NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY
1027 Budapest, Horvát u. 14-24.

ANNUAL REPORT 1999

Contents

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY

Balance sheet ASSETS

THUF

ASSETS	31.12.1998	31.12.1999
A. Fixed assets	**38,469**	**29,776**
I. Intangible assets	4,816	2,420
1. Rights and concessions	0	0
2. Intellectual properties	4,816	2,420
3. Capitalised costs of establishment and reorganisation	0	0
II. Tangible assets	24,658	18,387
1. Land and buildings	0	0
2. Equipment, machinery, vehicles	24,658	18,387
3. Assets under construction	0	0
4. Advance on assets under construction	0	0
5. Revaluation surplus on tangible assets	0	0
III. Financial investments	8,995	8,969
B. Current assets	**18,233,421**	**24,176,456**
I. Inventories	17,300	17,300
1. Raw materials and consumable goods	0	0
2. Goods	17,300	17,300
3. Subcontracted services	0	0
4. Advances	0	0
II. Receivables	934,575	6,072,583
1. Receivables from member institutions	540,842	5,616,342
a) Premium receivables	38,364	0
b) Receivables devolved to the Fund	262,073	5,320,392
c) Fees concerning obligations with recourse	240,405	295,950
2. Other receivables from credit institutions	365,194	430,917
3. Receivables from depositors	0	0
4. Receivables from the government	0	0
5. Other receivables	28,539	25,324
III. Securities	17,230,408	18,077,271
1. Government securities	17,230,408	18,077,271
2. Other securities	0	0
IV. Liquid assets	51,138	9,302
1. Cash, cheques	360	251
2. Bank deposits	50,778	9,051
C. Prepaid expenses and accrued income	**957,195**	**883,498**
TOTAL ASSETS	**19,229,085**	**25,089,730**

Budapest, February 29th 2000

Dániel Jánossy
Managing Director

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY
Balance sheet EQUITY AND LIABILITIES

THUF

EQUITY AND LIABILITIES	31.12.1998	31.12.1999
D. Shareholders' equity	**18,310,665**	**21,536,606**
I. Registered capital	807,017	807,267
II. Reserves	12,932,772	17,503,648
III. Revaluation reserve	0	0
IV. Retained profit for the year	4,570,876	3,225,691
E. Provisions	**860,815**	**3,497,069**
F. Liabilities	**8,469**	**49,221**
I. Long-term liabilities	0	0
II. Short-term liabilities	8,469	49,221
1. Liabilities due to member institutions	151	0
2. Short-term credits	0	113
3. Liabilities due to depositors	0	0
4. Liabilities due to the government	0	0
5. Other short-term liabilities	8,318	49,108
G. Accrued expenses and deferred income	**49,136**	**6,834**
TOTAL EQUITY AND LIABILITIES	**19,229,085**	**25,089,730**

Budapest, February 29th 2000

Dániel Jánossy
Managing Director

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY

Profit and loss account (total cost method)

THUF

	Description	1998	1999
01.	Premium income from member institutions	4,992,799	3,405,472
02.	Fee income from receivables recovered by depositors' order	0	0
03.	Commission income from the reimbursement of deposits with state guarantee	0	0
04.	Fines due to NDIF collected by the Hungarian Banking and Capital Market Supervision	9,724	84,655
I.	Income from deposit insurance (01+02+03+04)	5,002,523	3,490,127
II.	Other income	127,988	5,103
	Reversal of provisions	801,976	860,815
III.	Non-deposit insurance income	66,879	55,545
IV.	Income from financial transactions	5,091,806	5,206,733
V.	Extraordinary income	27,294	0
05.	Expenses on the payment of frozen deposits	0	11,740
06.	Expenses on receivables collected on behalf of depositors	0	0
07.	Expenses on the payment of deposits guaranteed by state	0	0
VI.	Expenses on deposit insurance (05.+06.+07.)	0	11,740
VII.	Other expenses	330,344	99,240
	Provision charges	860,815	3,497,069
VIII.	Non-deposit insurance expenses	0	0
IX.	Expenses on financial transactions	5,171,625	2,583,552
X.	Extraordinary expenses	0	0
08.	Material-type costs	16,570	19,818
09.	Staff costs	106,151	117,320
10.	Depreciation	13,044	12,048
11.	Other costs	49,041	51,845
XI.	Operating costs (08.+09.+10.+11.)	184,806	201,031
A.	**Retained profit for the year (I.+II.+Reversal of provisions+III.+IV.+V.-VI.-VII.-Provisions - VIII.-IX.-X.-XI.)**	**4,570,876**	**3,225,691**

