurance premiums based on risk was introduced.

Decrease in the Intermediary Costs of Banks

Some important measures were taken in order to lower the intermediary costs on financial transactions. For example, the stamp duty on loan transactions and the special transaction tax imposed on time accounts were removed.

Primary Dealership

Turkish Treasury has applied a strengthened primary dealer program since 2003 in order to further enhance the liquidity of domestic debt and deepen the government bond market, to ensure the stability and continuity of the primary dealership system. Under the program, primary dealers commit to minimum levels of purchases at auctions, and to make markets in Treasury bills and domestic government bonds, both for outright transactions and for the lending of securities. The Treasury also provides a facility to swap other bills into benchmark bills, at its own discretion, to relieve any securities settlement shortages which might occur.

Road Map for the Transition to the New Basel Capital Accord (Basel II)

The Turkish Banking Regulation and Supervision Agency (BRSA) strongly supports the approach of the Basel Committee on Banking Supervision that envisages creating a more robust and risk sensitive capital adequacy framework. In order to enhance the understanding of the New Basel Capital Accord (Basel II) and establish efficient cooperation and discussion, a *"Steering Committee on Basel-II"* was formed with representatives from the BRSA and banks in March 2003. The Committee regularly meets and studies issues regarding implementation and conducts various projects to prepare a level playing field for better implementation of Basel II.

The Steering Committee unanimously agreed on "The Road Map for the Transition to New Basel Capital Accord (Basel II) " on September 26, 2003. The Road Map is subject to a dynamic assessment and updating process.

Banks in the sector and the regulatory amendments necessary to activate the system and the work on forming the organizational structure have been almost finalized. On the other hand, work for establishing the risk management system on a consolidated basis continues in many private banks.

TRLIBOR

A new system for the determination and fixing of Turkish Lira Reference Interest Rate (TRLIBOR) was initiated. Prior to the start of the system, the Participating Banks have signed a protocol with the Banks Association of Turkey. In accordance with the protocol, the participating banks ensure the determination and fixing of a reference interest rate for Turkish Lira on daily basis at maturities up to one year in the interbank market.

Determination of a reference interest rate is made by calculating the average of quotations in certain intervals during a session, called as "fixing". The interest rate determined in such a way is published by the Banks Association of Turkey on its web site.

Amendment in the Banks Act

With the Law no. 5020 published in the Official Gazette on December 26, 2003 some amendments were made to the Banks Act no.4389. The main aims of these changes are as follows:

- to accelerate the legal proceedings of receivables arising from banks, which are determined as their resources are used by their owners directly or indirectly in the own interests or in the interests of third persons so as to endanger the soundness of the bank, and thus whose management and supervision is transferred to the Saving Deposit Insurance Fund and/or whose banking license is revoked and liquidation process is started due to the decision of dissolution,

- to ensure the effective following of money, properties, rights and receivables from those banks, which are transferred to the bank owner's spouse, children and/or their blood relatives and/or those transferred to the controlling shareholders of the bank or to their companies and subsidiaries through simulation transactions.

With the latest amendments to the Banks Act, SDIF has secured an independent decision making mechanism out of BRSA.

Amendment in the Execution and Bankruptcy Act

The Law Amending the Execution and Bankruptcy Law no. 4949, was put into effect upon promulgation in the Official Gazette on July 30, 2003 (with the exception of some articles with a later effective date). By the comprehensive amendments and changes made in the Execution and Bankruptcy Law some positive steps have been taken for acceleration of the collection of receivables and for the prevention of bad faith acts on the part of debtors.

With the latest amendments made in the Execution and Bankruptcy Law on February 21, 2004, provisions related to restructuring of capital stock companies through conciliation have been added.

Market Developments

Excluding the Central Bank, the number of banks operating in Turkey decreased from 52 to 49 during the period under review, 35 of which are commercial banks and 14 non-depository banks. The banking license of one of the commercial banks (İmar Bankası A.Ş.) was revoked and two foreign commercial banks (ING Bank N.V. and Credit Suisse First Boston Bank) closed their branches in Turkey. The number of bank branches increased from 5,955 to 5,979 in the same period.

All assets and liabilities of Citibank N.A. İstanbul Branch Office, headquartered in New York, were transferred to Citibank A.Ş., established as a foreign bank in Turkey, registered in the commercial gazette on March 10, 2004.

Payment System Developments: Direct Debit

Under the coordination of the Banks Association of Turkey (BAT), a working group on forming of a Direct Debit (DB) scheme over the Turkish Interbank Clearing System (Electronic Funds Transfer - EFT) has been established. The DB schema has been concluded to be in operation by June 2004. The rules and regulations for operation of the DB scheme are set by The Central Bank of Turkey (CBT) and a special protocol has been agreed upon by the member banks. The pricing for the Direct Debit messages is set by a bilateral agreement between the banks depending on the data provided by CBT.

