

Prudential Supervision in Central and Eastern Europe: A Status Report on the Czech Republic, Hungary, Poland, and Slovenia

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I Introduction

The European Commission's Banking Advisory Committee published its own first review of the current state of preparations in the applicant countries this year.²⁾

From Austria's point of view it is particularly important to take a closer look at prudential supervision in Central and Eastern Europe, because compared to banks in other countries, Austrian banks have committed themselves strongly to subsidiaries and participations in Hungary, Poland, the Czech Republic and Slovenia.

This led the Oesterreichische Nationalbank, as one of the bodies involved in prudential supervision in Austria, to conduct a survey on the system of financial supervision in the four applicant countries listed above. The survey intends to offer a comparative overview of which stages the four applicants have reached in their implementation of EU legislation in the area of financial services and points out where implementation may lag behind.

The assessment was based on questionnaires;³⁾ legal documents, OECD publications, specialized papers and supplementary information were also taken into account.

We would like to stress that in the case of Slovenia, unlike in the remaining three countries, the evaluation of the supervisory system focused on draft legislation currently under review in Parliament rather than the existing law.⁴⁾ Presuming that the amendment will be enacted soon, it seemed more appropriate to use the new legislation for the comparison, as it contains manifold changes.

For the other countries, existing legislation was used, as far-reaching revisions and amendments have already taken place: In Poland the new Law on Prudential Supervision took effect as of January 1, 1998; in the Czech Republic the Banking Act was amended as of July 8, 1994, and twice in 1998; in Hungary a new Law on Financial Institutions and a Law on Investment Companies was passed in 1997.

2 Central and Eastern European Banking Systems in Transition

The banking systems in the Central and Eastern European Countries (CEECs) applying for membership were all built on the principles of planned economies. The basic structure showed slight variances from country to country.

1 *Financial Markets Analysis and Surveillance Division of the Oesterreichische Nationalbank. The standard disclaimer applies. The authors wish to thank Olga Radzyner and Peter Backé for their valuable comments.*

2 *See Document XV/1001/98 of the European Commission's Banking Advisory Committee: "Accession of new Member States to the EU: banking regulation and supervision in the accession states."*

3 *The Oesterreichische Nationalbank compiled a comprehensive set of questions and asked the four countries' central banks to provide the requested information. The questions concerned the organizational side of prudential supervision, the implementation of EU directives and the Basle Core Principles for Effective Banking Supervision. Most of the responses arrived after the deadline, which had been set on June 19, 1998.*

4 *Banking in Slovenia is regulated by the 1991 Law on Banks and Savings Banks. A comprehensive amendment is currently under review in Parliament. The amendment was adopted by the Government in July 1996, brought before Parliament in late 1996 and is expected to enter into force as of the end of 1998.*

The structure of the banking system was dominated by the requirements of central planning: Banking was a state monopoly, and the banking system consisted of a limited number of state specialized banks grouped around a monolithic central bank. Banks were not run as businesses; they were vital elements of the centralized allocation system.

In market economies, banks and financial markets play a key role. To accomplish a transition from central planning systems, where loans were granted on the basis of criteria not related to market performance, CEE banks and financial markets therefore urgently need to be developed and strengthened.

Restructuring the single-tier banking system to form a two-tier banking system separating the central bank and commercial banks became a top priority in all CEECs, not just the applicant countries, at a very early stage in the reform process. Yugoslavia took this step in 1971, followed by Hungary in 1987, Poland in 1989 and Czechoslovakia in 1990.

This restructuring brought about two main changes for the central banks: First, the departments that administered accounts and provided commercial credit facilities for businesses had to be converted into independent commercial banks. In other words, the central banks were obliged to shed their roles as quasi-commercial banks. Second, the central banks assumed functions similar to those fulfilled by central banks in market economies. They were called upon to safeguard their currency's internal and external stability, were vested with varying degrees of responsibility for managing government debt and official foreign reserves, and participated in prudential supervision.