Budapest, February 29th 2000

Dániel Jánossy
Managing Director

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY
Cash flow statement

THUF

Description	1998	1999
I. Cash flows from operating activities (lines 1-11)	**-4,934**	**-38,731**
1. Retained profit for the year	4,570,876	3,225,691
2. Depreciation charge	13,044	12,048
3. Write off of investment	3,061,944	0
4. Net provision charge	58,839	2,636,254
5. Gain on sale of fixed assets	0	0
6. Changes in trade creditors	-601	30,016
7. Changes in other short-term liabilities (excluding trade creditors)	1,100	10,736
8. Changes in accrued expenses	8,525	-42,302
9. Changes in trade debtors	-10,914	806
10. Changes in current assets (excluding trade debtors and liquid assets)	-7,467,101	-5,985,677
11. Changes in prepaid expenses and accrued income	-240,646	73,697
II. Cash flows from investing activities (lines 12-13)	**-5,287**	**-3,355**
12. Acquisition of fixed assets	-7,541	-6,596
13. Proceeds from sale of fixed assets	2,254	3,241
III. Cash flows from financing activities (lines 14-17)	**54,664**	**250**
14. Proceeds from issuance of share capital (capital increase)	54,664	250
15. Borrowings	0	0
16. Capital contribution received	0	0
17. Redemption of shares (capital decrease)	0	0
18. Repayment of loans	0	0
19. Capital contribution given	0	0
IV. Changes in liquid assets (lines +/-I.+/-II.+/-III.)	**44,443**	**-41,836**

Budapest, February 29th 2000

Dániel Jánossy
Managing Director

1. General

1.1 Presentation of National Deposit Insurance Fund of Hungary

Name of organisation:	**National Deposit Insurance Fund of Hungary, abbreviated name: NDIF or Fund**
Registered office:	**1027 Budapest, Horvát utca 14-24.**
Method of foundation:	**Act XXIV of 1993**
Date of foundation:	**March 31st 1993**
Form of business:	**916 other non-profit oriented body**
Scope of activity:	**6719 Additional financial services not listed elsewhere**
Tax number:	**10830516-2-41**
Statistical number:	**10830516-6719-916-01**
Social security number:	**71882-6**
Members of the Board of Directors:	Vice-President of the **National Bank of Hungary** Administrative Under-Secretary at the **Ministry of Finance** President of the **Hungarian Banking and Capital Market Supervision** (as of April 1st 2000 **Hungarian Financial Supervisory Authority**) Secretary-General of the **Hungarian Banking Association** Representative of the **National Federation of Savings Co-operatives** Managing Director of **NDIF** and their permanent deputies

