Financial Sector Legislation, Regulation and Infrastructure: Implications for Pre-Accession countries

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Abstract:

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Case study: Българската пенсионна реформа - тенденции и законодателство

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1. Contemporary achievements in Financial Sector Legislation and Regulation

1.1. A framework of the Financial Sector Legislation and Regulation

Financial sector stability is with crucial importance for all pre-accesion countries. This includes the compliance of the regulatory and supervisory framework for the financial sector and of its implementation with international standards. Under the framework of the International Monetary Fund and the World Bank joint Financial Sector Assessment Programme (FSAP) already are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, Bulgaria and Slovakia. Five major areas are assessed in the FSAP of IMF and the WB:

Standards and Codes Assessed in the FSAP of IMF&WB				
Transparency in Monetary and Financial Policies (MFP)	Banking Supervision (BCP)	Securities	Insurance (ICP)	Payment System (SIPS)
Source: FSAP, 2000, http://www.imf.org/external/np/fsap/2001/review.htm				

Transparency is not an end in itself, nor is transparency a substitute for pursuing sound policies; rather, transparency and sound policies are better seen as complements. This standards and codes go beyond transparency to promote good policies, notably the *Core Principles for Effective Banking Supervision* formulated by the Basel Committee for Banking Supervision, the *Objectives and Principles of Securities Regulation* formulated by the International Organization of Securities Commissions (IOSCO), and standards being developed by the Committee on Payment and Settlement Systems (CPSS), the International Association of Insurance Supervisors (IAIS), and the International Accounting Standards Committee (IASC).

According findings of the FSAP for candidate countries:

- Macroeconomic volatility and distortions introduced in the economy by external shocks or poor management are placing stress on financial intermediaries in some countries.
- In many countries, FSAP assessments have highlighted the need for strengthening the framework for banking supervision in order to enhance financial system stability.
- Public sector banks have often been identified as over-exposed to credit risk or requiring recapitalization.
- Analyses of securities markets have revealed important deficiencies. Weaknesses tend to be concentrated in supervision, settlement systems, corporate governance and sovereign debt management. Accordingly, follow up action to date has focused on building securities market infrastructure and institutional capacity.
- Judicial reform has been identified as a key developmental priority, particularly with respect to facilitating access to credit, enacting collateral law and speeding up debt recovery

1.1.1. Monetary and Financial Policies (MFP)

The focus of the FSAP for MFP is on transparency. The good transparency practices for the formulation and reporting of monetary and financial policies help to contribute to the adoption of sound policies. According "Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles" (1999) macroprudential analysis aims to highlight the two-way linkages between macroeconomic performance and financial sector soundness. Macroprudential indicators (MPIs) comprise both aggregated microprudential indicators of the health of individual financial institutions (e.g., capital adequacy, earnings and solvency), and macroeconomic variables associated with financial system soundness (e.g., volatility in exchange rates and interest rates). Therefore aggregated microprudential indicators have been found to be primarily contemporaneous or lagging indicators of soundness; macroeconomic variables can signal imbalances that affect financial systems, and so tend to be leading indicators. As a results for all pre-accession countries financial crises usually can occur when both types of indicators point to vulnerabilities, that is when financial institutions are weak and face macroeconomic shocks.

Good transparency practices for monetary policy by central banks [1] includes four major sections:

I. Clarity of Roles, Responsibilities and Objectives of Central Banks for Monetary Policy
II. Open Process for Formulating and Reporting Monetary Policy Decisions
III. Public Availability of Information on Monetary Policy
IV. Accountability and Assurances of Integrity by the Central Bank

Good transparency practices for financial policies by financial agencies is also based on four sections:

I. Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies
II. Open Process for Formulating and Reporting of Financial Policies
III. Public Availability of Information on Financial Policies
IV. Accountability and Assurances of Integrity by Financial Agencies

1.1.2. Banking sector legislation and supervision

There is a two-level bank system comprising of a central bank and commercial banks in all pre-accession countries. Practice has shown that the Central Bank laws provide for a substantial part of the rules and regulations for banking activities in those countries. Respective ordinances serve as regulatory legislative instruments providing for the activities of the commercial banks. These ordinances comply with the legislative norms of the EU and specifically the recommendations of Ecofin.

In **Bulgaria** the legal framework for the BNB is provided mainly by the Law on the Bulgarian National Bank (June 1997) and by the Law on Banks (June 1997). Certain issues concerning the activities of the BNB are covered by the Law on Bank Deposit Guarantees (April 1998) and the Law on Foreign Exchange (September 1999). These laws are implemented via several BNB regulations (1997-2000).

The legal framework governing the activities of The Central Bank of Cyprus (CBC) is comprises the Banking Law (No. 66 (I) of 1997), This law sets the legal framework

[1] Source: http://www.imf.org/external/np/mae/mft/code/index.htm

within which banking business may be conducted and to a large extent reflects the principles and rules of European Union (EU) banking directives.[2]
Three basic laws provide the framework for the activities of the central bank in the **Czech Republic**: Act No. 6/1993 Coll.1 on the Czech National Bank (as amended by the Act No. 442/2000 Coll.1); Act No. 21/1992 Coll.1 on Banks (as amended ten times between 1992 and 1998); The Foreign Exchange Act No. 219/1995 Coll.1

In Czech Republic the Act on the CNB and the Act on Banks define these entities and provide the legal framework for their activities. The Foreign Exchange Act stipulates the rights and obligations of residents and non-residents in foreign exchange relations, the conditions for foreign exchange licenses and permits, and the foreign exchange supervision provided by the CNB and the Ministry of Finance (MoF).

The main national laws, regulations and specific provisions that provide the framework for the activities of the Bank of **Estonia** are: the Constitution of the Republic of Estonia, effective from 3 July 1992, Articles 65, 74, 78, 104, 111 and 112; the Law on the Central Bank of the Republic of Estonia, effective from 18 June 1993, amended version effective from 7 May 1994; the Credit Institutions Act (provides the legal basis for the establishment, activities and dissolution of credit institutions and the principles and legal basis for the supervision of credit institutions), effective from 20 January 1995, new version effective from 1 July 1999; the Law of the Republic of Estonia on the Security for the Estonian Kroon (EEK), effective from 20 June 1992; the Currency Law of the Republic of Estonia, effective from 20 June 1992/ the Statute of the Bank of Estonia, effective from 4 September 1996

Act LX of 1991 on the National Bank of **Hungary** (ANBH) – as amended by the Acts LXIX and LXX of 1992, IV of 1994, CV of 1995, CXLVI of 1997 and CLVIII of 1997 – provides the framework for the activities of the NBH. Parliament passed the ANBH in order to strengthen the stability of the Hungarian currency, the operation of the domestic payments system, the internal and external financial equilibrium of the national economy, its lasting development and international integration. Act XCV of 1995 on Foreign Exchange (AFE) designates the NBH as the sole authority for foreign exchange transactions.

Specific accountancy rules of the NBH are contained in the Government Decree 18 of 1997 on the Accounting of the NBH and its amendments.

The Bank of **Latvia**, Latvia's central bank, is a public law entity established by Parliament (the *Saeima*, the former Supreme Council) and operates under the Law on the Bank of Latvia (adopted on 19 May 1992 and amended in 1997, 1998 and 1999).

The framework for the activities of the Bank of **Lithuania** (BoL) is the Law on the Bank of Lithuania (Law on the BoL, adopted on 1 December 1994, No. I-678, and the Law on the Credibility of the Litas (adopted on 17 March 1994, No. I-407).

The Central Bank of **Malta** Act (CBM Act) of 1967 established the CBM as a corporate body having a distinct legal personality. The CBM was formally established

[2] Acknowledgments are due to the European Central Bank for the comprehensive information about current legal status of banking systems of all apllicant countries (see references)

with the promulgation of a Legal Notice in April 1968 which brought most sections of the CBM Act into force.

Under the Constitution of the Republic of **Poland** of 2 April 1997 (Article 227), the NBP is the central bank of the State and has the exclusive right to issue legal tender as well as to develop and pursue monetary policy. The NBP acts in accordance with the Act on the NBP of 29 August 1997.

The framework for the activities of the National Bank of **Romania** (NBR) – is laid down by Law No. 101/1998 regarding the Statute of the NBR and Law No. 58/1998 (the Banking Act).

The Legal background of the **Slovak** banking system are The National Bank of Slovakia (NBS) Act, The Banking Act No. 21/1992 Coll.1, as amended by Act No. 264/1992 Coll., Act No. 249/1994 Coll., Act 374/1994 Coll., Act No. 58/1995 Coll., Act No. 233/1995 Coll., Act No. 58/1996 Coll., Act No. 118/ 1996 Coll., Act No. 386/1996 Coll., Act No. 12/1998 Coll., Act No. 44/1998 Coll., Act No. 170/1998 Coll. (Act No. 278/1998 Coll.: the full wording) and Act No. 252/ 1999 Coll; Act of the National Council of the SR No. 118 dated 20 March 1996 on the protection of bank deposits, with amendments to other related laws, as amended by Act No. 154/1999 Coll., which covers the Deposit Protection Fund itself, contributions to the Fund and compensation for inaccessible deposits; The Foreign Exchange Act of the National Council of the SR No. 202 dated 20 September 1995, as amended. The Housing Savings Act No. 310/1992 of the Code, as amended.