The existing specialized banks were also transformed, sectoral restrictions were lifted and in addition to new state-owned banks, privately owned banks were admitted. Furthermore, foreign banks and joint ventures were granted access to the markets. Both the old and the new banks were free to conduct retail and corporate banking business, some were granted foreign exchange licenses; interest rates were liberalized. With the help of foreign advisors and following Western models, legal frameworks and a supervisory system were developed for the banking sector.

The difficulties involved in building a two-tier banking system were fairly similar in all CEECs:

The main problems in the transition phase were the insufficient capital base and the high level of bad debt. The latter was at first a burden inherited from the times of the planned economy, when politicians decided who should be granted a loan; later, however, the bulk of bad debt stemmed from the first years of transition. Criteria of economic soundness and risk were not applied, losses were automatically covered, and either there were no bankruptcy laws or they were simply ignored. Recapitalization programs were designed to replenish the newly founded state-owned universal banks' insufficient capital base.

At first, the main banks in the commercial sector were either directly or indirectly owned by the state. By privatizing the commercial banks, governments hoped to make their management more transparent, tighten their practices of lending, improve internal reporting structures and increase effi-

ciency. In the meantime, the countries under review, especially Hungary and Poland, have privatized large parts of their commercial banking sector.

This study focuses on the crucial challenges posed by the need to establish efficient supervisory bodies in the process of transforming the banking system.

EU accession negotiations have already begun with the countries reviewed in this paper. By the time of their entry into the Union, these future Member States will have to have adapted national legislation to comply with the EU Directives, which of course include the EU banking Directives.

According to the White Book¹) published by the Commission in 1995, which advises CEECs on how to implement EU directives, stage I measures in the field of banking legislation include:

- the First Banking Directive (77/780/EEC),
- the Own Funds Directive (89/299/EEC),
- the Solvency Ratio Directive (89/647/EEC), and
- the Deposit Guarantee Directive (94/19/EC).

Before the accession countries attain membership status in the EU, they are required to adopt all the directives that have been issued so far by the EU, i.e. the banking legislation listed among Stage Two measures in the White Book.

As is well known, the EU Council has ruled that the Commission is to monitor the implementation of secondary legislation in the candidate countries and report regularly to the Council on the candidates' progress in adopting and implementing the *acquis communautaire*.

3 Organizational Structures of the Financial Markets' Supervisory Systems

In Slovenia, credit institutions are supervised by the Bank of Slovenia's supervisory division. Insurance companies are supervised by the state body for insurance supervision, which is part of Slovenia's Ministry of Finance.

An independent body, the Securities Market Agency, has been set up to supervise investment companies and funds, and brokerage houses dealing in stocks and securities.

An Office for the Prevention of Money Laundering has been established in the Ministry of Finance.

In Hungary, the formerly separate bodies of banking, securities and stock market supervision were combined as of January 1, 1997, to form a body called Hungarian Banking and Capital Market Supervision – HBCMS.²) By merging the supervisory bodies, the government aims to improve the supervision of the universal banking system.

In the Czech Republic, the Ministry of Finance is in charge of supervising insurance and investment companies; the Securities and Exchange Commission regulates and supervises the capital market.

Banking supervision is in the hands of the Czech National Bank (CNB). The CNB banking supervision department was reorganized as of June 1,

¹ "Preparation of the associated countries of Central and Eastern Europe for integration into the internal market of the Union." EU Commission (1995).

² ÁPTF – Állami Pénz- és Tőkepiaci Felügyelet.

1998, to step up both on-site inspection and the analytical aspects of banking supervision.

In Poland, the banks' activities have been supervised by the Commission on Banking Supervision as of January 1, 1998. The Commission's decisions are implemented by a separate unit within the National Bank of Poland (NBP), the General Inspectorate of Banking Supervision.

Separate bodies were founded to supervise the investment and insurance sectors: The Securities and Exchange Commission, the State Office for Insurance Supervision and the State Office for the Supervision of Pension Funds.