Funding the Activities of Bank Supervisory Authorities

The Banking Regulation and Supervisory Agency (BRSA) is funded through assessments paid by regulated institutions; the Savings Deposit Insurance Fund (SDIF) is funded through deposit insurance assessments.

UNITED KINGDOM

Introduction

UK banks again performed strongly during the period under review, with the major quoted banks reporting record profits against a background of relatively strong domestic growth, a continued strong US economy and signs of greater Eurozone stability. Financial markets were also more stable in 2003, following the volatility and depressed state of the previous two years.

Financial Services Regulation

Financial Services Authority: New Management, New Regulatory Approaches

The year has seen a major change in the Financial Services Authority's management structure following the appointment of a new Chairman and Chief Executive in September 2003. The new appointments coincided with a shift of emphasis from policy development – with the Financial Services and Markets Act 2000 bedded down and the FSA and its Rulebook fully established – to implementation and consumer issues. In November the FSA announced a new management structure to take effect from April 2004. This was intended to:

- put the FSA in best possible position to achieve its vision of efficient, orderly and clean financial markets and helping retail consumers achieve a fair deal,
- build on the successful characteristics of the existing organization while embracing a more risk based approach, and
- allow more delegation of responsibility, speed of action and focus on critical issues and make it easier for firms and consumers to do business with the FSA.

Reflecting the increased emphasis on consumer issues, the new management structure distinguishes more clearly between retail and wholesale responsibilities within a matrix structure that specifically provides for cross-sectoral themes. It is also intended to position the FSA to handle effectively the many thousands of new firms which will fall within its remit when mortgage and general insurance regulation are introduced at end-October 2004 and in early 2005 respectively.

The FSA recognizes that it will not be easy to draw back from its rule-making function, particularly in the context of the need to transpose a mass of European Union financial services legislation into national law. This includes the 42 directives of the Financial Services Action Plan, the highly complex Risk Based Capital Directive that will provide the basis for the Europe-wide implementation of the Basel Accord, and a number of consumer protection directives with significant financial services implications. The Lamfalussy process, whose extension to banking and insurance was agreed by the European Parliament on March 31, 2004, clearly envisages a major role for national regulatory authorities like the FSA in the detailed transposition of high-level European legislation into national law and regulation. One can therefore expect a period of experimentation as the FSA seeks, in cooperation with the financial services industry, new ways of implementing legislation – for example, co-regulation with the industry through codes or guidelines – that are less intensive of its rule-making resources.

FSMA Review

In November 2003 the government announced a review of the Financial Services and Markets Act, in line with its earlier commitment in response to the Cruickshank Report (Donald Cruickshank 'Competition in UK banking: a report to the Chancellor of the Exchequer', March 2000) to review the impact of the Act on banking competition two years after its implementation. The review focuses on three areas:

- the impact of the Act on competition in the financial services markets;
- various aspects of the Financial Services Authority's work, in particular in relation to compliance costs arising from the complexity of its Rules Handbook and practitioners' difficulties in obtaining individual guidance, the volume of consultation, the FSA's approach to cost-benefit analysis, and consumer education; and
- the role of the Financial Ombudsman Service, where concerns had been expressed by the industry that it was, through the precedents set by its adjudications, effectively making rules.

The government has stressed that it has no intention of mending what is not broken and has emphasized that it believes that the regulatory framework established by the Financial Services and Markets Act has been a resounding success. Different strands of the review are being undertaken by the Treasury, the Office of Fair Trading (OFT) and the FSA and the government expects the review to be completed within a year. It is envisaged that the concerns about the Financial Ombudsman Service will be resolved through a mechanism for identifying and handling complaints with wider implications that includes consultation with industry and stakeholder groups.

Retail Product Distribution

Major changes can be expected in the regulatory framework for the distribution of retail financial products, against a background of growing concerns about inadequate savings, particularly for pension provision, and a fall in consumer confidence in financial products following a series of mis-selling scandals. The Financial Services Authority sees three requirements for a restoration of confidence: financially capable consumers, appropriate products and clear information about them, and responsible product providers. It realizes that the first is a long-term project and that, in the short term, the emphasis must be on the last two. A recurrent theme of the FSA's approach is the need to treat customers fairly.

Two particular reforms are in progress. The first is the abolition of the polarization requirement that obliges firms to choose between selling their own products and those of other providers. This will be combined with requirements for improved disclosure of product information, particularly commission payments. Discussions with the industry are focused on agreeing disclosures that do not create a competitive distortion between products sold on a commission basis and those that are not. The authorities aim to introduce the reform in October.

At the same time the authorities are consulting on proposals, based on the recommendations of the Sandler Review (Ron Sandler 'Medium and Long-Term Retail Savings in the UK: A Review', July 2002), for a suite of simple products that can be sold through a simplified sales process, particularly to those on lower incomes, subject to a cap on charges. Many in the industry felt that the authorities' original thinking on the level of charges was unrealistic and would not provide sufficient incentive for firms to provide the products; following discussions, the government announced in June 2004 an increase in the cap from 1 to 1.5 per cent.