The Legal background of the **Slovenian** banking system are the Law on the Bank of Slovenia, Official Gazette No. 1/1991, 5 June 1991 (Law on the central bank with articles explicitly authorizing the central bank to collect and process data on monetary and credit activities), Law on Banking, Official Gazette No. 7/ 1999, 5 February 1999 (National banking law that regulates the conditions for the establishment, operation, supervision and winding-up of banks and savings banks. It includes provisions on regular monthly reporting by banks to the central bank), The Foreign Exchange Act, Official Gazette No. 23/1999, 8 April 1999 (The Act regulates (i) transactions between residents and non-residents involving domestic or foreign means of payment, (ii) transactions between residents involving foreign means of payment or transactions whose object is the foreign means of payment themselves and (iii) unilateral transfers of assets to or from the Republic of Slovenia which do not represent transactions between residents and non-residents), The Securities Market Act, Official Gazette No. 56 /1999, 13 July 1999 This act regulates the national securities market. It covers specific responsibilities relating to banks' activities in securities trading, bankruptcy, guaranteed claims of investors, supervision tasks as well as the acquisition of data and information on securities trading.

The Law of the Central Bank of **Turkey** is accepted on January 14, 1970 (Law No 1211), (It was amended several times by: amended by Law No.3098 of December 6, 1984; Law No. 3291 of May 28, 1986; Law No. 3670 of October 25, 1990; Law No. 3985 of April 21, 1994; Law No. 4389 of June 18, 1999; Law No. 4651 of April 25, 2001)

1.1.3. Securities and capital market

The financial sectors and especially the capital markets of pre-accession countries are in different stage of their development. The process of accession to the EU require from all pre-accession countries to adopt their economic systems to the principles of stage 3 of EMU. Financial markets are one of the important parts of this system.
For an economy a liquid, efficient and transparent capital market is important for an efficient resource and risk allocation and encourages investments, particularly for pre-emerging markets. The providing and the processing of financial information create transparency, developed capital markets and efficient resource and risk allocation.

In early 1989, the secondary market price of the external bank debt of the initial Brady plan countries was quoted at only 40 cents per dollar originally lent. Private capital flows were largely limited to concerted lending or arrears. Some observers even argued that the heavily indebted emerging market countries might not be able to regain access to private international financial markets for a generation. Instead, the 1990s have witnessed a totally unexpected transfer of capital to emerging markets.

The extent of positive correlation between the EU capital markets and the capital markets of the pre-accession countries is expected to grow as the accession process progresses. The extent of the exchange risk is an important factor influencing the amount of capital inflows in all pre-accession countries. With the introduction of the EURO the pre-accession countries are able to develop a range of scenarios for reduction of the exchange risk for EU investors. This includes adoption of various legislative regulations and linking their national currencies with the EURO.

Pre-accession markets research for fixed income instruments - theoretical considerations

The large-scale capital flows to emerging markets in the 1990s stimulated various empirical studies that sought to identify the key factors driving those transfers. These studies have typically divided the factors influencing capital flows into so-called push and pull factors (Fernandez-Arias, 1996: 389-418). Push factors encompass both structural and cyclical developments in international (mainly mature) financial markets that have led investors to diversify their portfolios internationally and seek higher yields in emerging markets. Pull factors refer to the macroeconomic and structural policies in emerging markets as well as other political and non-economic developments that have increased the perceived creditworthiness of debtors in developing markets.

The scale and composition of the capital flows to emerging markets in the 1990s have been influenced by a series of ongoing structural changes in international financial markets. Clearly, the most important change has been the growing liberalisation of domestic financial markets and capital account transactions in both mature and emerging market economies.

The fundamental concept in the valuation of fixed income instruments is arbitrage defined as the simultaneous purchase and sale of the same, or essentially similar, securities in two different markets taking advantage from different prices. Such arbitrage requires no capital and entails no risk. An arbitrageur simultaneously buys a fixed income instrument and sells it a higher price in another market. He thus realises an immediate profit while no future cash flows are generated. The importance of arbitrage trading lies in its driving prices towards fundamental values and keeping markets efficient. This robust methodology can be used to develop valuation models and to analyse spreads. It is very useful to analyse economies with pegged exchange rate arrangements which many pre-accession countries have established; pegs can be linked to a single currency (the Euro) or to a currency basket. So we are able to use for arbitrage mechanisms securities from mature capital markets. Arbitrage models can cover any fixed income instrument, provided that face value, interest coupon, maturity and market price are known.

Pre-accession market research for equities and investment decisions -theoretical considerations

Risked avers rational investors make their investment decisions following one basic strategy: They try to hold a risk-efficient portfolio. For a given risk they invest in the portfolio with the highest expected return, or for a given expected return they realise the portfolio with the lowest risk. Risk is measured as the deviation of expected return. The portfolio selection model, presented in any textbook on finance and investment, gives the explanation of such rational investment decision.

The key finding of the portfolio selection model is that depending on the covariance of returns a risk reduction can be achieved by combining several securities. Those risks that cannot be eliminated by diversification are categorised as systematic risk or market risk. Opposite to market risk, the unsystematic risk, which is specific to each kind of equity, can be eliminated by diversification. An economic interpretation of the systematic risk could describe it as a concurrent effect of macroeconomic influences on all returns on equities. The unsystematic risk exclusively depends on company-specific causes and only affects the returns of the observed company's equities.

The portfolio selection model is primarily applied to investment decisions in traded securities. For equities traded on mature markets, series of historical prices and, by implication, returns do exist over a sufficient period of time. For these securities it is possible to calculate the required variances and covariance. For emerging capital markets, however, especially on various central European securities exchanges, these data sets do not exist.

The Capital Markets in the Context of EU Accession

The main institutions supporting the capital market are:

- The Stock Exchange;
- The Central Depository;
- The State Securities Commission.
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According the practise of predominant number of pre-accession countries all three institutions needs very clear legislative support. The most serious difficulties facing these institutions comes from the forces that are creating pressures that are slowing development of open and transparent market (Petranov, S., Miller, J., 1999:11)

According legislation practice the CD must organize and maintain reliable systems for:

- dematerialized shares book-entry registration

- maintain shareholders' registry of the companies traded
- maintain a registry of the securities traded
- immobilize share certificates that are a matter of public trading
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As a coordination institution the Central and Eastern European Central Securities Depositories Association (CEECSDA) was established in 1998. The main goal of the association is to share experiences, to find common solutions and set up common principles for efficient and safe securities settlement within the Central and Eastern European region.

Bulgaria	Central Securities Depository AD (CD AD)	***www.cdad.bg***
Cyprus	Self-regulation (Unit of Cyprus Stock Exchange)	***http://www.cse.com.cy/***
Czech Republic	Securities Centre UNIVYC Ltd. Czech Securities Commission (CSC)	***www.scp.cz*** ***www.pse.cz/Univyc*** ***http://www.sec.cz/***
Estonia	Estonian CSD Ltd.	www.depo.ee
Hungary	Central Clearing House and Depository (Budapest) Ltd.	***www.keler.hu***
Latvia	Latvian Central Depository	***www.lcd.lv***
Lithuania	Central Securities Depository of Lithuania (CSDL)	***www.csdl.lt***
Malta	Central Securities Depository (Unit of Malta Stock Exchange)	***http://www.borzamalta.com.mt/***
Poland	National Depository for Securities (NDS)	***www.kdpw.com.pl***
Romania	National Securities Clearing, Settlement and Depository Company Bucharest Stock Exchange	***www.sncdd.ro*** ***www.bvb.ro***
Slovakia	Centre for Securities of the Slovak Republic (SCP)	***www.scp.sk***
Slovenia	Central Securities Clearing Corporation (CSCC)	***www.kdd.si***
Turkey	ISE Settlement and Custody Bank Inc. (Takasbank)	***http://www.takasbank.com.tr/***
Source: http://www.ceecsda.com/		

All efforts on securities regulations are established under the framework of the IOSCO (the international organization of security regulatory agencies, seld-regulatory organizations and international institutions) objectives and principles endorsed at its annual meeting in 1998.

The three core objectives of securities regulations (as a part of financial sector regulation) are:

- The protection of investors;
- Ensuring that markets are fair, efficient and transparent:
- The reduction of systematic risk (Elliott, Clark, Roth, 2002:12).

1.1.4. Insurance sector assessment

Insurance and the Insurance Core Principles (ICP) developed by the International Association of Insurance Supervisors (IAIS) are largely introduced in EU practice and candidate countries too. The FSAP provides the ICP assessments a useful context for assessing stability and development needs of the insurance system[3].

As a results of the FSAP the most commonly made recommendations are related to:

- Organization of an Insurance Supervisor: Increase the number of staff in the authority; improve the quality of staff (training and recruiting) and the supervisory framework; enhance the independence of the supervisor; strengthen indemnity of the supervisory staff.
- Licensing: Increase the supervisor's authority and role; strengthen licensing criteria; tighten up the rules on composite companies; set rules for changes in control to be similar to licensing requirements.
- Prudential Rules: Strengthen investment rules and limits; upgrade rules for valuation of liabilities; strengthen capital requirements; define rules for the use and disclosure of derivatives; enhance supervision of reinsurance arrangements.
- Corporate Governance: Clarify or define what is expected of boards of directors; establish risk management practices.