4 Implementation of EU Directives

4.1 First Banking Directive (77/780/EEC)

a) Objectives

This Directive is aimed at removing infringements on banks' right of establishment and freedom to provide services. It is intended to remove the most obstructive differences between the Member States' legislation and administrative rules, in order to facilitate the establishment and implementation of credit institutions' cross-border services (e.g. licensing, trademark protection, cooperation in the field of supervision, etc.).

b) Implementation

In the countries under review, the Directive appears to have been largely taken into account in existing and pending (e.g. Slovenia) legislation. Possible shortcomings can be overcome in the course of legislative procedure.

Among other things, the definition of credit institutions in Slovenia's Law on Banking Supervision should be adapted to the concept put forward by Article 1 of the First Banking Directive.¹⁾

Also, the provisions on professional secrecy should be adapted to the First (Article 12) and Second (Article 16) Banking Directive as well as the BCCI Directive in the countries under review.

In Slovenia and Hungary the conditions of exemption from professional secrecy should be defined in greater detail, to allow supervisory bodies to exchange information. These provisions of the Directive will have to be implemented to clear the way for the conclusion of bilateral Memoranda of Understanding (MoU) with EU supervisory bodies.

The Czech Republic has not adopted the commitment to collaborate closely with the Member States' competent authorities in the supervision of credit institutions as laid down by Article 7 of the Directive. The Czech National Bank has stated that the provisions would be adopted when the Czech Republic attains full membership.

Slovenia and Hungary still require banks' management staff to hold the respective citizenship, which does not conform with the provisions of the Directive either. Such requirements infringe the EU's principle of the free-

¹ Article 1 reads as follows: "For the purposes of this Directive: – 'credit institution' means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account [...]."

dom of establishment and provision of services, as well as the provisions of the First Banking Directive.¹⁾

Poland appears to have largely implemented the Directive.

4.2 Own Funds Directive (89/299/EEC)

a) Objectives

The Own Funds Directive provides a harmonized concept of own capital by defining the distinction between core and supplementary capital.

b) Implementation

The main points of the Own Funds Directive have been implemented in Slovenia, the Czech Republic and Hungary.

The legal provisions in Hungary diverge from the Directive's definition of supplementary and subordinated capital in a number of points. The Hungarian authorities agree that by not utilizing the leeway granted by the Directive, Hungarian legislation may hamper the competitiveness of banks that are subject to supervision in Hungary. Furthermore, the Hungarian Banking Act prescribes far more deductions to be made in the calculation of core capital; this also results in requirements which are more stringent than the EU's harmonized legal standards.

Member States are, however, entitled to enforce stricter legislation; consequently these issues are unlikely to be seen as obstacles.

Poland has only partially implemented this Directive to date. The Commission on Banking Supervision has stated its intention to move closer to EU standards; full implementation is scheduled to be achieved in 2004.

With the exception of some technical adjustments planned for 1999, the Czech Republic's implementation closely corresponds to the Directive's requirements.

In Slovenia, the main components of the Own Funds Directive were incorporated into the Draft Banking Law and the Draft Decree on the Method of Calculating the Capital Adequacy of Banks and Savings Banks. Some points require further harmonization, as elements of the Basle Capital Accord which are not provided for by EU legislation were included.

4.3 Solvency Ratio Directive (89/647/EEC)

a) Objectives

The Solvency Ratio Directive's main purpose lies in the harmonization of standards regarding the ratio between own funds and risk assets as well as off-balance-sheet business. The Directive prescribes a minimum capital ratio of 8%, which means that the sum total of credit institutions' risk assets must not amount to more than 12.5 times the value of its own funds.

¹ To conform with EU legislation, the requirements might be rephrased to be more like e.g. the related Austrian article, which lays down that at least one executive board member of every credit institution subject to supervision by the Federal Ministry of Finance must be available to answer to the authorities and must have a good command of German.

b) Implementation

In the Czech Republic, the existing CNB regulations do not quite conform with the Solvency Ratio Directive in some points, especially the weighting of assets and off-balance-sheet items. However, the CNB intends to attune its regulations to the Directive no later than in 1999.

In Poland, only basic elements of the Solvency Ratio Directive are included in the existing legislation on banking supervision. The Polish classification of own funds' risk categories is more stratified than the EU standards, and claims against regional governments and national credit institutions are treated more strictly than in the EU Directive.