Financial Capability

The FSA has always considered financial education an important part of its remit under its public awareness objective but it has now come to see consumers' 'financial capability' as an important element in meeting its consumer protection objective. In November 2003 it outlined a proposal 'to develop and implement a national strategy for financial capability'. It subsequently identified seven projects covering schools, young adults, the workplace, families, retirement, borrowing and advice that it will take forward in collaboration with partner organizations – government, industry and the not-for-profit sector. It will also undertake a major survey to measure consumer confidence and understanding of financial matters.

Wholesale Issues

There have been important regulatory initiatives in three areas affecting wholesale and institutional markets: analyst research and conflicts of interest, softing and bundling, and the listing review.

Regulators cannot hope to abolish conflicts of interest, which are inherent in any agency relationship; at best they can seek to ensure that they are properly managed, and the FSA's approach is based on requiring firms' senior management to take responsibility for this. The FSA's Consultation Paper 205 on *conflicts of interest in investment research*, issued in October

2003, perhaps represented the first example of the FSA's new pared-down approach to rule-making with considerably reduced guidance. A group of trade associations subsequently issued guidance to their members and the FSA provided comfort that the guidance was 'consistent with the intended effect of the Rule'.

The FSA has continued to consult on *softing and bundling.* 'Softing' is the practice whereby a broker agrees to pay for the supply of services from a third party to a fund manager in return for an agreed volume of business at an agreed commission rate: 'bundling' refers to the provision by brokers in a single commission charge of other in-house services, such as research, in addition to securities dealing. While it is quite possible that soft commission's days are numbered, the authorities have been hesitant about proscribing the possibly more insidious practice of bundling for fear of unintended consequences. The authorities' approach is based on increased transparency, with the industry being left to come up with proposals as to how this should be done.

Following its assumption of responsibility for the UK Listing Authority in May 2000, the FSA has completed a major review of the *listing regime* in anticipation of the implementation of a number of European Union directives (specifically the Prospectus, Transparency and Market Abuse Directives) and a major overhaul of UK company law.

UK Implementation of the Basel Accord

The Basel Committee reached consensus on a new Basel Accord on May 11, 2004. Implementation in the UK of the Accord and the EU Risk Based Capital Directive that will provide the legal basis for its European Union-wide implementation will be largely through the FSA's Rule Book – more specifically, the Prudential Sourcebook (PSB). A huge amount of work needs to be done both by the authorities and banks to meet the implementation dates mandated, end-2006 for the standardized and foundation approaches and end-2007 for the advanced approaches.

Liquidity

The FSA's discussion paper setting out a framework for prudential liquidity requirements, published in October 2003, reflected regulators' growing interest in liquidity, particularly in the context of banks' involvement in Value Transfer Networks (VTNs). Pressure of work on implementation of the Basel Accord has meant that resources have had to be transferred to this area and formal consultation on more detailed proposals on prudential liquidity is now not expected until autumn 2005 at the earliest, pending the outcome of a Joint Forum review of the current requirements. The Joint Forum is a group of banking, insurance and securities regulators formed under the aegis of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS).

Extension of Scope: Mortgages and General Insurance

Mortgages will be brought within the scope of the Financial Services and Markets Act from October 31, 2004, to be followed by general insurance in early 2005. The change will require many thousands of mainly small firms that are currently outside the FSA's remit to become authorized.

Payments Regulation

Considerable progress has been made by the Association for Payments Clearing Services (APACS) in opening the payments system to greater competition since the Cruickshank Report recommended a statutory payments regulator in March 2000. In December 2003 the government announced that the Office of Fair Trading (OFT) would play an enhanced role in relation to payments systems for a period of four years, at the end of which the government will review the situation and, unless there has been a significant improvement in competition, introduce legislation. The OFT subsequently established a Payments Task Force, on which both industry and consumer interests are represented, to oversee its enhanced role.

Money Laundering

With the coming into force of the Treasury's Money Laundering Regulations 2003 on March 1, 2004, the UK is now compliant with the European Union's Second Money Laundering Directive.

The Joint Money Laundering Steering Group, now established as a limited company bringing together sixteen financial sector trade associations, is pressing ahead with a radical revision of the Money Laundering Guidance Notes that provide guidance on compliance with the government's Money Laundering Regulations and the FSA's Money Laundering Rules. An important element in the revision will be a greater emphasis on a risk-based approach. An interim update, taking into account – among other things – the Treasury's Regulations and the anti-money laundering provisions of the Proceeds of Crime Act 2002, was published at end-January 2004.

The private sector's increasing commitment to the fight against money laundering has brought into focus its concerns about responsibilities in the public sector and the public's frustration with an identification regime that sometimes seems more directed at making life difficult for law-abiding citizens than at preventing criminal activity. The FSA, whose responsibilities are primarily concerned with the financial sector's anti-money laundering systems and processes, has responded with three initiatives – on targeting anti-money laundering activity, on identification and on developing a risk-based approach – that it will take forward with, among others, the financial sector and the law enforcement agencies.