1.1.5. Payment Systems

Every EU pre-accession and member country has at least one payment system whose role in the economy is so critical that it is regarded as a Systemically Important Payment System (SIPS). The Core Principles for Systemically Important Payment Systems (CPSIPS, or principles) have been drawn up by the G-10 Governors' Basle-based Committee on Payment and Settlement Systems (CPSS) as universal guidelines to encourage the design and operation of safe and efficient SIPS worldwide. They are widely accepted in various regulation documents of EU

The core principles for SIPS are:

I. The system should have a well-founded legal basis under all relevant jurisdictions.
II. The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.
III. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.
IV. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.
V. A system, in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.

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[3] Source: http://www.imf.org/external/np/mae/ins/2001/eng/index.htm#t1

VI. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.

VII. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.

VIII. The system should provide a means of making payments, which is practical for its users and efficient for the economy.

IX. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.

X. The system's governance arrangements should be effective, accountable and transparent (See: Barvell and others, 2002:19).

2. Pre-accession Countries Developments of Financial Sector Legislation, Regulation and Infrastructure

According finding in recent regular reports on progress towards accession there are still many differences in various negotiating areas, and especially in financial sector chapters. Bellow is given a brief description of financial sector legislation, regulation and infrastructure for all 13 pre-accession countries.

2.1. Bulgaria

In Bulgaria efforts will have to be continued to create a stable and efficient financial sector.[4] Bulgaria has maintained the stability of its banking system and developed sound banking supervision practices through the Bulgarian National Bank's Banking Supervision Directorate. The higher share of loans to private enterprises in the total lending to trade and industry (over 77%) is a positive sign, as is the declining share of loans to the public budget and state enterprises. The structure of the banking system has changed with the share of private banks reaching 81% at the end of 2000. The largest Bulgarian commercial bank, Bulbank, was privatised at the end of 2000. A number of formerly privatised banks have already changed majority ownership, attracting foreign banks. The share of foreign-owned bank assets is thus around 73%. The privatisation of the banking system has resulted in a more competitive environment which, for instance, has triggered an upgrading of information systems of commercial banks, thus creating conditions for higher quality services and modernisation of the product range. There is also a substantial increase in the demand for credit cards and international debit cards in the country. Risk evaluation capacities should however be improved. There is still a shortage of know-how in the banking sector that needs to be addressed, even though the Institute of the Bulgarian Banking Association is carrying out intensive training programmes. Despite the progress made in adopting securities legislation, the capital market has not developed further. The Securities Commission as a regulator of the capital market, will need further training, particularly since its management was renewed in May 2001.

Bulgaria also needs to complete significant further steps in alignment with the *acquis* in the insurance sector. The situation in terms of transposition of EC insurance *acquis*

[4] The information bellow is based on: 2001 Regular Report on Bulgaria's Progress towards Accession (document No SEC (2001) 1744, Brussels, 13.11.2001

is still lagging behind as only the first generation Directives have been transposed so far. The privatisation of the biggest state-owned insurance company has not yet taken place. Bulgaria still needs to develop a competitive insurance market. The staff of the newly created agency for supervision over insurance and gambling is in urgent need of training to carry out its tasks. The legitimacy of this agency is in any case open to question as long as it remains responsible for supervision of both insurance and gambling. However, the Government has just announced its intention to separate these responsibilities.

Bulgaria has achieved substantial alignment of its national legislation with EC legislation in the field of free movement of capital.

Almost no progress was observed in the area of **payment systems,** although the start of work to establish a real-time gross settlement system (RTGS) is a small but positive step.

In the area of **money laundering,** the amendments to the Law on Measures against Money Laundering reorganised the Bureau of Financial Intelligence into a state agency. This Bureau is entirely financed by the State Budget and reports annually to the Minister of Finance.

2.2. Cyprus

The Central Bank as the regulator of the banking industry has issued rules and is implementing policies and practices which are similar to the Recommendations of the Basle Committee of Banking supervision and broadly in line with EC directives.[5] The Banking Law empowers the Central Bank to exchange information with foreign as well as with national supervisory authorities. The Law contains extensive enforcement powers and penalties, which include the power to revoke a licence. The supervisory process includes both on-site examination and offsite monitoring. Upon accession the authorisation requirement with respect to the “economic need criterion” which the Central Bank may presently apply should be waived and the exchange of information with non-banking supervisory authorities and the notion of large exposure should be streamlined. Due care should also be given to the timely implementation of the agreed profound restructuring of the Co-operative Credit and Saving Societies sector. Furthermore, it will be important to make sure that branches of Cypriot banks which may set up in other EU countries are providing their customers with the same level of deposit guarantee as offered in Cyprus.

As regards the *insurance sector,* some basic features of the EC supervisory system are covered by the current legislation. Cyprus should finalise the transposition of the Non-Life and Life Insurances Directives and complete its reform of the legal bases for insurance supervision; it should provide adequate staffing for its supervisory bodies. In addition, further alignment is needed as regards accounting rules.

The computerisation of the Insurance Companies Control Service (ICCS) of the Ministry of Finance and an appropriate training of members of staff in using the

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[5] The information bellow is based on: 2001 Regular Report on Cyprus' Progress towards Accession (document No SEC (2001) 1745, Brussels, 13.11.2001

developed system facilities has been started in late 2000. New posts have been awarded to the ICCS in June 2001 so that the additional recruitment of 11 staff members is expected for 2002.

In the field of *investment services and securities markets,* in order to align Cypriot law with the *acquis,* there is still a need for certain amendments to the Securities and Stock Exchange Laws, e.g., to ensure that the Securities and Exchange Commission is able to exchange information and co-operate with other competent authorities. In particular, Cypriot authorities are encouraged to immediately transpose the two key Directives in this area: the investment services and the capital adequacy Directive, both of which are due to be transposed in autumn 2001. Furthermore, harmonisation is needed with regard to investor compensation and prospectuses.

The Council of the Stock Exchange and the Securities and Exchange Commission (SEC) are the relevant competent authorities for the implementation and supervision of the Stock Exchange Laws and Regulations. Given that their powers and human resources have been extended it is likely that the implementation record will make progress.

The overall standard of supervision in the *financial service sector* in Cyprus appears to be satisfactory. Cyprus is encouraged to continue the effective implementation of the *acquis* in particular as regards the establishment of the necessary administrative and regulatory infrastructure to ensure an efficient and well-supervised financial sector.

However, the efforts in aligning with the *acquis* in the field of capital movements must continue to ensure a proper functioning of the markets from the date of accession. A timely and orderly removal of remaining restrictions for capital movements is essential to avoid the risk of sudden disruptions in the financial markets upon accession. This point refers to, portfolio transactions, financial credits and the opening of deposits abroad. The abolition of the statutory limit in interest rates and their determination as of January 2001 by the Central Bank should facilitate the process of liberalisation.

Concerning cross border credit transfer Cypriot legislation has been aligned with the relevant Directive through the amendments to the banking law of June 2000 and the instructions of the Central Bank of November 2000 thereunder. The mechanism to settle disputes foreseen in Art. 10 of the Directive has also been established.

As regards **prevention of the use of the financial system for money laundering,** an amendment of November 2000 implements the EU Joint Action of 3 December 1998 on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds from crime.

2.3. Czech Republic

In the banking sector of Czech Republic, an important amendment to the Act on Banks, dealing with regulation and banking supervision, has been delayed.[6] Therefore

[6] The information bellow is based on: 2001 Regular Report on the Czech Republic's Progress towards Accession (document No SEC (2001) 1746, Brussels, 13.11.2001

further action is still required, in particular to provide for the principle of a single banking licence, consolidated supervision, enhanced cooperation with foreign supervisors, and exchanges of information. As noted in the previous Regular Report, the Czech Republic also needs to make progress by adopting the new Act on Payments. Alignment in the sphere of accounting has been improved by adoption of the amendment to the Act on Accounting which applies across a range of financial organisations.

Further legislative steps concerning Insurance Contracts, Insurance Advisors and Loss Adjusters will be necessary to complete alignment in the insurance sector. The Czech Republic has yet to transpose some of the main objectives of the third-generation life and non-life directives. The process of de-monopolisation of the insurance industry continues. The Act on Liability Insurance for Damage Caused by Operation of a Vehicle and Amendments to the Third-Party Motor Liability Insurance Act which entered into force between July 1999 and January 2000 have contributed to alignment in their particular fields. Improvements need to be made in the area of registration and further changes will be necessary to align fully with the Fourth (Motor) Directive. In addition, steps will have to be taken to ensure the separation of life from non-life insurance activities.

In the area of *investment services and securities' markets*, important progress has been made with the amendments to the Acts on Securities, Bonds and the Stock Exchange. Further measures will be necessary to complete harmonisation of the securities market with the acquis, addressing issues such as co-operation between the Czech Securities Commission and those in Member States and the minimum level of investor compensation. As stated in the 2000 Regular Report, the Czech Securities market still suffers from the structural problem of the "two prices" system, which will need further attention.

The Ministry of Finance is responsible for drafting legislation relating to the capital market, whereas surveillance of the market falls within the remit of the Securities Commission, which was established 3 years ago. Staffing of the Securities Commission is now largely adequate, with no significant increases planned. A code of best practice was recently approved and a new Department (on Mandatory Buy-Outs and Commercial Code subjects) established.