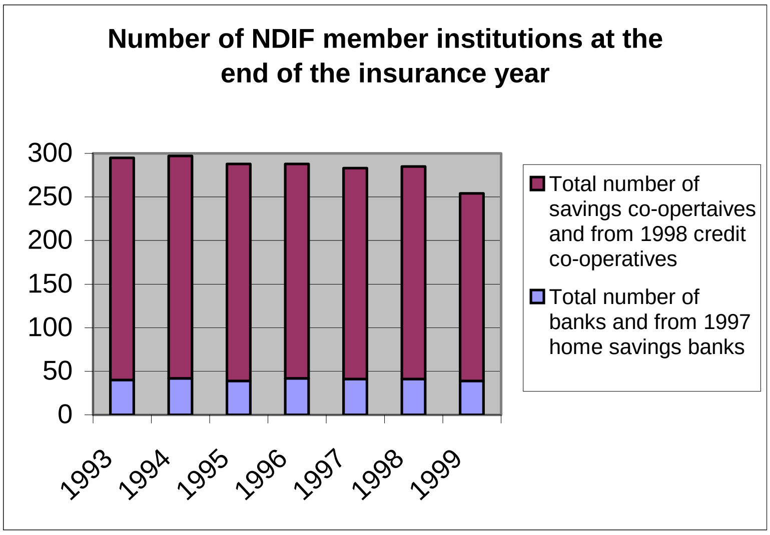
1.2 The member institutions of the Fund and their deposit portfolios

1.2.1 Number of member institutions

On December 31st 1998 the Fund had a total of 285 members, which included 37 banks, 4 home savings banks, 236 savings co-operatives and 8 credit co-operatives. By December 31st 1999 the number of the Fund's members had dropped to 254 for the following reasons:

- During the year – due to mergers and liquidations – the number of member banks fell by 2 (Európai Kereskedelmi Bank Rt. merged into Citibank Budapest Rt., and Realbank Rt. was liquidated).
- Through mergers, the number of savings co-operatives dropped by 30 and with the foundation of Eurodirect Savings Co-operative this figure increased by one. Therefore in total, the number of savings co-operatives decreased by 29.

On December 31st 1999 the Fund had a total of 254 members, including 35 banks, 207 savings co-operatives, 8 credit co-operatives and 4 home savings banks.



1.2.2 Review of insured deposit portfolio by type of deposit and member institution

According to the 1998 year-end balance sheet data, the shares of the commercial banking sector (including home savings banks) and the co-operative sector (including credit co-operatives) in savings deposited at credit institutions was around 92.6 and 7.4% respectively. This proportion was 93.2 and 6.8% at the beginning of 1998 (Table 1).

Breakdown of savings by type of financial institution

Table 1

Description	1998 opening	1999 opening		
	Portfolio in THUF	Portfolio in THUF	of which (%)	
			Banks and home savings banks	Co-operative credit institutions
Deposits	**3,536,735,585**	**4,158,432,229**	**92.8**	**7.2**
of which savings deposits	501,507,498	593,190,189	72.7	27.3
other deposits	3,035,228,087	3,565,242,040	96.1	3.9
Securities	**384,418,182**	**362,292,377**	**93.4**	**6.6**
Interest payable	**70,809,345**	**80,603,553**	**82.6**	**17.4**
TOTAL	**3,991,963,112**	**4,601,328,159**	**92.6**	**7.4**

The share of deposits insured by NDIF in savings at credit institutions increased from 68.3% to almost 71% during 1998, while the portfolio guaranteed by the state fell from 10.0% to around 7.7% and the non-insured portfolio from 21.7% to 21.4%. Thus the proportion of deposits with some form of institutional protection within the credit institution sector rose from 78.3% at the beginning of 1998 to 78.6%, as a result of the decrease in deposits guaranteed by the state and the increase in deposits insured by the Fund. The share of non-insured savings fell, albeit slightly. This was the result of an increase in the level of protection of interest on deposits (recorded among accrued expenses and deferred income and not yet accounted). The share of non-insured/unguaranteed savings deposits rose by 8% (Table 2).