UK Taxation Developments

Anti-Avoidance Registration Requirements

The UK has introduced disclosure rules which will require promoters and taxpayers to notify the Inland Revenue of certain tax avoidance transactions and arrangements. Similarly there is legislation requiring businesses to disclose various VAT avoidance arrangements to HM Customs & Excise.

UK Domestic Transfer Pricing and Thin Capitalization

Until now transfer pricing and thin capitalization rules only applied to cross-border transactions. As a result of decisions of the European Court of Justice the UK government has decided to apply an arms-length test requirement to transactions, including financial transactions, with a related domestic entity. Corresponding adjustments will be available to the related entity and the main result of the change is a significant compliance cost. There are exemptions for smaller companies.

Management Expenses

The complex legislation that sometimes restricted tax relief to unwary holding companies is amended in the Finance Bill 2004. Corporation tax relief will be extended to companies involved in investment business.

Introduction of International Accounting Standards

Measures are introduced in Finance Bill 2004 to ensure that companies adopting International Accounting Standards are not disadvantaged and continue to receive similar tax treatment to that applicable to companies that continue to use UK GAAP. In particular this applies to a range of hedging positions, for example cash flow hedges and fair value hedges.

The Finance Bill 2004 permits impairment provisions for companies accounting under IASs to be tax deductible. This is an advantage over the tax treatment of provisions under UK GAAP – specific bad debt provisions being allowed for tax and general provisions disallowed. There is a possibility that relief for the opening impairment provisions arising on the switch to IASs will be spread over a still to be specified number of years.

Implementation of the EU Savings Tax Directive

Implementation of the Savings Tax Directive has been postponed for six months until July 1, 2005. The delay is intended to ensure that the European Union does not take action until Switzerland and a number of other non-EU countries have introduced equivalent measures. The UK has introduced the necessary legislation and published substantial guidance notes.

Fees

Regulatory Responsibilities

The UK has a single financial services regulator, the Financial Services Authority (FSA). Responsibility for banking supervision was transferred from the Bank of England to the FSA in June 1998, even before the FSA took on its full responsibilities for financial services. The Bank of England retains general responsibility for financial stability and monetary stability.

The FSA's statutory objectives, as laid down in the Financial Services and Markets Act 2000, are:

- to maintain market confidence,
- to promote public awareness of the financial system,
- to secure the appropriate degree of consumer protection, and
- to reduce financial crime.

The Act also requires that, in meeting its objectives, the FSA has regard to a number of principles of good regulation relating to the efficient and economic use of its resources, the responsibilities of authorized firms' senior management, proportionality, facilitating innovation, the international character of financial services, and avoiding competitive distortions.

Financing the Financial Services Authority

The Financial Services and Markets Act provides that the FSA may make Rules for charging fees in relation to the performance of its functions. As with its other Rules, the FSA is obliged to consult on the structure and amount of the fees that it charges.

Fees are generally set according to a structure of 'fee-blocks', each of which applies to a different sector of the financial services industry. In setting fees the FSA aims to recover the costs that it incurs in regulating each sector.

Most of the FSA's funding to undertake its statutory obligation is derived from 'periodic fees', payable annually. The FSA also charges separate 'application fees' as a contribution towards the cost of processing applications from firms seeking authorization and 'special project fees' for regulatory work performed primarily for the benefit of a single firm or small group of firms. 'Application fees' are also charged to firms seeking variations in their permissions.

The use of fee-blocks is intended to ensure that similar businesses are charged fees on a similar basis and minimize cross-subsidies between sectors. Within any fee-block a firm's annual fee will depend on its potential impact on the FSA's regulatory resources. The FSA uses a 'size of business' measure (the 'fee-tariff base') as a proxy for potential impact. The measure used is different for different fee-blocks; for deposit-taking institutions the FSA uses a measure of assets and liabilities ('modified eligible liabilities').

To ensure that the FSA has no financial incentive to levy fines, fines are used to reduce fees in the following year. Firms subject to investigation may also find themselves charged for expenses incurred by the FSA.

Consumer Education

The Financial Services Authority aims to fund the leadership of its financial capability strategy from its fee income but envisages that the bulk of the funding for consumer education will come from partner organizations – specifically government, industry and charitable trusts.

Financial Services Compensation Scheme and Financial Ombudsman Service

The Financial Services Authority also acts as agent to collect levies on behalf of the Financial Services Compensation Scheme and the Financial Ombudsman Service.

The *Financial Services Compensation Scheme (FSCS)* is the single compensation scheme created under the Financial Services and Markets Act to replace eight previous compensation schemes. It became operational on 1st December 2001 when the Act came into force. The scheme covers claims that firms are unable to pay – in general, because they are insolvent or have gone out of business. It is financed by a levy intended to cover the scheme's management expenses and likely compensation payments in the coming year, and is divided into three sub-schemes (for deposit-takers, insurance companies and investment firms), which in turn are divided into contribution groups that, in general, reflect the fee-blocks used by the FSA to calculate periodic fees. All authorized firms are obliged to contribute towards that part of the scheme's management expenses not directly related to compensation payments; contributions to the compensation costs levy are calculated on the basis of firms' potential liabilities to customers eligible to claim on the scheme.