Stronger regulatory powers for the Securities Commission and an extension of the scope of its activities would improve the transparency of Czech financial markets.

Concerning **payments systems,** alignment with the *acquis* remains to be completed in the area of securities' settlement systems. A body responsible to handle customer complaints on cross border credit transfers remains to be established.

As regards **money laundering**, existing anonymous accounts (bearer passbooks) have still to be abolished. The Czech Republic will amend its Banking Act in order to discharge existing bearer passbooks, but it needs to shorten the period during which existing anonymous accounts can still be used.

2.4. Estonia

In the *banking and securities* fields in Estonia, issues which remain to be settled concern the inclusion of commodities and commodity derivatives in the existing capital adequacy regime, as well as provisions allowing for the recognition of contractual netting.[7] An overall revision of capital adequacy standards has been announced for 2001. The monitoring of operational risk needs to be addressed in this context. As regards securities and investment services in particular, in order to implement the Securities Act adopted in October 2001 in practice, a large number of regulatory provisions will be needed to bring Estonian legislation in conformity with the *acquis*.

This regards, in particular, requirements for capital adequacy of investment firms, reporting and information to be published by companies for stock-exchange listing. With regard to banking, specific attention should be paid to preparing the deposit guarantee scheme for the situation in which it will have to cover deposits of Estonian banks in other EU countries. In the *insurance* field, considerable progress is reported above. Nevertheless, some of the main objectives of the third generation of the life- and non-life-directives are not yet fully transposed (e.g. the complete abolition of prior approval of terms and conditions of contracts and tariff rates for obligatory insurance). Legal transposition is also required in the field of supplementary supervision of insurance undertakings in an insurance group, as well as in the field of annual accounts and consolidated accounts of insurance undertakings. Furthermore, efforts are necessary to prepare a prudential framework for the future implementation of the principle of mutual recognition when it comes to cross-border insurance business within the EU.

As regards **payment systems**, Decree no.2 of the President of the Bank of Estonia was adopted in May 2001 to partially transpose the Directive on cross-border transfers. The Law on Contractual and Non-contractual Relations, adopted in September 2001, introduced further alignment with the *acquis*. However, the introduction, under the responsibility of the Bank of Estonia, of a new interbank payment system based on a Real Time Gross Settlement (RTGS) system for large value payments and a Designated-time Net Settlement (DNS) system for retail payments, experienced delays.

In October 2000, the **Money Laundering** Prevention Act was amended, in particular to specify the tasks and obligations of the Money Laundering Information Office and the client identification requirements. Casinos and real estate undertakings were directly brought into the act as potential subjects of money laundering.

2.5. Hungary

In the field of **financial services**, new legislation on the credit institutions passed at the end of 2000 has achieved quite a number of further alignments in the *banking sector*, with the exception of those parts of the *acquis*, which can only be applied by

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[7] The information bellow is based on: 2001 Regular Report on Estonias' Progress towards Accession (document No SEC (2001) 1747, Brussels, 13.11.2001

Member States.[8] In particular, licensing procedures and criteria, the own funds definition, the solvency ratio and capital adequacy rules have been addressed. Consolidation and large exposure rules, as well as the post-BCCI directive, have also been addressed.

In the *insurance sector*, a series of implementing legislative acts on reporting, intermediaries, technical reserves and other issues were adopted, thus completing the framework set out in the insurance law of 2000. The system of compulsory third-party motor vehicle liability insurance has been revised and liberalised.

No particular development can be reported with respect to the *securities markets*.
On the other hand, Hungary has already achieved a substantial degree of alignment in *financial services*. Of course, it is only upon accession that the necessary rules providing for internal market conditions with regard to branching and the free provision of services can take effect. In particular with regard to securities, more work will be needed before Hungary can be regarded as fully complying with the *acquis*; contractual netting and investor compensation schemes should be addressed. The accounting standards meet EC and international requirements and international co-operation is underway with current efforts to conclude memoranda of understanding with the most relevant partner countries. The present regime for the setting up of foreign bank branches in Hungary is rather rigid and will have to be modified with a view to accession. In the insurance sector, it is also still necessary to review the regime governing composite (life and non-life) insurance businesses, as well as that concerning the investment of assets covering mathematical reserves and the guarantee fund.

The Hungarian Financial Supervisory Authority is responsible for the financial services sector. It has its own separate budget and is legally independent. It is guided by the Basle Core Principles for Banking Supervision.

No further progress is to be reported as regards the *acquis* on **payment systems**.
As for the *acquis* on **money laundering**, new legislation adopted at the end of 2000 prohibits the opening of anonymous savings books and the deposit of additional funds into existing ones, and requires customer identification for withdrawals. However, these new provisions will only enter into force upon Hungary’s accession. While the stock of anonymous savings deposits has decreased during the latest years the remaining deposits still amount to approximately € 600 million. As a result of the present situation, Hungary was added to the list of non-co-operative countries and territories in June 2001 by the Financial Action Task Force (FATF), an international body set up to promote the fight against anti-money laundering.

2.6. Latvia

On *banking* in Latvia, the rules, policies and practices to be applied by the new competent supervisory authority are similar to the Recommendations of the Basle Committee on Banking supervision and to EC provisions.[9] There is also good co-

[8] The information bellow is based on: 2001 Regular Report on Hungarys’ Progress towards Accession (document No SEC (2001) 1748, Brussels, 13.11.2001
[9] The information bellow is based on: 2001 Regular Report on Latvias’ Progress towards Accession (document No SEC (2001) 1749, Brussels, 13.11.2001

operation with foreign supervisory bodies. Latvia has to ensure in particular that the minimum requirements concerning the deposit guarantee scheme are gradually achieved.

Supervision of credit institutions has to date been carried out by the Credit Institutions' Supervision Department of the Bank of Latvia. At present, the 50 staff members are engaged in both on-site examinations and off-site analysis. According to the Law on Credit Institutions, onsite examinations must be carried out at least once a year. 47 on-site examinations were conducted in 2000, focusing on assessment of borrowers' financial standing and solvency, as well as enhancement of internal control systems to provide for prudent management of traditional and new risks. The competent Division in the supervisory body appears to be well staffed with qualified personnel.

As regards the *insurance sector,* the basic features of the EC supervisory system are covered by the current legislation. However, some of the Latvian prudential provisions are still different from those contained in the *acquis*, in particular concerning reinsurance as well as insurance against civil liability in respect of the use of motor vehicles, including the structure of liability and the minimum level of third-party cover. In addition, further alignment is needed as regards accounting rules.

In the field of *investment services and securities markets,* there is still a need to ensure the gradual fulfilment of the minimum requirements under the investor compensation scheme in order to align with the *acquis*. Shortcomings in the transposition of other securities legislation might also have to be corrected.

Overall, the standard of supervision in the financial services sector in Latvia has been quite satisfactory. The transfer of powers to the new supervisory body, the Financial and Capital Market Commission, is not expected to disrupt the supervision process while strengthening coordination.

Full financial independence will gradually be achieved by 2007. Latvia should pay due attention to the smooth transfer of responsibilities, securing its independence and ensuring that the quality of its supervision activities during this initial phase does not fall below standard.

As regards **payment systems**, the Bank of Latvia issued amendments to the legislation on Credit Transfers which entered into force in January 2001 to further align with the *acquis* on cross-border credit transfers. In September 2001, the Bank of Latvia adopted recommendations for transactions effected by means of electronic payments to implement the Commission's recommendations.

As for the *acquis* on **the prevention of the use of the financial system for the purpose of money laundering**, the number of reports received by the Office for the Prevention of Money Laundering increased to 4014 in 2000 (from 1111 in 1999), and the Office now has access to 350 databases; however no adequate increase in the resources of the Office has taken place. In June 2001, a special unit for the investigation of money laundering was established in the Board of the Finance Police of the State Revenue Service.

2.7. Lithuania

Considerable progress has been made in the field of financial services in Lithiania, and especially with regard to the *banking sector*.[10] In December 2000, the Board of the Bank of Lithuania adopted a resolution on capital adequacy calculation rules. The resolution lays down the procedures for the measurement of assumed market risks (interest rates, equity, foreign exchange, counterpart and commodity risks) and the additional capital requirements to cover such risks. Additional rules on consolidation of financial statements and on consolidated supervision were adopted by the Bank of Lithuania in March 2001.

In January 2001, the Law on Commercial Banks was further amended providing the possibility for foreign natural and legal persons other than existing foreign credit institutions to set up new banks in Lithuania without any restrictions. The changes in the law are additional to existing requirements regarding large exposures and annual financial statements; they specifically make the owner of credit institutions responsible for internal controls and aim at guaranteeing the independence of internal auditing.

In February 2001, the Deposits Insurance Law was amended, providing for the insurance and compensation of deposits kept in Lithuanian commercial banks, in branches of foreign banks, in the Central Credit Union and in credit unions.

In March 2001, a new law setting out the supervisory role of the Bank of Lithuania was adopted. The law provides, *inter alia*, for the independence of the Bank of Lithuania The Credit Institutions Supervision Department of the Central Bank performed on-site inspections of all licensed banks in 2000. Provisioning against substandard and doubtful loans of 20% and 40% respectively has been set, while such loans have decreased as a proportion of the banks' portfolios. An early warning system has also been set up.