However, the Polish government has announced that the Banking Act will be fully harmonized with the Solvency Ratio Directive as of January 1, 1999. Off-balance-sheet business will be included on the basis of the original exposure approach.¹⁾

Slovenia and Hungary can be said to have largely implemented the Directive.²⁾

4.4 Deposit Guarantee Directive (94/19/EC)

a) Objectives

This Directive is built on two principles: First, all credit institutions registered in the EU must subscribe to a deposit guarantee scheme. Second, deposits in branch offices are covered by the guarantee system in the Member State of the head office. The minimum sum covered by deposit guarantee schemes has been set at ECU 20,000.

b) Implementation

In Slovenia, the main principles of the Deposit Guarantee Directive have been incorporated into the draft law. However, the guarantee is limited to natural persons, whereas the EU Directive also includes legal persons, although their coverage can be reduced by up to 10%.

At present, deposits in Hungary are only guaranteed up to a limit of approximately EUR 5,000, which is not in line with EU legislation, even if one takes into account EU transitional provisions.³⁾

The Hungarian authorities argue that the fact that the average level of income in Hungary lies well below EU levels justifies a lower coverage margin.⁴⁾ The Hungarian central bank regards the EU levels of coverage as too high for Hungary and therefore calls for a transition period of five years.

In the Czech Republic, the latest amendment of the Banking Act includes, among other things, a further step towards fulfilling the EU Deposit Guarantee Directive: Guarantees now also cover legal persons,

1 One should bear in mind, however, that the marking-to-market approach is more widely recognized internationally.

2 Note that none of the accession states has implemented the Netting Directive, which provides for the recognition of bilateral netting agreements regarding some off-balance-sheet items. As a result, credit institutions may have to hold larger volumes of own funds to comply with the 8% minimum own funds requirement.

3 Article 7 stipulates that Member States may retain the maximum amount laid down in their guarantee schemes up until December 31, 1999, provided that this amount is not less than EUR 15,000.

4 From the Hungarian point of view, implementing higher coverage margins would entail moral hazard.

and the upper limit for coverage has been raised from 80% to 90% of deposits (from CZK 300,000 to CZK 400,000).

Yet to comply with EU legislation, the coverage would have to amount to approximately CZK 770,000 (EUR 20,000). Furthermore, no mention of the three-month time limit within which depositors are to be paid is made (Article 10 of the Directive); in addition, deposits in branches abroad are not covered by the Czech deposit guarantee scheme, and Czech bank bonds as well as deposits in foreign currencies¹⁾ are excluded from the scheme.

In Poland, the Deposit Guarantee Directive has not been implemented yet, at least not as far as the levels of coverage are concerned. According to the National Bank of Poland, the minimum coverage prescribed by the Directive is to be introduced soon; no exact date was mentioned, however. The legislation currently in force provides for a coverage of approximately EUR 5,000, whereas the Directive calls for EUR 20,000.

4.5 Second Banking Directive (89/646/EEC)

a) Objectives

This Directive stipulates that Member States mutually recognize each other's banking supervision results. The annex lists core banking activities which a credit institution can conduct throughout the EU, provided it is licensed to do so in the country where the head office is established.

b) Implementation

Overall, banking supervision legislation in all four countries surveyed is very restrictive on access for foreign credit institutions and the principle of mutual recognition of supervision. The "single licence principle," for instance, cited in the EU legal framework, has not been implemented. To open a branch office in Slovenia, a foreign bank, regardless of whether it comes from an EU country or not, must obtain a license from the local authorities.

The Bank of Slovenia's expressly stated right to supervise EU credit institutions' branch offices, which is laid down in the latest draft law, also represents a serious infringement on the Directive's core principles (home country principle). In addition, a number of important provisions on supervision were not included in the draft.²⁾

In Hungary, the requirements banks need to fulfill to be allowed to establish branch offices are much the same as for founding a subsidiary; such restrictions are not in compliance with the EU Directive.³⁾ To establish a branch office in Hungary, a credit institution needs to obtain authorization both from the authorities in its home country and the host country's authorities.