Breakdown of savings by type of coverage

Table 2

Description	1998 opening (%)			1999 opening (%)		
	Insured by NDIF	Guaranteed by the State	Non-insured	Insured by NDIF	Guaranteed by the State	Non-insured
Deposits	**75.7**	**11.9**	**12.4**	**77.1**	**8.2**	**14.7**
of which savings deposits	36.8	38.6	24.6	36.1	31.2	32.7
other deposits	82.2	6.6	11.2	83.9	4.4	11.7
Securities	**4.2**	**0.2**	**95.6**	**3.1**	**0.2**	**96.7**
Interest payable	**44.2**	**7.7**	**48.1**	**55.6**	**11.9**	**32.5**
TOTAL	**68.3**	**10.0**	**21.7**	**70.9**	**7.7**	**21.4**

The division of savings by type of protection in terms of sectors is as follows. At the beginning of 1999 NDIF insured 71.6% of savings deposited with banks and 62.4% of savings in the co-operative credit institution sector. These proportions correspond to a 2.5% rise in the banking sector and a 6.2% rise in the co-operative sector compared with the figures at beginning of 1998. In the banking sector, the protection provided by the Fund in terms of savings deposits and securities fell in comparison with the previous year, but the ratio of non-insured savings increased considerably (Table 3).

In the co-operative sector, the protection provided by the Fund increased significantly in 1998, which was essentially caused by the reclassification of security-type deposits based on Section 88 of the Act on Credit Institutions. In 1999 the increase fell to 6.2%. The level of protection provided by NDIF increased solely to the detriment of state-guaranteed deposits, the share of non-insured deposits rose slightly, which can be attributed to non-registered savings deposits (Table 4).

In recent years, the proportion of savings not insured by institutions was always greater in savings co-operatives than in banks. This difference evened out by the beginning of 1999.

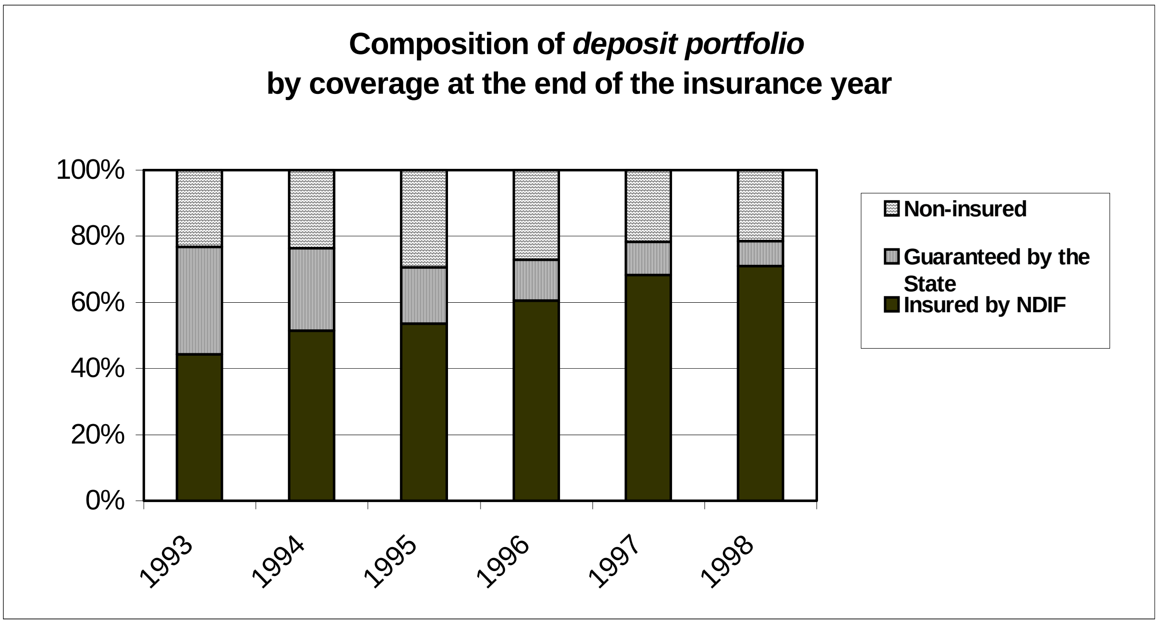
Breakdown of savings by coverage and type of credit institution at the beginning of 1999