Concerning the *Insurance sector*, the Lithuanian Government adopted, in November 2000, a Resolution on Annual Financial Accounts of Insurance Companies. This Resolution brings the accounting requirements for insurance companies further in line with the *acquis*.

In May 2001, the Insurance Act was further amended, liberalising the investment of insurance assets abroad, regulating the acquisition of qualifying holdings in insurance companies as provided for by the "third generation" Directives and opening up, for WTO countries, the freedom of services in certain classes of transport insurance.

In the field of *investment services and securities markets*, there have been no significant legislative developments. In the field of financial services**,** Lithuanian legislation is now largely in line with the *acquis* as regards banking. In the field of insurance, a positive development has been the adoption of legislation on compulsory third-party liability motor insurance with the aim of implementing in full the requirements of the acquis by January 2004. Due attention should be paid to ensuring

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[10] The information bellow is based on: 2001 Regular Report on Lithuanias' Progress towards Accession (document No SEC (2001) 1750, Brussels, 13.11.2001

timely implementation of this legislation. Further efforts are required to ensure legislative alignment in the areas of tourist assistance and legal expenses, as well as the Third Generation Directives. Legislation in the investment service and securities sector needs to be brought further into line with the acquis.

In the field of **money laundering**, the implementation of anti-money laundering measures should be improved and the independence of the Financial Intelligence Unit in the Tax Police should be ensured. The institutions responsible for the enforcement of the prevention of money laundering and the co-ordination of their activities require strengthening.

2.8. Malta

On *banking*, Malta follows the main principles of Community prudential legislation and the Banking sector is also assessed against the Basle Core Principles for Banking Supervision.[11]

However, the Netting Directive, the Consolidated Supervision Directive and the post-BCCI Directive still remain to be fully transposed. In this context, particular attention must be given to the notion of "close links" and the issue of co-operation with foreign authorities. Malta also needs to set up a deposit guarantee scheme, for which preparations are underway.

As regards the *insurance sector,* Malta has adopted regulations that were intended to align its legislation with most of the *acquis* in this sector. However, an assessment of their compliance with the *acquis* remains to be made. A bill still needs to be adopted to enable the Government to implement the Single Market provisions for insurance at the moment of accession (single licence principle, cross-border branching rules, co-operation with foreign supervisors, etc., as required by the "third generation" insurance Directives).

In the field of *investment services and securities markets,* not much progress has been made since 2000. The amendments to the Investment Services Act and to the Insider Dealing Act still have to be adopted to bring Maltese law in line with the *acquis*. The Directive on Undertakings for Collective Investments in Transferable Securities still has to be transposed. Malta also needs to introduce an investor compensation scheme.

Concerning payment systems, Malta still has to finalise necessary amendments to its primary legislation to implement the EU *acquis* in this area. Malta has, in particular, to transpose the provisions of the Directives on cross-border credit transfers and on settlement finality in payment and securities settlement systems. Out-of-court redress procedures for the settlement of disputes on cross-border credit transfers also need to be introduced.

As regards money laundering, a bill amending the Prevention of Money Laundering Act and establishing the financial intelligence unit still has to be adopted by Parliament. Malta will also have to set up a financial intelligence unit.

[11] The information bellow is based on: 2001 Regular Report on Maltas' Progress towards Accession (document No SEC (2001) 1751, Brussels, 13.11.2001

2.9. Poland

According to the law on the National Bank of Poland (in force as of January 1998), the Commission of Banking Supervision is entrusted with the responsibility of supervising the banking institutions.[12] The Commission is chaired by the NBP President and composed of the deputy minister of finance, a representative of the President, the Commission of Securities and Exchanges, the Bank Guarantee Fund and the General Inspectorate of Banking Supervision.

The tasks of the Committee are *i.a.* the establishment of security norms for banks and supervision of compliance with laws and norms by banks. The General Inspectorate of Banking Supervision (GINB) is an executive body of the Commission of Banking Supervision. GINB is an autonomous unit of the National Bank of Poland. It is composed of around 500 staff, of whom 320 work on on-site examinations. The GINB has continued to be perceived as an efficient and well-organised institution.

The Law on the bank guarantee requires further modification to align it with the EC Directive on deposit guarantee schemes.
The insurance sector is supervised by the State Office for Insurance Supervision (PUNU), acting under the Insurance Law. The main task of this body is to protect the interests of insured persons. Particular functions of PUNU are the monitoring and audit of insurance, and the licensing and monitoring of insurance brokers.

PUNU also takes part in the activity of the Insurance Guarantee Fund (made up of contributions from insurers), especially in cases where the resources of the Fund are used to cover claims against a bankrupt insurer. Another task carried out by PUNU is co-operation with the Ministry of Finance in drafting legislation and issuing licenses for new insurers.

Efforts had been undertaken to adopt further legislation in the field of insurance but these did not pass all stages of the legislative process. One consequence is that the intended reorganisation of insurance supervision has not taken place.

The pension fund sector is supervised by the Pension Funds Supervision Office (UNFE), established in 1998. The basic purpose of UNFE is to protect the interests of all members of open pension funds (2nd pillar of social security system in Poland) and participants of employee pension programmes (3rd pillar). UNFE supervises the activity of pension funds and pension companies as well as employee pension programs. UNFE is responsible for conducting licensing procedures. The additional purpose of the office is to enhance public awareness about pension funds and pension programmes, in particular concerning the rights appertaining to the funds' members and programmes' participants.

The Securities and Exchanges Commission (SEC) was established in 1991 and is a governmental agency in charge of supervision of public trading of securities. In 1998, its responsibilities were broadened and now also cover commodity exchanges. The Commission is composed of its chairman (nominated by the Prime Minister), 2

[12] The information bellow is based on: 2001 Regular Report on Polands' Progress towards Accession (document No SEC (2001) 1752, Brussels, 13.11.2001

deputies and 6 representatives of ministries. On top of this, the office of the Securities Commission employs 144 persons in 8 departments. Within the reporting period, the Commission met 27 times and issued 901 resolutions. The responsibilities of the Commission are the following: the supervision of fair trade and competition in securities markets, including equal access to information, protection of investors, the licensing and supervision of companies traded on public markets (265, of which 45 were authorised in 2000), the licensing and supervision of brokerage houses and banks conducting brokerage activity (49), as well as investment and trust funds (85), and educating the general public about securities markets.
With regard to **payment systems**, further progress is required in completing the transposition of the acquis and establishing out of court redress procedures for the settlement of disputes between banks and customers on cross-border transfers.
As was noted in the 2000 report, the overall level of alignment with the *acquis* in this area is high. This has in particular been further reinforced by the adoption of legislation with regard to **money laundering**. Compliance with the recommendations of the Financial Action Task force should be ensured.

2.10. Romania

Concerning financial services as a whole, Romania will still have to make substantial efforts to bring its legal framework in line with the *acquis*.[13] However, in the *banking sector* Romanian legislation has made some progress towards compatibility with the *acquis* and further steps forward continue to be made. Its rules, policies, and practices follow broadly the Recommendations of the Basle Committee on Banking Supervision and to the relevant EC directives. Despite progress in this area, the sector is still fragile and only the consistent application of the regulatory and supervisory framework over a period of time will re-establish confidence.

As regards the *insurance sector,* the late establishment of the Insurance Supervision Commission (ISC), which is in charge of drafting relevant secondary legislation, has delayed the implementation of the *acquis*. Furthermore, the situation concerning administrative capacity of the new Insurance Supervisory Commission is unclear, and indications are that the ISC will require considerable strengthening in terms of staff, training, and equipment. At present, a large number of currently registered insurance companies are not expected to meet the requirements of the legislation. While waiting for the new law to come into force, some of these companies have continued to operate, while others do not report any activity at all. In the meantime, no new companies have been able to commence operations in the sector. The ISC will have to meet a considerable challenge during its start-up period to oversee all operators in the sector, while laying the groundwork for its own operations.

In the field of *investment services and securities markets,* current legislation remains incompatible with the *acquis*. The new law on securities supervision is still before Parliament. In the absence of a suitable legal framework, the National Securities Commission can only make marginal improvements in the situation, which has given rise to major crises in recent years.

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[13] The information bellow is based on: 2001 Regular Report on Romanias' Progress towards Accession (document No SEC (2001) 1753, Brussels, 13.11.2001

Moreover, the administrative capacity of the National Securities Commission continues to be a cause for concern. As noted in previous years, the National Securities Commission’s effectiveness is restricted by the limited number and experience of its staff. This reduces its capacity to gather and process information about operators in its sector. Considerable progress is necessary in this area - starting with the creation of an adequate legal framework.

Preparations for the creation of a new inter-bank payment and settlement system are, as yet, at an early stage. Considerable work remains to be done in order to transpose the *acquis* in payment systems (including the introduction of adequate and effective redress procedures for settlement of disputes between bank and customers) and to improve the payment infrastructure.

The National Bank of Romania regulates and supervises banking and credit institutions, operates exchange control and oversees the payment system. The National Bank has sufficient staff and administrative capacity to ensure the effective application of legislation in these areas.

In the area of money laundering the National Office for the Prevention and Control of Money Laundering needs to complete the recruitment process and the acquisition of certain specialised equipment related to enforcement. The National Office for the Prevention and Control of Money Laundering has introduced important measures concerning the reporting obligations of financial institutions, but revision to the current legal framework is required concerning the civil liability of the Office in the course of investigations.