The *Financial Ombudsman Service* was set up on December 1, 2001 under the Financial Services and Markets Act to provide a simple and informal mechanism for resolving disputes between firms and their customers that offers an accessible alternative to the courts. It is funded mainly from a combination of 'case fees', paid by firms against which a complaint has been referred, and a levy based on a measure of liabilities to 'eligible complainants'. Firms that do not do business with eligible complainants are exempt from the levy.

UK Listing Authority

The Financial Services Authority acts as the UK Listing Authority and as such levies a range of fees on listed companies and their sponsors.

Bank of England: Cash Ratio Deposits

The Bank of England's responsibilities for financial stability and monetary stability are financed by a levy on the banks based on their eligible liabilities. Although the banks argued for a wider allocation of the costs on the grounds that the benefits of financial and monetary stability are spread wider than the banking sector, HM Treasury concluded in its most recent quinquennial review of the Cash Ratio Deposits scheme, completed in 2003, that no change was warranted in its structure. The Treasury proposed an alignment of the CRD definition of deposits with the FSA's, an increase in the minimum eligible liable threshold to £500 mn and that the Bank of England should consider how the transparency of the scheme could be enhanced.

UNITED STATES

Introduction

There were many U.S. legal and regulatory developments during the 2003-2004 time period that have important implications both for domestic banks and international banks with U.S. operations. Among the most significant was the June 2004 release by the Basel Committee on Banking Supervision (the "Basel Committee") of a new version of the long-anticipated Basel II capital accord ("Basel II"). In response, the U.S. federal banking agencies announced their intention to conduct a fourth Quantitative Impact Study and continued plans to implement Basel II in the United States. Earlier, in late 2003, the Federal Reserve Board (the "FRB") issued new guidance on the anti-tying provisions of the Bank Holding Company Act. In July 2004, the Securities and Exchange Commission (the "SEC") released proposed Regulation B to implement the so-called "push-out" provisions of the Gramm-Leach-Bliley act (the "GLBA"). Money laundering issues and implementation of the USA PATRIOT Act also continued to be a focus of regulatory attention.

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") continued to influence the concept of "corporate governance" and all banks with U.S. operations have begun to experience its effects whether or not they are specifically bound by its provisions as issuers of securities sold in U.S. markets. In May 2004, the U.S. federal banking regulators issued new guidelines for so-called complex structured finance transactions ("CSFTs"). The focus of the CSFT guidelines on the importance of strong policies and procedures is further evidence of a continuing U.S. regulatory emphasis on risk management and oversight issues. Similarly, the importance of adopting risk-based policies and procedures to implement the USA PATRIOT Act has been emphasized by U.S. regulators.

Basel II

On June 26, 2004, the Basel Committee approved a new version of Basel II, thereby concluding a five-year negotiation process that will result in more sophisticated international rules for determining minimum capital requirements for globally-active banks. In announcing its release, Jaime Caruana, Chairman of the Basel Committee and Governor of the Bank of Spain, stated that Basel II "represents an unparalleled opportunity for banks to improve their risk measurement and management systems…it builds on and consolidates the progress achieved by leading banking organizations and provides incentives for all banks to continue to strengthen their internal control systems".

Plans for implementation of Basel II have been met with skepticism by some U.S. regulators and government officials who have expressed concerns that Basel II's operational risk management objectives are better suited to a supervisory approach than to a quantitative measurement approach. U.S. critics of Basel II also note that it is likely to be adopted in the United States only by the largest banking organizations, which may then enjoy a competitive advantage over smaller institutions that would find the quantitative "advanced" Basel II approaches too difficult and costly to implement.

Anti-Tying Provisions

On August 25, 2003, the FRB issued proposed interpretation and guidance regarding Section 106 of the Bank Holding Company Act ("BHCA") prohibition on "tying" of certain services. Section 106 of the BHCA generally prohibits banks from conditioning a customer's purchase of one product on the customer's purchase of another "tied" product, particularly when the relationship between bank and customer involves both commercial banking and investment banking. The FRB's proposed interpretation seeks to clarify the scope of the anti-tying provisions by enumerating a range of "traditional banking products" that are exempt from Section 106. The guidance also outlines the types of internal procedures that would be appropriate to reduce the likelihood of "tying" violations and notes that non-banking subsidiaries of banks and bank holding companies are not directly covered by Section 106.

The continuing regulatory scrutiny of tying has led banks and their affiliates to review and update their internal controls and procedures to facilitate compliance with Section 106. Among the measures typically recommended for banks with U.S. operations have been the following: (1) Banks should review and update their anti-tying policies and procedures on a periodic basis; (2) Banks should make certain that their anti-tying training programs focus on "tying" in the context of their particular lines of business; and (3) Banks should make certain that they have in place internal audit procedures that could be used to detect specific "tying" violations.