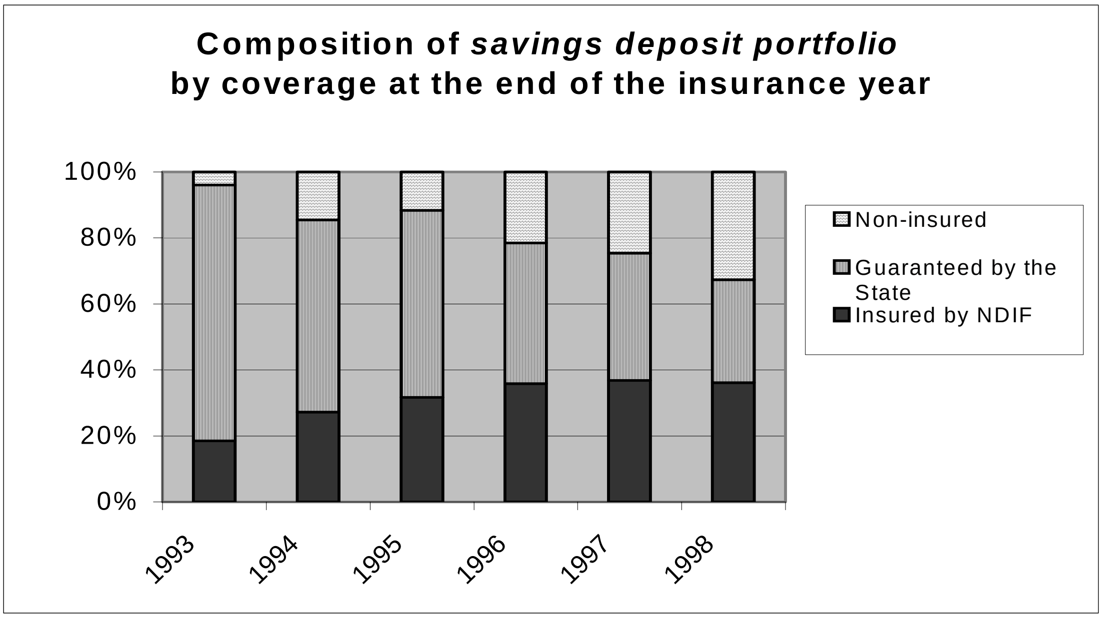
Table 3

Description	Banks and home savings banks (%)			
	Insured by NDIF	Guaranteed by the State	Non-insured	**Total**
Deposits	**78.1**	**7.6**	**14.3**	**100.0**
of which savings deposits	25.7	35.7	38.6	**100.0**
other deposits	84.7	4.0	11.3	**100.0**
Securities	**0.2**	**0**	**99.8**	**100.0**
Interest payable	**57.4**	**7.7**	**34.9**	**100.0**
TOTAL	**71.6**	**7.0**	**21.4**	**100.0**

Table 4

Description	Co-operative credit institutions (%)			
	Insured by NDIF	Guaranteed by the State	Non-insured	**Total**
Deposits	**64.5**	**16.6**	**18.9**	**100.0**
of which savings deposits	63.8	19.2	17.0	**100.0**
other deposits	65.4	13.6	21.1	**100.0**
Securities	**44.4**	**3.0**	**52.6**	**100.0**
Interest payable	**47.0**	**36.4**	**16.6**	**100.0**
TOTAL	**62.4**	**16.3**	**21.3**	**100.0**





1.3 Indemnity commitments of the Fund

The division of institutional protection in respect of savings at credit institutions (the indemnity commitments of the Fund and the state guarantee commitments) evolved as follows between 1993-99:

In 1993, when deposit insurance started, the Fund insured around 44% of savings, state-guaranteed deposits accounted for around 32.5%. About 23% of savings were not insured.

At the beginning of 1999, NDIF was the main provider of institutional protection with a 71% share, while the state guarantee share of deposits untouched since 1993 dwindled to 8%. The proportion of non-insured deposits changed only slightly (from 23% to 21%).