2.11. Slovak Republic

Slovakia has brought its banking legislation closer to alignment with many of the requirements enshrined in EC banking directives governing the areas of minimum capital, licensing requirements, supervision on an individual and consolidated basis, internal control requirements, exchange of information between financial supervisory bodies and capital adequacy rules.[14] Particular attention should now be given to legislative provisions for transposing the *acquis* relating to the deposit guarantee scheme and the schedule for meeting the EC minimum level of guarantee; the deposit guarantee scheme should be structured in such a way that it will, after accession, be able to cover foreign branches of Slovak banks.

Concerning the insurance sector, the approval of the Act on the contractual insurance of motor vehicle third-party liability brings the operation of the insurance market in Slovakia closer to community standards.

Little progress has been achieved in the investment services and securities field. The investment services, capital adequacy and collective investment directives have not been transposed yet. In the same vein, the legislative transposition for the securities market sector has to be completed before the accession.

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[14] The information bellow is based on: 2001 Regular Report on Slovakias’ Progress towards Accession (document No SEC (2001) 1754, Brussels, 13.11.2001

As regards specifically the investor compensation scheme, the compatible legislative framework and the alignment of the levels of compensation with the EC requirements need to be completed.

Concerning the *acquis* on **payment systems**, in February 2001, the National Bank of Slovakia approved the strategy for the introduction of the Real Time Gross Settlement System in the Slovak payment system infrastructure.

On **money laundering**, Slovakia has made some progress by implementing the new law adopted last year. The Financial Analytical Unit, established within the Financial Police Office of the Police Corps, is now involved each time a financial institution identifies an unusual operation/transaction on an anonymous account. Enforcement records, available for 1999 and 2000, show that the number of investigations of illegal financial transactions doubled from 1999 to 2000, leading to an increasing number of prosecutions.

The newly established Financial Market Authority supervises the insurance and capital markets.
The National Bank of Slovakia exercises prudential supervision of credit institutions. Some residual powers remain with the Ministry of Finance in relation to specialised financial institutions. These financial supervisory authorities should strengthen their mutual co-ordination in the application and enforcement of legislation in the capital markets, banking and insurance sectors.

2.12. Slovenia

As regards banking, Slovenian legislation is already aligned to a high degree, also concerning the free establishment of foreign banks.[15] The provisions requiring adjustments concern prudential requirements on capital adequacy, as well as the home country control principle, which there are plans to incorporate into secondary legislation at accession. The cross-border dimension of deposit insurance (coverage of branches abroad) should be taken into account in this context.

Slovenia should now enhance its efforts to ensure effective implementation and supervision of the legislation, as well as to expand co-operation with other European supervisory authorities.

In the area of **insurance**, Slovenia still needs to pass new legislation in order to align with the *acquis* as regards compulsory insurance for motor vehicles. Otherwise Slovenian legislation is largely aligned with the *acquis*, even if some provisions will only be applied gradually. Some further adjustments to secondary legislation will be required on accession in order to implement the home country control principle. Continued efforts are needed to reinforce the supervisory body in order to ensure sufficient intensity of controls.

In the area of **investment services and securities markets**, an important step remains to be taken through adoption of legislation on investment funds and management

[15] The information bellow is based on: 2001 Regular Report on Slovenias' Progress towards Accession (document No SEC (2001) 1755, Brussels, 13.11.2001

companies, following in particular the UCITS (Undertakings for Collective Investment in Transferable Securities)Directive. A few parts of secondary legislation remain to be enacted on the basis of the Securities Markets Act. All in all, however, the level of legislative alignment is quite advanced. Attention will have to be paid to the effective fulfilment by the securities markets agency of its new supervisory tasks, and to more systematic co-ordination with the other supervisory bodies.

Slovenia introduced a real time gross settlement (RTGS) system in 1998. A Giro clearing system for retail payments was introduced in 1999 and a decision was adopted on the conditions and methods for carrying out international transactions. The legislative developments and the ongoing reform of the payment system confirm the good overall progress of Slovenia in this area.

Slovenia has made good progress in the field of cross border credit transfers and it has already partially transposed the relevant *acquis* by adopting a decision on the conditions and the methods for carrying out international transactions. However, alignment remains to be completed and an adequate and effective complaints and redress procedure for settlements in this area still needs to be implemented.

Slovenia's legislation concerning **money laundering** is in line with the *acquis*. Compliance with the recommendations of the Financial Action Task Force should be ensured.

2.13. Turkey

In the field of **financial services**, and in particular the *banking sector*, important changes have taken place as part of the programme "Strenghtening the Turkish Economy" which was adopted in March 2001.[16] As part of these reforms, the Banking Regulatory and Supervision Authority issued a programme on "Restructuring the banking sector" in May 2001. This accelerated the privatisation of State-owned banks, which had started in September 2000.

In the field of *investment services and securities market*, the adoption by the Capital Market Board of the Regulation on the functioning of the Investor protection fund is a welcome development. It is now essential that the Central Registry becomes operational.

In the field of insurance, specific restrictions on the freedom of services remain. The Insurance Surveillance Board maintains links with the Ministry of State for Economic Affairs and may therefore not be qualified as fully independent. This matter needs to be further reviewed.

Concerning **securities**, two regulations were adopted in June 2001 by the Capital Market Board. One concerned the functioning of the Investor Protection Fund, intended to cover losses incurred by customers of insolvent securities firms, and the other the establishment and functioning of a central registry. The function of the central registry is to manage a fund intended for the progressive liquidation of

[16] The information bellow is based on: 2001 Regular Report on Turkeys' Progress towards Accession (document No SEC (2001) 1756, Brussels, 13.11.2001

insolvent intermediaries. The regulation will enter into force once the central registry, which is to administer the Fund, is operational.

A Communiqué on the principles regarding licensing and registration of working in the field of capital markets has been published in June 2001.

In the field of **insurance** services, three laws have been adopted since the previous Regular Report. These relate to insurance and reinsurance brokers (October 2000), to Individual retirement and Saving System (April 2001), and an amendment to the Regulation on Insurance Adjusters (May 2001).

As a result of the economic crisis of February 2001, Turkey has embarked upon a substantial reform of the financial sector. These reforms included the restructuring of the banking system, and the privatisation or closure of certain ailing banks Rapid completion and implementation of banking sector reform is essential, to complete alignment with the acquis.

In general, the conditions for foreign companies wishing to be listed on the Turkish stock exchange are similar to those applied to EU companies. However, a foreign company must also be listed in its home country.

Outward transfers of funds by residents are free, provided they are for sums below US$ 5 million. For larger amounts, official authorisation remains necessary. The conditions under which non-residents may exports large sums are unclear.

Turkey needs to properly enforce the legislation on money laundering, in force since August 1999. Compliance with the Recommendations of the Financial Action Task Force should be ensured.

The Central Bank is connected to the TARGET system of the European Central Bank for real time transaction in EUROs.

Appendix 1

FSAP findings for the financial systems of certain pre-accession countries

	Number of Institutions	Assets		
		In millions of leva	In percent of Total assets	In percent Of 2002 GDP
Banks	35	12,707	93	39
Foreign-owned banks	25	9,411	69	29
Subsidiaries	18	8,406	62	26
Branches	7	1,005	7	3
Domestic	10	3,296	24	10
Private banks	6	787	6	2
State-owned banks	4	2,509	18	8
Agricultural credit unions	33	23	0	0
Securities firms	69	54	0	0
Finance companies 2/	42	112	1	0
Collective investment schemes	1	7	0	0
Investment funds	2	4	0	0
General insurance companies	19	409	3	1
Life insurance companies	12	195	1	1
Licensed Pension funds	9	127	1	0
Total financial system	221	13,638	100	41

Sources: Bulgarian National Bank and IMF staff estimates and projections.

Structure of financial sector of Bulgaria (March, 2002)

Structure of financial sector/Ref. period	1995	1996	1997	1998	1999	2000
	Total assets (In billions of korunas)					
All financial institutions	...	1,976	2,314	2,417	2,530	...
of which						
Deposit money banks 2/	1,472	1,709	2,069	2,166	2,229	2,328
Insurance companies	92	125	126	134	151	...
Investment funds 3/	...	119	95	86	112	113
Pension funds 4/	7	24	23	31	37	40
Memo item						
Gross domestic product	1,381	1,572	1,669	1,798	1,833	1,911
	Relative share in total assets of the financial sector (In percent)					
All financial institutions	...	100	100	100	100	...
of which						
Deposit money banks	...	86	89	90	88	...
Insurance companies	...	6	5	6	6	...
Investment funds	...	6	4	4	4	...
Pension funds	...	1	1	1	1	...
	Size of total assets relative to GDP (In percent)					
All financial institutions	...	126	139	134	138	...
of which						
Deposit money banks	...	109	124	120	121	122
Insurance companies	...	8	8	7	8	...
Investment funds	...	8	6	5	6	6
Pension funds	...	2	1	2	2	2
	Number of financial institutions					
All financial institutions						
of which						
Deposit money banks	55	53	50	45	42	40
Insurance companies	35	35	40	41	42	42
Investment funds	...	469	350	270	198	189
Pension funds	44	44	44	30	24	20
Credit unions 5/	154	...	...	...	...	93
Securities firms 6/	619	...	...	...	...	190
Leasing companies 7/	...	...	...	...	122	...