Proposed Regulation B

On June 16, 2004, the SEC released its long-anticipated proposed Regulation B, with the objective of implementing the "push out" provisions of GLBA. Proposed Regulation B attempts to clarify the extent of the bank exemption from the definitions of "broker" and "dealer" of the Securities Exchange Act of 1934 (the "Exchange Act"), and therefore from the registration requirements of that Act. As a practical matter, Regulation B purports to determine which securities activities a bank must "push out" to a registered broker-dealer affiliate. When fully implemented, proposed Regulation B is likely to have a significant impact on banks with extensive trust and private banking operations, as well as banks with previously limited but expanding brokerage activities. Banks will need to consider whether their business lines consist of "identified banking products" which will continue to be exempt or whether their current and contemplated activities will need to be conducted in an existing broker-dealer affiliate or perhaps require the establishment of a new SEC-registered broker-dealer. Other Regulation B issues of particular interest include a proposed exemption for certain non-U.S. transactions, exceptions to the "chiefly compensated" requirement of the trust and fiduciary activities exemption, and the so-called "networking exemption." First, proposed Regulation B would exempt a bank from the definition of "broker" and "dealer" under the Exchange Act if it effects, as agent or as riskless principal, transactions in which eligible securities are sold to a non-U.S. person resident outside the United States in compliance with SEC Rule 903. This exemption, which was recommended by the Institute of International Bankers, would, subject to certain conditions, also permit a bank to effect the resale of certain eligible securities (a) by or on behalf of a non-U.S. person to another non-U.S. person or to a registered broker-dealer, or (b) by or on behalf of a registered broker-dealer to a non-U.S. person. However, this exemption would not permit banks to effect transactions involving U.S. persons other than registered broker-dealers.

Also significant is the exception that allows banks to effect transactions in a trustee or fiduciary capacity without registering as a broker, as long as certain conditions are met. One such condition that has been particularly controversial as proposed is the requirement that the bank be "chiefly compensated" for such transactions on the basis of (1) an administrative or annual fee, (2) a percentage of assets under management, (3) a flat or capped per order processing fee that does not exceed the cost the bank incurs in executing such transactions, or (4) any combination of the foregoing. Proposed Regulation B provides two exemptions, the "business line exemption" and the "account-by-account" exemption; from the "chiefly compensated" requirement. A bank would be exempt in any year that it can demonstrate that, during the preceding year, its ratio of "sales compensation" to "relationship compensation" was not more than one to nine; either for each business line or for the entire bank – the "business line exemption." Likewise, under the "account-by-account" exemption, a bank would be exempt from the "chiefly compensated" requirement with respect to a particular trust or fiduciary account in any year that the bank met the "chiefly compensated" requirement with respect to that account during the preceding year.

A third exception, the so-called "networking exception," would allow banks to collaborate with broker-dealers in offering financial services to the bank's customers. This limited exception allows bank employees who are not also registered representatives of a broker-dealer to receive, in connection with such networking activities, incentive compensation in the form of a "nominal one-time cash fee of a fixed dollar amount."

Regulation B is a highly-detailed and complex regulation that will undoubtedly be the subject of continuing discussion and controversy among banks that find themselves subject to its requirements. Other proposed exemptions set forth at Regulation B include a sweep account exception, an affiliate transactions limitation, a safekeeping and custody activities exception, and a general exemption for bank sales of money market securities to "qualified investors" and certain other persons.

USA Patriot Act

The past year has seen continued emphasis by U.S. government agencies on anti-money laundering initiatives. The Financial Crimes Enforcement Network ("FinCEN"), a bureau of the Treasury Department, has stated that money laundering through foreign shell banks continues to be a key area of concern, despite the adoption of extensive certification requirements for correspondent banking relationships that might possibly involve "shell banks." "Shell banks" are "brass plate" banks without a physical presence in any nation and banks and broker-dealers with U.S. operations are prohibited from opening accounts for them. Although the USA PATRIOT Act has put in place documentation requirements to ensure that U.S. banks and broker-dealers know the identity of owners of privately-held banks and other intermediaries that might possibly be "shell banks," the enhanced scrutiny of possible "shell bank" activities continues to be a prominent regulatory focus.

In July 2004, U.S. bank regulators released enhanced bank examination procedures relating to Section 326 customer identification programs ("CIPs"). Such CIPs are required to outline specific forms of required identification from individuals and entities that are bank customers. Like the focus on "shell banks," the July 2004 statement on Section 326 bank examination procedures highlighted a continuing focus on KYC issues by U.S. bank regulatory agencies.

While the failure of FinCEN and the other U.S. banking and securities regulatory agencies to adopt final rules for investment advisers, hedge funds and insurance companies; among others, has resulted in some uncertainty for banks that transact business with these entities as customers and transaction counterparties, the general trend among financial institutions in the U.S. has been to adopt a conservative approach to anti-money laundering issues based on the actual language of the USA PATRIOT Act, the various proposed rules and industry best practices.