The NDIF indemnity commitment ratio within insured deposits fell to 45% (a 3% drop compared to 1998). This was caused by the fact that within the insured deposit portfolio, which is covered by the Fund, the stock of deposits higher than HUF 1 million, i.e. the non-insured part of deposits grew. As a result, the insured deposits portfolio within the whole savings portfolio increased (the level of protection rose from 68% to 71%), but the indemnity commitment of NDIF fell by 1% (from 33% to 32% within the savings deposited at credit institutions).

To take a wider interpretation of the joint extent of NDIF insurance and state guarantees, the conclusion is that according to current legal regulations in force *there is approximately a 40% indemnity commitment in Hungary to ensure the smooth operation of the credit institution system and to strengthen depositor confidence*. From this, the credit institution sector covers 32% of the indemnity pertaining to NDIF and the state budget is responsible for other 8% (Table 5).

Indemnity obligations of the Fund in 1993, 1998, 1999

Table 5

Description	Start of insurance year	(%)			
		Insured by NDIF	Guaranteed by State	Non-insured or non-guaranteed portfolio	Total
Total savings by type of coverage	1993 1998 1999	44.2 68.3 70.9	32.5 10.0 7.7	23.3 21.7 21.4	100.0 100.0 100.0
Ratio of indemnity or guarantee obligations within the insured/guaranteed portfolio (for NDIF, up to HUF 1 million)	1993 1998 1999	n.d. 48.0 45.0	100.0 100.0 100.0	0 0 0	- - -
Ratio of indemnity or guarantee obligations within the savings portfolio of all NDIF member institutions	1993 1998 1999	**n.d.** **32.8** **31.9**	**32.5** **10.0** **7.7**	**0** **0** **0**	**n.d.** **42.8** **39.6**

n.d. = no data

1.4 Sources of the Fund and the proportion of liquid assets to commitments

According to Section 119 of the Act on Credit Institutions, the own revenue sources of the Fund include one-off admission fees, regular premium payments and if necessary, extraordinary annual contributions paid by the members, returns on financial investments of the Fund and the portion recovered from receivables transferred to the Fund. These sources may be supplemented by the Fund through borrowing.

a.) Admission fee:
Those credit institutions which receive a license to collect deposits must pay an admission fee to the Fund upon becoming a member institution. The admission fee corresponds to 0.5% of the registered capital of the member institution.
In 1999 the income of the Fund on these grounds was THUF 250, through the admission of Eurodirect Savings Co-operative.

b.) Annual premium:
Section 121 (1) and (2) of the Act on Credit Institutions specifies the upper limit for the statutory annual regular premium to be paid by the members as 0,2% of the deposit portfolio of the member institution insured by the Fund as at December 31st of the year preceding the year under review. When establishing the annual premium payment of Fund members, the whole of their insured deposit portfolio must be taken into account.

From 1999 the premium policy of the Fund changed significantly. Instead of the former two rates, the member institutions had to fulfil their annual payment requirements based on four premium rates which decrease in increments the higher the deposit size (the 1999 premium policy of the Fund is detailed in Chapter 3.2).

Due to the structural change in the premium rates the average premium rate fell from 0.18% to 0.107% and the premium income of the Fund dropped from HUF 4.9 billion in 1998 to HUF 3.4 billion in 1999.
The decrease in premium income took place in the *banking sector*. There were several reasons for this:

- The relatively quick growth rate of the premium base from previous years slowed down. This premium base was accompanied by a lower average premium rate.
- The average (weighted) premium rate of credit institutions with small deposits, which make up two-thirds of the premium base, fell significantly (from 0.19 to 0.117%). This points to the fact that the deposit composition of credit institutions with small deposits- in comparison to the HUF 1 million indemnity limit – has also shifted towards larger deposits.

The development at *savings co-operatives* was the opposite, because the relatively swift premium base increase was accompanied by a small drop in premium rates. This led to a premium income rise in comparison to the previous year.