Sources: the CNB, MoF and CSC.
1/ Only types of financial institutions, for which there is data for the respective indicators, appear in the table.
2/ Data from the statistical reports submitted by the CNB to the IMF. Data adjusted by netting out interbank deposits and correcting for the double counting of repos of CNB bills in official statistics.
3/ End of June 2000 data. Includes closed-end investment privatization funds structured as joint-stock companies, closed-end unit trusts, and open-end unit trusts.
4/ End of June 2000 data.
5/ Total assets of the 93 credit unions that held licenses at the end of 2000 were an estimated CZK 10.4 billion, or 0.5 percent of GDP.
6/ Data on asset management companies (153 in 1995, 75 in 2000) and brokerage firms (466 in 1995, 115 in 2000).
7/ Data for members of the Czech Association of Leasing Companies only. At the end of 1999, the latter accounted for 95 percent of the domestic leasing market and had combined assets of CZK 142 billion or 7.7 percent of GDP.

Czech Republic: Financial Sector Indicators

(In percent of total assets)

	Dec-98	Dec-99	Dec-00	Sep-01
Credit institutions	84.6	81.9	80.2	80.0
Investment firms	2.0	1.8	1.5	1.3
Investment funds	4.1	4.5	5.1	4.6
Insurers	5.4	5.9	6.3	6.9
Pension funds	1.6	2.6	3.6	4.0
Financial enterprises	2.2	3.3	3.5	3.4
Total	100.0	100.0	100.0	100.0
Total NBFIs	15.4	18.1	19.8	20.0

Source: HFSA.

Hungary: Financial system structure

Financial Institutions	Number	Assets (millions of lats)	Assets (percent of GDP)
Banks	21	2,485	57.4
Credit unions	17	1	--
Insurance companies	25	115	2.7
Brokers	22	...	...
Pension funds (third pillar)	4	6	0.1
Investment funds	3	...	...
Leasing companies 1/	5	140	3.2

Source: Bank of Latvia, Insurance Supervision Inspectorate, and Securities Market Commission.

1/ Five companies undertake the bulk of the leasing, three of which are subsidiaries of Latvian banks. Their assets are deducted from banks' assets (first row of the table). In addition, four banks undertake leasing activities in the order of LVL 85 million directly.

Latvia: Structure of Financial System at end-2000

	Jun-01			
	Number	Assets (M litas)	Pct of assets	Pct of GDP
Banks	15	13,305	87.1	27.7
Private	13	11,473	75.1	23.9
Domestic 1/	9	10,693	70.0	22.2
Foreign 2/	4	780	5.1	1.6
State-owned	1	1,734	11.3	3.6
Other banking institutions 3/	1	98	0.6	0.2
Institutional investors	46	967	6.3	2.0
Insurance companies	33	859	5.6	1.8
Life	7	127	0.8	0.3
Nonlife	26	732	4.8	1.5
Pension funds	-	-	-	-
Investment companies	13	108	0.7	0.2
Investment holding companies	12	107	0.7	0.2
Collective investment schemes	1	1	0.0	0.0
Other nonbank	150	911	6.0	1.9
Leasing companies	15	833	5.5	1.7
Securities firms	25	55	0.4	0.1
Brokerage companies	21	52	0.3	0.1
Investment management 4/	4	3	0.0	0.0
Mortgage institutions	-	-	-	-
Credit unions and cooperatives	39	23	0.1	0.0
Insurance brokers	71	...	...	...
Microfinance institutions	-	-	-	-
Other	-	-	-	-
Total financial system 5/	212	15,280	100.0	31.8
Memorandum items:				
Branches of domestic banks	160	-	-	-

Sources: Bank of Lithuania, Ministry of Finance, Department of Statistics, and staff calculations and estimates.

1/ Domestically incorporated private commercial banks, including subsidiaries of foreign banks.
2/ Branches of foreign banks.
3/ Includes a state-owned loan workout company (Turto Bankas). Data adjusted for assets entrusted for management by the state.
4/ Includes investment consulting and management companies, and investment management companies.
5/ Does not include the capitalization of the stock market.

Lithuania: Structure of Financial System at mid-2001

Type of Institution	Assets (In Millions of Zloty)	Share in Assets (in percent)	Number of Institutions
Commercial banks	349,022	86.5	77
Insurance companies	28,935	7.2	56
Cooperative banks	15,410	3.8	781
Brokerage houses	3,604	0.9	48
Investment funds	3,215	0.8	15
Pension funds	2,256	0.6	21
Credit unions	883	0.2	158
Total financial system	403,325	100	1,410

Source: National Bank of Poland.

Poland: Structure of Financial System at end-1999

	Number of Institutions					Total Assets	
						(SIT billions)	(In percent of GDP)
	Dec 31 1995	Dec 31 1996	Dec 31 1997	Dec 31 1998	Dec 31 1999	Dec 31 1999	Dec 31 1999
Banks	33	31	28	24	25	2,687.6	73.7
Savings banks	10	7	6	6	6	11.0	0.3
Savings & loan institutions	72	71	70	70	68	55.0	1.5
Brokerage houses*	44	46	43	42	42	653.0	18.0
Management companies	28	26	26	23	22	n.a.	n.a.
Authorized investment funds	68	72	60	46	46	599.0	16.5
Mutual funds	18	15	15	15	17	8.7	0.2
Insurance companies	12	12	13	13	13	222.6	6.1
Reinsurance companies	2	2	2	3	3	41.9	1.1

* Includes 10 banks authorized to carry out trading operations.
(Assets include SIT116.9 billion in own account, 19.2 billion under management, and 516.9 billion in investments on account of third parties.)

Memo items:						Share of Baking System Assets (Percent)
State-owned banks	3	3	3	3	3	41
Foreign-owned banks	6	4	4	3	5	5

Source: *Bank of Slovenia.*

Slovenia: Financial System Structure

(In billions of Slovak koruna, unless indicated otherwise)

	1997	1998	1999	2000	2001
Assets of all financial institutions	**841.5**	**864.6**	**824.9**	**934.6**	**1061.9**
of which:					
Deposit money banks	757.3	777.4	738.7	834	931.3
Insurance companies	41.2	47.1	48.9	53.3	66.8
Voucher privatization funds	6.1	4.6	4.8	0	0
Investment funds	2.4	2.4	3.2	5.8	8.4
Pension funds	0	0.9	1.6	3.2	5.4
Leasing Companies	34.5	32.2	27.7	38.3	50
Memo items					
Gross domestic product	686	751	815	887	960
Customer deposits	441.5	457.4	499.8	588	654.8
Share of assets of financial sector	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
as a percentage, of which					
Deposit money banks	90.0	89.9	89.6	89.2	87.7
Insurance companies	4.9	5.4	5.9	5.7	6.3
Voucher privatization funds	0.7	0.5	0.6	0.0	0.0
Investment funds	0.3	0.3	0.4	0.6	0.8
Pension funds	0.0	0.1	0.2	0.3	0.5
Leasing Companies	4.1	3.7	3.4	4.1	4.7
Percentage of GDP					
All financial institutions	**118.7**	**111.6**	**98.7**	**102.8**	**107.4**
as a percentage of which					
Deposit money banks	106.8	100.3	88.4	91.8	94.2
Insurance companies	5.8	6.1	5.8	5.9	6.8
Investment funds	0.3	0.3	0.4	0.7	0.9
Pension funds	0.0	0.1	0.2	0.4	0.6
Leasing Companies	4.9	4.2	3.3	4.2	5.0
Number of financial institutions					
Dealer/brokers	132	148	154	141	130
Deposit money banks	29	27	26	23	21
Insurance companies	23	26	28	29	28
Investment management companies	12	18	19	6	9
Leasing companies	41	44	44	42	35
Pension funds	2	3	4	4	4

Sources: NBS, FMA, industry associations; and Fund staff estimates.

Appendix 2
Case study: Bulgarian pension reform – trends and legislation

Bulgarian pension reform has turned into final stage of its development. According the new legislation Bulgarian pension system is built in three columns:

<table>
<tr><td colspan="4">Bulgarian pension system</td></tr>
<tr><td>First column</td><td colspan="2">Second column</td><td>Third column</td></tr>
<tr><td>Obligatory pension insurance</td><td colspan="2">Additional obligatory pension insurance</td><td>Additional optional pension insurance</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td>First column</td><td colspan="2">Second column</td><td>Third column</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td>Costs covering</td><td colspan="2">Capital covering</td><td>Capital covering</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td>Fixed pensions</td><td colspan="2">Fixed contributions</td><td>Fixed contributions</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td>State administrated</td><td colspan="2">Privately managed</td><td>Privately managed</td></tr>
<tr><td></td><td>Professional pension fund</td><td>Universal pension fund</td><td></td></tr>
</table>

First column

The Bulgarian first pension insurance column represents a typical costs covering system that has been frequently modified in the last few decades. The most recent legislative amendments (Obligatory Social Security Code, in force as of January 1, 2000) are aiming an increase of the retirement age and establishment of more direct relationship between the insurance contributions paid throughout the entire length of service and the pensions paid. The retirement age is 60 years and 6 months for men and 55 years and 6 months for women. The required age is six months higher compared to the age as per the old system. The retirement age is to be increased by six months every year until finally reaching 63 years for men and 60 years for women. By the Obligatory Social Security Code the so-called “point system” has been introduced too. A person is entitled to retire in pension, if he has reached the required age and has collected the required points, being the sum of the insurance service and the age. In 2000 the points are 98 for men and 88 for women. The pension points shall gradually increase during the next years of reform, until reaching the figures 100 for men and 94 for women. The employer pays 80% of the relevant insurance contribution, while the insured person pays the remaining 20%. The insurance burden shall be gradually transferred from the employer to the insured person, until reaching equity between two of them in 2007.