¹ Pursuant to the Deposit Guarantee Directive, only deposits in currencies other than those of the Member States can be excluded.

² E.g. minimum requirements for initial capital are not imposed on savings banks and savings cooperatives; there are no provisions on the competent authorities' right to withhold authorization under certain circumstances, etc.

³ The "single licence principle" defined in the EU Directive stipulates that a credit institution wanting to establish a branch office in another EU country is required to inform only its own domestic authorities, who then pass on the information to the host country's authorities. Accordingly, branch office supervision also lies in the hands of the home country authorities (home Member State principle).

With the exception of the Czech Republic, all countries surveyed point out in their statements that the freedom of establishment and to provide services can only be granted once they obtain full EU membership, because their banking sectors are not yet ready for fully fledged cross-border competitive pressure. As this is a highly sensitive and controversial issue politically, the process of negotiations and adjustment in this field is likely to become rather protracted.

The Czech Republic has voiced its intention to correct existing shortcomings before it obtains full membership in the EU. This can be understood to imply recognition of the underlying home country principle. Some deficiencies remain regarding provisions on excluding credit institutions from the upper limit of shares they are permitted to hold in nonfinancial institutions and regarding the exchange of information with third countries (professional secrecy).

4.6 Annual and Consolidated Accounts Directive (86/635/EEC)

a) Objectives

The Annual and Consolidated Accounts Directive aims to harmonize provisions companies have to adhere to in order to protect shareholders' and third parties' interests. Inter alia, the Directive affects annual accounts and valuation rules (hidden reserves are authorized under certain circumstances).

b) Implementation

Due to the choices and generous leeway for interpretation the Directive offers, the degree of implementation does not seem all too relevant.

The definition of Slovenia's accounting standards was based on the international framework of the IAS (International Accounting Standards). Owing to the general character of EU and IAS guidelines, Slovenia was able to incorporate domestic specifics and experience into the definition of its own standards, as well as strong elements taken from U.S. accounting principles. Overall, Slovenia can be said to have implemented the Directive.

If one takes into account the ample scope for interpretation mentioned above, Hungary can also be considered to have largely implemented the Directive. Some deviations from the Directive, however, concern publication, the balance sheet structure and the profit and loss accounts.

Poland reports that it has fully implemented the Directive; the Czech Republic intends to adopt the regulations in 1999.

4.7 Consolidated Supervision Directive (92/30/EEC)

a) Objectives

The Consolidated Supervision Directive provides a platform for the supervision of banking groups on a consolidated basis. To render this supervision effective, it has been expanded to apply also to groups of companies which hold more than 20% of a financial institution's voting rights or capital, even if the parent undertaking is not a credit institution. The competent authorities must be in a position to receive all the necessary data for all undertakings in the group in order to be able to assess the credit institutions' financial situation in the group framework.

b) Implementation

None of the four countries under review appears to be close to full implementation of this Directive, which is so crucial to EU framework legislation.

In Slovenia, the Directive's basic elements have been incorporated into the draft law, the details, however, do not conform to EU legislation. The current draft proposal refers to a regulation which the Bank of Slovenia and Slovenia's auditing body have yet to compile, which is to define the details of consolidated supervision in Slovenia.

Hungary has only partially implemented this Directive so far. Hungarian legislation on banking supervision stipulates that consolidated supervision is to take place at least once every year. The law does not call for additional consolidated supervision between these annual supervision inspections, however.

Furthermore, the requirements of consolidated supervision are not defined clearly enough. Each credit institution is obliged to fulfill the banking supervisory requirements primarily on its own.

In the Czech Republic this Directive (as well as the Annual and Consolidated Accounts Directive) has not been incorporated into Czech legislation. Implementation is due to start in 1999.

It is remarkable that unlike the remaining CEECs, the Czech Republic has not even implemented the rudiments of the Consolidated Supervision Directive.