The change in the premium payment system was supported by a favourable development in the financial situation of NDIF. The NDIF coverage ratio – which compares the Fund assets (in government securities) with indemnity liabilities – rose during 1998 from 1% to 1.12%. (In the calculation is compared the portfolio of liabilities as of December 31st 1998 with NDIF's assets prevailing on the same date, the same calculation was used at the beginning of 1998.)

The average size of deposits at credit institutions in the year under review rose by 31%, from THUF 209 at the beginning of 1998 to THUF 274.

Besides the normal premium payment requirements, every six months the Fund may set increased or preferential premiums. Based on the Premium Regulation, *increased premiums* might be set if the member institution did not comply with the prescribed capital adequacy indicator and/or complied with its premium or premium advance payment requirement with a delay of more than 30 days, or carried out particularly risky activity. (Section 121 (6) and (7) of the Act on Credit Institutions). Four member institutions paid increased premiums during 1999, which increased the premium income of the Fund by HUF 1.2 million.

In view of double protection, *preferential premium rates* were used for savings co-operatives, which were members of the National Savings Co-operatives' Institution Protection Fund, an organisation that concluded a co-operation agreement with the Fund and has adequate financial coverage. The preferential premium was applied for 203 savings co-operatives and this discount reduced the premium income of the Fund for the current year by HUF 80 million. In return, the National Savings Co-operatives' Institution Protection Fund refunds one-third of the possible indemnification eventually paid by the Fund to depositors under double protection as well as co-operates with the Fund upon request, e.g. in examination and prevention actions.

2.The Fund's assets, financial position and the result of operations

Main groups of assets in the balance sheet of the Fund as of December 31st 1999:

B.S. ref.	Description	1998 (THUF)	1999 (THUF)	1999/1998 (%)
A.	Fixed assets	38,469	29,756	77
B.	Current assets	18,233,421	24,176,476	133
C.	Prepaid expenses and accrued income	957,195	883,498	92
	TOTAL ASSETS	**19,229,085**	**25,089,730**	**130**
D.	Shareholders' equity	18,310,665	21,536,606	118
E.	Provisions	860,815	3,497,069	406
F.	Liabilities	8,469	49,221	581
G.	Accrued expenses and deferred income	49,136	6,834	14
	TOTAL LIABILITIES	**19,229,085**	**25,089,730**	**130**

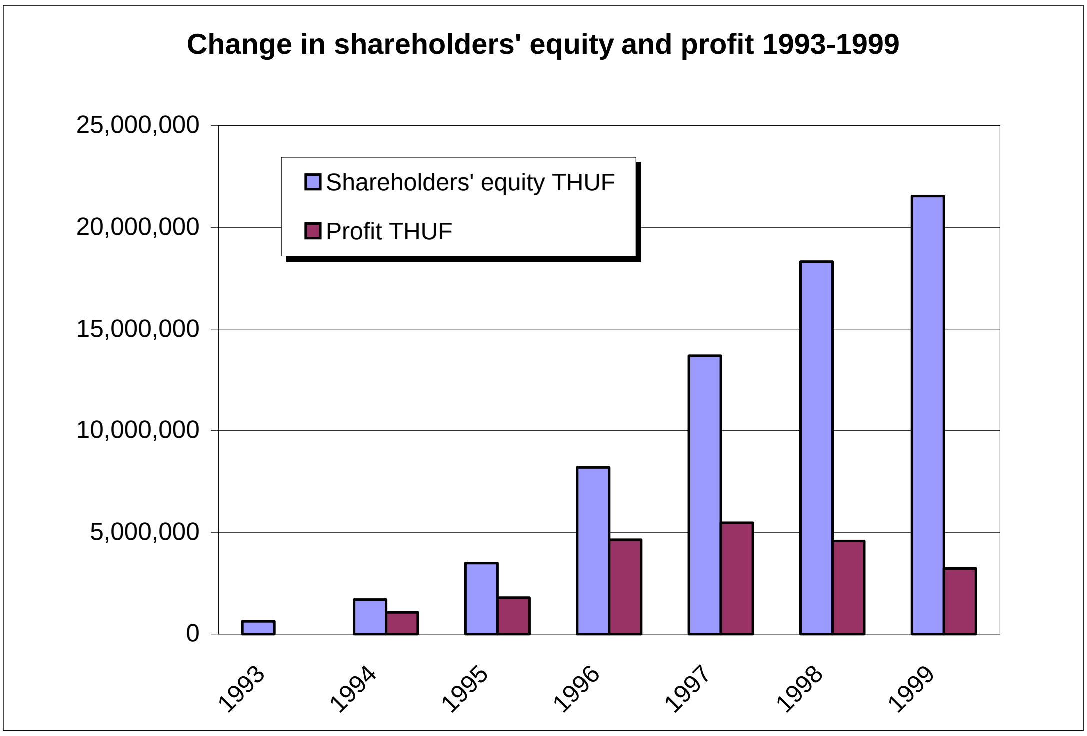
The balance sheet total rose almost by HUF 6 billion (by more than 30%). The rise among assets was caused by the increase in current assets, principally in receivables but also to a lesser degree in securities. Among equity and liabilities, more than half the total balance sheet increase was due to the growth in shareholders' equity (HUF 3.2 billion) and to a smaller extent in provisions.