Sarbanes-Oxley and Corporate Governance

Implementing Sarbanes-Oxley has resulted in higher expectations generally for corporate governance and business conduct in the United States. Whether or not the requirements are applicable as a strictly legal matter, the federal banking and securities regulators have applied Sarbanes-Oxley principles of accountability, high ethical standards and strong corporate oversight and responsibility to all aspects of conduct of a banking business in the United States.

Both the FRB and the OCC seem to have embraced the concept of broad applicability of Sarbanes-Oxley principles. The general view is that strictly legal approaches to questions of appropriate corporate government and business ethics may at times fall short of supervisory expectation. Increasingly, it seems likely that the U.S. supervisory process will emphasize the adequacy of a bank's internal control systems and risk management self-assessment policies and procedures. Banks will be expected to have in place adequate compliance policies, procedures and practices which are adopted, implemented and enforced by management. Further, they will be expected to create a management process capable of addressing issues that could lead to heightened legal, operational or reputation risks. The regulators have indicated their understanding that such risk management and internal control, policies and procedures will vary depending on the size and business activities of any particular bank.

One aspect of Sarbanes-Oxley that has been especially controversial and troublesome for international banks with U.S. operations is the Section 402 prohibition on loans to directors and officers. Reflecting a proposal recommended by the Institute of International Bankers, the SEC released in April 2004 a final rule exempting certain qualifying international banks from the Section 402 lending prohibition. The final rule states that insider loans making the rules requirements (i.e., loans made on arm's-length terms, made pursuant to employee benefit plans that do not discriminate in favor of executive officers, or made pursuant to home country supervisory approval) will satisfy the conditions of Section 402 regardless of whether an international bank's home country laws or regulations specifically contain comparable restrictions. The final rule provides that the condition concerning comprehensive consolidated supervision ("CCS") may be met on a country-by-country basis (i.e., so that an international bank issuer would satisfy the CCS requirement if any one or more international banks from its home country had received a CCS determination from the Federal Reserve Board and the issuer is subject to comparable supervision and regulation). The SEC removed the proposed rule's board of directors approval requirement, which would have required that an international bank's board of directors approve any loan that, when aggregated with all other loans to a particular insider, exceeded U.S. $500,000. Further, the new Form 20-F disclosure requirements regarding certain "problematic" loans to insiders have been revised in the final rule to allow issuers not to disclose the identity of the insider if a company's home country laws or regulations prohibit such disclosure. An issuer would be required to file a legal opinion confirming the existence of such a confidentiality requirement and make certain disclosures regarding the withholding of the confidential information.

In connection with its revised treatment of certain loans for Section 402 purposes, the SEC also adopted a broad definition of "foreign bank" (i.e., a definition substantially similar to the definition in Subpart B of the FRB's Regulation K, which, among other things, removes the requirement in the proposal that the bank be substantially engaged in deposit-taking activities). The final rule also expands the scope of the exemption: (i) to cover loans by an international bank to its insiders or those of its parent or other affiliates, and (ii) to cover loans made by subsidiaries of an international bank if the subsidiary is under the supervision or regulation of the bank supervisor in the international bank's home jurisdiction.

Risk Management Procedures and Internal Controls for Complex Structured Finance Activities

On May 19, 2004, the FRB, Comptroller of the Currency, SEC and other U.S. federal banking agencies issued proposed supervisory guidance regarding risk management procedures and internal controls for complex structured finance transaction ("CSFT") activities of U.S. financial institutions, including U.S. broker-dealers and banks. The proposed guidance (the "CSFT Guidance") would also apply to broker-dealer subsidiaries of international banks and to the U.S. branches and agencies of international banks that engage in CSFT activities.

The CSFT Guidance notes that a financial institution's board of directors has ultimate responsibility for establishing the "institution's risk tolerance for CSFTs and ensuring that a sufficiently strong risk control framework is in place to guide the actions of the financial institution's personnel." The proposed statement provides sample characteristics of CSFTs that should indicate a heightened level of legal or reputational risk requiring heightened scrutiny by the institution. The CSFT Guidance urges institutions to "establish a clear process for identifying those CSFTs that involve heightened legal and reputational risk," and to have a review process that can adequately assess the appropriateness of going forward with such a transaction. Finally, the proposed statement strongly encourages each financial institution's board of directors to implement a code of professional conduct that sets forth the institution's internal controls and expectations for conduct by its personnel concerning CSFTs.

The international banking industry raised a number of concerns with the proposed CSFT Guidance, as indicated in the Institute's July 19, 2004 comment letter. The comment letter reminded the Agencies that U.S. branches and agencies of foreign banks are not separately incorporated and do not have separate boards of directors. The proposed CSFT Guidance seems to treat branches and agencies as distinct financial institutions when this is not typically the case. In addition, the Institute urged the agencies to recognize that an international bank's U.S. risk management policies and procedures necessarily will need to be adapted to the bank's global policies and procedures, as informed by home country legal, regulatory and supervisory requirements.