Poland has implemented only parts of the Directive. The new Banking Act contains provisions on consolidation; however, these provisions only relate to banks, not to financial holding companies, financial institutions, securities firms or companies providing ancillary banking services. Nonetheless, without full implementation of the consolidated supervision principle, the supervision of finance groups operating on an international level appears inadequate. Polish legislation on banking supervision does at least provide for international cooperation among supervising bodies.

4.8 Large Exposure Directive (92/121/EEC)

a) Objectives

This Directive prevents banks from granting an excessive volume of loans to a single debtor or a group of connected debtors. A loan is classified as a large exposure if its value is equal to or exceeds 10% of the creditor's own funds.

b) Implementation

Slovenia's draft law fully implements the Directive.

Legislation in Hungary largely corresponds to the Directive. The regulations on subsidiaries and parent companies are stricter in Hungary than in the EU Directive. This could be linked to the fact that Hungary has not yet established any efficient structures for consolidated supervision.

Czech legislation is largely in line with the Directive:

Article 4 (3) of the Directive states that a credit institution may not incur large exposures which in total exceed 800% of its own funds; in the Czech Republic this limit was set at 230%, which means that Czech legislation is stricter in this respect. The Czech authorities have, however, stated

their intention of bringing their regulations in line with the EU Directive by 1999.

Overall, legislation in Poland corresponds to the Large Exposure Directive; however, and this is no minor exclusion, the provisions on large exposures of consolidated groups were not included.¹⁾

4.9 Capital Adequacy Directive (93/6/EEC)

a) Objectives

The Capital Adequacy Directive (CAD) defines minimum requirements for initial capital and own funds to cover market risk with securities from banks' and security firms' trading portfolios. Securities which do not belong to the trading book but to the bank book need to be backed by own funds according to the Solvency Ratio Directive.

b) Implementation

In Slovenia, the Directive has not been implemented so far; this was explained by the commercial banks' minor trade volume. Nevertheless, a new decree is to implement the Directive's Annex III on own funds requirements for open foreign exchange positions.

In Hungary no regulations on market risk have been implemented yet. So far, this gap has been bridged by stricter requirements on credit risk and, above all, off-balance-sheet business.

A recent amendment to the Hungarian Banking Act will regulate trade in securities as of the beginning of 1999. The amendment of the Act on the Flo-tation of Securities, on Investment Services and on the Securities Exchange contains some elements of the CAD, such as the definition of the securities trade book and the daily marking-to-market requirement. Provisions on the capital requirements for the trading book are forthcoming.

In the Czech Republic, no steps have been taken so far to implement this Directive, but the government plans to implement measures as of 1999.

In Poland implementation has not begun, nor have any plans to commence been announced yet.

4.10 Money Laundering Directive (91/308/EEC)

a) Objectives

The Money Laundering Directive is designed to combat the laundering of profits derived from criminal activity, above all drug trafficking. To this end, credit and financial institutions are required to identify their customers in any transactions amounting to EUR 15,000 or more.

b) Implementation

So far, only Slovenia has fully implemented this Directive; it introduced the necessary measures in a special law published in 1994.

In the remaining three countries under review the Directive has been implemented by and large; however, according to the Commission's Banking

¹ *The Large Exposure Directive similarly applies to both single credit institutions and consolidated groups of institutions. The Directive was implemented in both in Article 27 (large exposure) and Article 30 (groups of credit institutions) of the Austrian Banking Act.*

Advisory committee, anonymous accounts are legal in Hungary, the Czech Republic and Poland.¹⁾ The Hungarian authorities are considering abolishing these accounts and identifying the owners of existing anonymous savings accounts.²⁾ Furthermore, these accounts are not covered by deposit guarantee schemes.

4.11 BCCI Directive (95/26/EC)

a) Objectives

This Directive is intended to improve the efficiency of banking supervision in the wake of the collapse of the Bank of Credit and Commerce International (BCCI).

b) Implementation

The Slovene draft law largely corresponds to the Directive. However, some adjustments should be made in the provisions concerning the granting of licenses, central administration, professional secrecy and external auditors.

