

## **PREPARATION FOR SINGLE MARKET SUPERVISION TASKS**

International Law Office Internet Publication September, 2001

Author: Dr. Judit Budai, Dr. Hédi Bozsonyik

Act CXII of 1996 on Credit Institutions and Financial Enterprises (“Banking Act”) regulates the performance and supervision of financial services and supplementary financial services in Hungary and the supervision of financial services activities carried out abroad by credit institutions domiciled in Hungary via financial institutions established abroad. On the basis of Act I of 1994 (announcing the association agreement between Hungary and the member states of the European Union, in which Hungary undertook to harmonize its legal regulations with EU norms in the course of its preparations for joining the EU), Hungary has already harmonized its banking regulations with 12 EU directives (e.g., concerning principles of administrative requirements and supervision of the foundation and operation of credit institutions, requirements with respect to the prudent operation and capital adequacy, principles of consolidated bank and financial holding supervision, prevention of money laundering, deposit insurance and consumer protection in providing consumer credits).

In 1998, the Banking Act was already amended to allow for the domicile in Hungary of branches of foreign financial institutions subject to the obtaining of the necessary license specified in the Banking Act.

As of January 1, 1999, the Banking Act enabled credit institutions to trade in various securities (not just T-bonds) i.e. to render investment services, and therefore, to apply for universal financial and investment services licenses.

By Act CXXIV of 2000 new amendments have been introduced to the Banking Act.

### **(I) Effectiveness of amendments**

The majority of the amended provisions of the Banking Act came into force on January 1, 2001. There are provisions in the amendment which relate to the introduction of the single licensing practice within the EU. Therefore, these provisions will only come into force when the act announcing Hungary’s joining the EU shall come into force.

### **(II) Subject of the amendments**

#### **2.1 Scope of the Act**

The amended provisions extended the scope of the Banking Act. Previously, unless regulated otherwise in international agreements, the Banking Act extended to the supervision of financial services, supplementary financial services, bank representation activities and deposit insurance activities carried out in Hungary as well as to the supervision of financial services, supplementary financial services and bank representation activities carried out abroad by credit

institutions domiciled in Hungary via financial institutions established by them abroad.

The new provisions extend the scope of the Banking Act to (i) the consolidated supervision of bank groups and financial holding groups with respect to such group members as well as to those which are not deemed to be financial institutions, additionally (ii) to the supervision of third party business associations to which a credit institution may out-source administration (management) activities connected to its services.

The supervision extends to the licensing of foundation, commencement of operation, transformation, change of control, change of activity, appointment of officers and requiring reporting by financial institutions to supervising prudent operation of financial institutions, e.g. capital adequacy, owners, etc.) The supervision is carried out primarily by the Hungarian State Supervision of Financial Organization (“SSFO”), and with respect to certain supplementary financial services and activities carried out in a foreign currency, by the National Bank of Hungary.

With respect to the consolidated control of bank and financial holding groups, the amendment sets forth an additional requirement as a condition to obtaining of a foundation license by a financial institution so as to enable the SSFO to carry out the consolidated supervision function, i.e. the supervision of the bank group’s or financial group’s prudent operations on a group level. Namely, the financial institution must present to the SSFO the internal information flow and reporting system within the group and the founders must undertake to comply with the statutory reporting obligation to secure the consolidated supervision. Non-compliance with this obligation shall result in the withdrawal of the operation license.

It is the task of the SSFO to determine in the form of an SSFO Order to specify which administration (management) activities connected to credit institutions’ services may be out-sourced by credit institutions to a third party business association. The condition of out-sourcing shall be a preliminary (30 days in advance) reporting to the SSFO of the commencement of such mandate. The SSFO shall be entitled to refuse the out-sourcing, if the mandate agreement to be concluded between the credit institution and the third party business association (which must also be submitted to the SSFO) does not contain among others the presentation of procedures (e.g. internal rules, facilities) to keep bank secrets confidential and the approval of the third party business association to on-the-spot supervision of its records by the internal controller of the out-sourcing credit institution, the SSFO and the National Bank of Hungary. Financial enterprises do not have to report such out-sourcing to the SSFO prior to its commencement. However, they must comply with the provisions of the amendment, if the out-sourcing involves the transfer of data to be deemed as a bank secret.

## 2.2 Activities and domicile in Hungary not subject to license

The amendment intends to ensure that Hungary properly adapts to the EU principle of the free movement of financial services and the practice of single licensing.

This means that following the joining of Hungary to the EU credit institutions and certain financial enterprises which were founded in another EU member state shall be entitled to perform cross-border financial services and supplementary financial services without the obligation to establish a branch in Hungary.

Currently, a foreign financial institution may only perform cross-border activities in Hungary if it establishes a branch. The operation of the branch as a financial institution is subject to a license. As of January 1, 2001, however, financial institutions which are domiciled in an OECD member state may provide loans and render financial leasing services as cross-border services without the obligation to establish a branch in Hungary, if they obtained a license for such activities in their home country, and if they comply with applicable Hungarian foreign exchange regulations.

Additionally, the amendment sets forth that following the joining of Hungary to the EU, credit institutions and certain financial enterprises which were founded in another EU member state shall be entitled (i) to perform cross-border financial services and supplementary financial services regarding which they obtained a license in their home country, or (ii) to establish a branch in Hungary for such activity without a license. However, there will be a preliminary reporting obligation.

### 2.3 Other amendments

In line with the international undertaking assumed towards the OECD, the amendment allows branches of foreign financial institutions established in Hungary to render asset management services in the future to voluntary mutual insurance funds.

The amendment increased the minimum initial capital requirement of financial enterprises (enterprises which may obtain a license to render various financial and supplementary financial services, except for such services such as the collection of deposits which are reserved for credit institutions) from HUF 20 million to HUF 50 million. The amendment further expanded the definitions of financial enterprises by financial holdings the minimum initial capital requirement of which is now HUF two billion. The amendment also expanded the requirements for prudent operation (i.e., provisions on equity, risk-based capital, reserves, capital adequacy requirements, limitation on undertaking of risks) to financial enterprises which formerly applied to credit institutions only.

Finally the amendment contains a number of specification of definitions and specification of technical procedural rules with respect to supervision and reporting requirements to further harmonize the Banking Act and its terminology with international practices.

*For further information on this topic, please contact Dr. Judit Budai and Dr. Hédi Bozsonyik at Szecskay Law Firm - Moquet Borde & Associés by telephone (+36 (1) 353 1255) or by fax (+36 (1) 353 1229) or by e-mail ([mba@szecskay.hu](mailto:mba@szecskay.hu)).*