Second column

The second pension insurance column is a completely new field that has been legally governed as of the beginning of 2000. The funds of the second column have not started their real operation yet, because of the lack of regulations in regard with some legal procedures, terms and requirements.

Two forms of additional obligatory pension insurance (second column) have been legally regulated: ***universal*** – for persons born after January 1, 1960 and ***professional*** – for persons exercising work classified as being of first and second labor category.

The funds of the second column shall be managed by pension insurance companies – the same that manage also the funds of the third column.
As of January 1, 2000 persons, who exercise work classified as being of first and second labor category shall be obliged to insure themselves in additional professional pension funds for earlier retirement. The contributions for the professional pension funds of the second column shall be totally paid by and at the expenses of the employers. The amount of the contribution is, as follows:

- For persons, who exercise work classified under the first labor category – 12% of the gross labor remuneration;
- For persons, who exercise work classified under the second labor category – 7% of the gross labor remuneration.

As of January 1, 2002 all persons born after January 1, 1960 and insured under Section I of the Obligatory Social Security Code shall be obligatory insured in universal pension fund too. The employer shall pay 75% of the contribution for universal pension fund of the second column, while the insured person shall pay the remaining 25%. The insurance burden shall be gradually transferred from the employer to the insured person, until reaching equity between two of them in 2007. The amount of the contribution shall be specified in the Act on the Budget of the Social Security Fund.
The contributions paid by employers in pension funds of the second column are acknowledged as activity related costs under the Corporate Income Tax Act. The individual insurance contributions paid in universal pension funds of the second column are deducted for taxation purposes under the Taxation of the Income of Natural Persons Act. The revenues deriving from the investment of a pension fund's assets, allocated to the individual accounts of the insured persons, are not subject of taxation under the Taxation of the Income of Natural Persons Act.
The pension funds of the second column have been legally regulated in the Obligatory Social Security Code (Official gazette No. 110 dd. December 17, 1999).

Third column

The third pension insurance column has been existing in Bulgaria for six years now. It is based on an optional participation in pension funds, which are established and managed by pension insurance companies. The pension funds of the third column offer capital covering insurance schemes with fixed contributions and individual accounts with capitalization, where the contributions are paid both by the employers and the insured persons. An excellent tax regimen exists for the insurance contributions of the third column. The additional optional pension insurance has been regulated by a special law: the Additional Optional Pension Insurance Act (Official gazette No. 65 dd. July 20, 1999), which integrated the regulation base that had been existing in various acts and enactments for five years.

Tax concessions

The employer may pay insurance contributions for his workers and employees, including under a contract for management assignment. The payment of insurance contributions on behalf of the employer does not oblige the insured person to pay contributions at his own costs.
Under the Corporate Income Tax Act, if the contributions paid by an employer for additional optional pension, health and social security or insurance amount up to BGL 40 per month per worker or employee, including under a contract for management

assignment, they shall be considered as activity related costs. The employer's contributions over BGN 40 per month per worker or employee shall be subject of lump-sum taxation.

Summary of the tax concessions for additional optional pension insurance at the employer's costs, under the Corporate Income Tax Act
By the Amendments and Supplements to the Taxation of the Income of Natural Persons Act (Official gazette No. 111 dd. December 21, 1999) amendments have been made in Art. 23 and Art. 36 of the Corporate Income Tax Act, as follows:
Item 25 has been introduced in Art. 23, Para 2 of the Corporate Income Tax Act, and namely: "The financial result before tax transformation shall be increased by the employers' contributions for additional optional pension, health and social security or insurance, which are not social expenditures exceeding BGL 30 per month per each insured worker or employee, including under a contract for management assignment".
Art. 36, Para 1 of the Corporate Income Tax Act now reads: "The social expenditures made by employers, regardless if they are performing economic activity or not, including for persons whom the management has been assigned, shall be tax levied at the source, being this tax final, except for the contributions for additional pension, health and social security and/or insurance that do not exceed BGL 40 per month per each insured person".
Under Art. 2, Para 2 of the Regulation on the remuneration elements and the incomes, on which insurance contributions are paid and on the calculation of the pecuniary benefit for temporary disability or pregnancy and childbirth (Decree of the Council of Ministers No. 263 dd. December 30, 1999; Official gazette No. 6 dd. January 21, 2000) State Social Security contributions shall not be assessed on the contributions for additional optional pension insurance.

The individual contributions for additional optional pension insurance are fully deducted from the income of natural persons before taxation according to the procedure and method as specified by the Taxation of the Income of Natural Persons Act.

Summary of the tax concessions for additional optional pension insurance at the insured person's costs, under the Taxation of the Income of Natural Persons Act
By the Amendments and Supplements to the Taxation of the Income of Natural Persons Act (Official gazette No. 153 dd. December 23, 1998) amendments have been made in the Taxation of the Income of Natural Persons Act too:
In Art. 20, Para 2 of the Taxation of the Income of Natural Persons Act the words "totally amounting up to 30% of the minimum monthly salary for the country" have been removed.
Now it reads: "The taxable income under Para 1 shall be reduced by the sums paid for optional social, pension and/or health insurance."
Thus the dependence between the amount of the tax concession for optional social, pension and health insurance and the minimum salary for the country has been eliminated. The full amount of the individual contributions for optional insurance is not subject of taxation.
The same amendment applies for self-insured persons too:
In Art. 22, Para 2 of the Taxation of the Income of Natural Persons Act the words "totally amounting up to 40% of the 12 minimum salaries for the country" have been removed.

By the Amendments and Supplements to the Corporate Income Tax Act (Official gazette No. 153 dd. December 23, 1998), which is in force as of January 1, 1999 Item 8 has been introduced in Art. 26 of the Taxation of the Income of Natural persons Act, according to which the incomes received by the optional pension funds are subject of overall income tax too, and namely: "The tax base is the gross sum of the incomes received by ... optional social, pension and health insurance."

The revenues from the investment of a pension fund's assets, allocated to the individual accounts of the insured persons, are not subject of taxation under the Taxation of the Incomes of Natural Persons Act.

The Obligatory Social Security Code, which is currently in force, provides that the state should invest at least 50% of the accumulated pension contribution in state securities. At the same time the Code admits the investment of up to 10% of the accumulated funds of the pension funds in the developed foreign capital markets. On the other hand, the state securities issued by the Ministry of Finance are quite limited in volume and terms and cannot satisfy the investment needs of the funds. Another parallel negative factor is the lack of developed national capital market to offer the institutional investors quality issues of corporate securities of risk, profitability and liquidity that meet the requirements of that type of investors. It is highly probable very soon – in the next two or three months –serious demand of quality financial instruments to be evidenced on this market for the investment of pecuniary funds accumulated by now in the form of insurance contributions. According to the statistics the National Insurance Institute is expected to transfer the amounts accumulated in the accounts of the employed persons of 1st and 2nd labour category to the various professional funds, for the time being the total amount of these funds is about BGL 31 million. According to data of the Ministry of Labour and Social Policy the pension companies shall raise about BGL 250 million by the end of 2001. Considerable increase of the funds is expected during the next years and at the beginning of 2004 they are expected to reach BGL 1 billion. The long-term schedules show that as of 2015 the amount shall reach about BGL 5 billion. The persons who have made an additional optional pension insurance are already about 410 000.
The above analysis shows that an accumulation of serious financial resource in the pension funds is in course, and in their capacity of institutional investors they'll need to structure quality investment portfolios of securities (corporate, governmental, municipal). Due to the undisputed fact of the lack of developed capital market in the country, there is a real possibility of investments in the developed foreign capital markets on behalf of this type of institutional investors.

Assets accumulation forecast for additional obligatory pension insurance in pension funds	
In thous. BGN	
2005	1 223 158
2010	3 833 666
2020	14 077 201

Describing the expected incomes of the additional obligatory pension insurance funds, the following should be accounted:
- gross work salary height (for 2000 it is 248 BGN, as per National Statistic Institute data)
- variations of the insurance payments (fees)

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- gross work salary height (for 2000 it is 248 BGN, as per National Statistic Institute data)
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Monthly fee for universal pension fund ratio salary (forecast)	
Year	*Share*
2002	*2%*
2003	*2%*
2004	*3%*
2005	*4%*
2006	*5%*
2007	*6%*
Future years	*7%*

- variations of the insurance congregation:
    - at present for Professional Pension Funds - about 130 thousand people, with tendency for decrease
    - at present for Universal Pension Funds - about 900 thousand people, with tendency for increase
    - Growth of the number of ensured people for Universal Pension Funds should be expected also from the decrease of the unemployment.

Expected changes in the law measures for the additional pension insurance:
- Higher share for investments in foreign stocks, quoted on the stock exchange - possible growth up to 15%
- Definition of the order and ways for investments in foreign countries - at present no such law measures
- Definition of the order and ways of forming pension reserves and the requirements for their investment.

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