In Hungary this Directive has not been formally implemented thus far; some provisions are nevertheless already inscribed in existing legislation. The crucial "principle of close links" (if the supervisory body is obstructed in properly performing its duty by the close links between the credit institution and other legal or natural persons, no license is to be issued) has not been fully incorporated into Hungarian legislation to date.

In the Czech Republic, on the other hand, the Directive has been largely implemented, while some formal shortcomings remain regarding the exchange of information between the supervisory authorities and external auditors.

In Poland, the Directive has not been sufficiently implemented up to the present. Some of the principles are contained in the existing law on banking supervision, such as the exchange of information between the competent authorities to safeguard the stability of the financial market.

4.12 Netting Directive (96/10/EC)

a) Objectives

This Directive is designed to foster a wider recognition of bilateral netting. Automatic bilateral netting of claims in the same currency should be allowed, so that only a single net sum, rather than gross liabilities, needs to be backed by own funds.

b) Implementation

As doubts regarding the applicability of bilateral netting agreements prevail in the legislature of the countries under review, none of the countries have so far implemented the Netting Directive.

¹ The Polish delegation at the sub-committee meeting on financial and economic affairs in Brussels on November 26, 1998, stated that there are no anonymous accounts in Poland.

² According to reports in the press on November 2, 1998, a draft proposal to abolish anonymous accounts has already been brought before Parliament.

5 Summary and Conclusions

5.1 Implementation of EU Secondary Legislation

In recent years, all four candidate countries under review (the Czech Republic, Hungary, Poland and Slovenia) have undertaken serious efforts to comply with EU secondary legislation and the Basle Core Principles for Effective Banking Supervision.

From the prudential supervision point of view, the most serious flaws are to be found in the fact that the *Consolidated Supervision Directive* has not or only partially been implemented:

The *Czech Republic* has not implemented even parts of the Directive; *Hungary* cannot be said to have included the concept of consolidated supervision into its current practice; *Poland* does not appear to have implemented it sufficiently, whereas *Slovenia* at least plans to implement parts of the Directive in the draft law which Parliament has yet to review and pass.

The implementation gap is less wide in the case of the *Deposit Guarantee Directive*:

As regards the level of coverage, the *Czech Republic*, *Hungary* and *Poland* have not yet fully implemented the Deposit Guarantee Directive. *Slovenia* has not established a deposit guarantee scheme so far; the draft law currently under review by the Slovene Parliament does not correspond to the Directive in all details.

Further efforts will also be needed to achieve compliance with the *First and Second Banking Directives*: The underlying *single licence principle* of EU framework legislation has not been put into force by any of the countries surveyed. *Hungary*, *Poland* and *Slovenia* do not intend to implement the Directives' main objectives, above all the right of establishment and the freedom to provide services, before their accession to the EU; only the *Czech Republic* is committed to full compliance ahead of attaining full membership.

The fact that the *Capital Adequacy Directive* has not been implemented should be noted; however, on account of the minor scale of trading activities in the countries under review, this shortcoming does not appear to be particularly significant, at least not as far as prudential supervision is concerned.

The existence of *anonymous accounts* in the countries under review¹⁾ – with the exception of Slovenia – should not be left unmentioned either.

Cooperation with EU supervisory bodies and with authorities in non-EU countries appears to be possible within certain limits, in practice, however, such cooperation is likely to be restricted.

The *Solvency Ratio Directive* has been implemented to varying degrees; the restrictive handling in comparison with EU guidelines may largely be due to problems in each individual banking sector and the underlying reform process. Moreover, this restrictiveness does not infringe on EU Directives.

¹ See footnote 1 on page 90.

5.2 Assessment of the Effectiveness of Prudential Supervision in the Applicant Countries under Review

Overall, it appears to be too soon to attempt a final assessment of prudential supervisory bodies' effectiveness in the candidate countries under review, because the definition of legal frameworks and the implementation of concepts and objectives have not been completed yet.

All the countries under review seem to have staffed their supervisory agencies well enough to enable them to comply with international requirements effectively.

The restructuring of supervisory bodies' legal and administrative framework, which has been largely oriented on Western European models, shows the characteristics of committed professionalism and appears to be going into the right direction.

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