Tax Matters

Partnership Withholding Tax

The Institute commented on the Treasury Department's proposed regulations under Section 1446 of the Internal Revenue Code of 1986 (the "Code"). The proposed regulations concerned the obligation of a partnership to pay a withholding tax on "effectively connected taxable income" allocable under Section 704 of the Code. The Institute agreed with several commenters that the proposed regulations should be revised to permit a partnership – in appropriately circumscribed situations and subject to specific conditions designed to ensure that any tax owed will be paid – to take account of losses or other favorable tax attributes of a foreign partner in determining the amount of tax to be withheld under Section 1446, so that such Section 1446 tax may more closely approximate the foreign partner's actual tax liability. The Institute noted that U.S. branches of foreign banks are highly regulated and scrutinized by bank examiners as to compliance with U.S. law, including tax obligations. In light of such close regulatory oversight, the Institute requested the Treasury Department to modify the proposed regulations to provide a mechanism whereby a partnership could reduce the amount of Section 1446 tax it withholds in respect of a partner that is a foreign bank having a U.S. branch, upon receiving a notice from the bank certifying its status and informing the partnership about the appropriate amount of Section 1446 withholding tax. Additionally, the Institute requested that the Treasury Department modify the proposed regulations to provide that the U.S. branch of a foreign bank or a U.S. affiliate may, subject to meeting certain conditions regarding the amount of assets and number of personnel in the United States, enter into an agreement with the IRS to pay any Section 1446 tax that may be due in respect of a partnership investment by another member of the group.

Global Dealing

The Institute and the Securities Industry Association ("SIA") jointly commented on proposed regulations by the Treasury Department and the Internal Revenue Service concerning the allocation of profit and loss from global dealing operations. The joint recommendations cover issues raised by deemed qualified business units ("QBUs"), the appropriate treatment of capital, and the profit allocation methods specified in the proposed regulations.

The comment letter noted the proposed regulation's treatment of QBUs could increase the risk of multiple taxation, administrative burden, and the risk of penalties on foreign participants. In response the Institute and the SIA recommended that, in the case of global dealing operations conducted through separate legal entities, the proposed regulations be revised to provide for a single-step allocation of income or loss (in contrast to the proposed regulation's two-step allocation) among the legal entities involved.

The comment letter goes on to recommend that the proposed regulation's treatment of capital be clarified to state clearly and in keeping with industry practice that (1) a capital provider may be a global dealing participant and may receive an allocation of residual profit or loss, after compensating trading and other functions under an appropriate methodology; (2) the allocation of profit or loss to the capital provider (who is treated as a participant) should be based on a functional analysis of the type and degree of risk borne by the capital provider; and (3) operating profit or loss be reduced by the "cost of carry" prior to allocation under one of the profit allocation methods (the "cost of carry" is an amount charged by the firm's internal treasury function to the global dealing participant that provides the capital and serves as the booking location). The comment letter also urges that the proposed regulations be revised to better coordinate the treatment of interest expense under Code Section 1.882-5 with the profit split method.

Finally, the comment letter notes that the traditional profit allocation methods outlined in the proposed regulations – the comparable uncontrolled financial transaction, gross markup and gross margin methods – cannot be applied to allocate profit and loss from a global dealing operation that follows a "non-transactional" model, i.e., an operation in which two or more participants combine their resources to create and sell a financial product to an unrelated customer and to hedge any risks associated with the product. In response to this deficiency, the Institute and the SIA recommended that the proposed regulations be revised and expanded to include a wider range of profit allocation methods including a profit-based compensation method, a hedge fund method, a bid/ask spread method and other unspecified methods.

The Department of the Treasury and the Internal Revenue Service are expected to issue final global dealing regulations before the end of 2004.

Earnings Stripping

Both the tax bill that was passed by the Senate and the bill that was reported out by the House Ways and Means Committee follow the approach advocated by the Institute of not changing the current law's general "earnings stripping" rules under Code Section 163(j). The Senate bill, however, contains a provision that would expand the earnings stripping rules applicable to partnerships. Section 462 of the Senate bill would revise Code Section 163(j) to (1) attribute partnership items to corporate partners on a look-through basis but then provide (2) that if an interest deduction is not disallowed on that basis, Section 163(j) will then be applied to the interest in the partnership separately (meaning that partnership interest deductions cannot exceed Section 163(j) limits as applied to the partnership income allocated to the corporate partner). Because of concerns with the language, the Institute of International Bankers and others are seeking revisions to this provision.

Funding the Activities of Bank Supervisory Authorities

The Office of the Comptroller of the Currency (OCC) as well as a number of state banking departments are funded through assessments paid by the regulated institutions independent of the government's general budget process. Similarly, banking departments in New York and other states are also funded through such assessments, but the departments are nevertheless subject to the government budget process, including any spending freezes. The Federal Reserve System's bank supervisory activities are funded through the central bank's own budget process, while the Federal Deposit Insurance Corporation is funded through deposit insurance assessments.