Summary evaluation of profit

In 1999 the Fund achieved a retained profit for the year of THUF 3,225,691. This was HUF 1.3 billion down on the 1998 figure, the reason for which is shown in the following table.

Description	1998 (THUF)	1999 (THUF)	Difference (THUF)
Income from deposit insurance	5,002,523	3,490,127	-1,512,396
Other income	127,988	5,103	-122,885
Use of provisions	801,976	860,815	58,839
Non-deposit insurance income	66,879	55,545	-11,334
Income from financial transactions	5,091,806	5,206,733	114,927
Extraordinary income	27,294	0	-27,294
Total income	11,118,466	9,618,323	-1,500,143
Expenses on deposit insurance	0	11,740	11,740
Other expenses	330,344	99,240	-231,104
Provisioning	860,815	3,497,069	2,636,254
Non-deposit insurance expenses	0	0	0
Expenses on financial transactions	5,171,625	2,583,552	-2,588,073
Extraordinary expenses	0	0	0
Total expenses	6,362,784	6,191,601	-171,183
Operational costs	184,806	201,031	16,225
Total expenses and operational costs	6,547,590	6,392,632	-154,958
Retained profit	4,570,876	3,225,691	-1,345,185

Three factors influenced markedly the drop in the retained profit for the year, the rise in provisioning, the drop in expenses on financial transactions (the difference of which practically cancelled each other out) and the decrease in deposit insurance income due to the lower premium rate. The effect of operational costs on the profit continues to be negligible.



3. Supplementary information and additional data

3.1 PR activity of the Fund

The main direction of the 1999 PR policy was defined by the crisis management following the closure of Realbank Rt on January 14th 1999. With the assistance of NDIF's communications advisor, Capital Communications Kft., the Fund published the compulsory announcements in compliance with its obligations stipulated in the Act on Credit Institutions. In addition the Fund continuously provided information related to submitting claims and payments via press conferences, press announcements, the voicenews service and regional television channels. For the purposes of receiving the significantly increased amount of client telephone queries, NDIF organised an information service reachable on the telephone or the voicenews service. The Fund put great effort into summarizing and assessment client questions on a daily basis for updating of outgoing information, with particular attention to the issues that concerned depositors the most.

Continuing the process from the previous year NDIF organised regional press conferences in Szombathely, Zalaegerszeg and Miskolc, which focused on issues of local importance. In addition to general deposit insurance issues, emphasis was laid on information related to Realbank payments.

One of the important successes of 1999 was the implementation of the Deposit Register listing the insured deposit products., but the awareness of the Deposit Register is still not satisfactory. A film was produced to be broadcast on regional television for the popularization of the Deposit Register.

3.2 Premium policy of the Fund

The implementation of a refined premium payment system, which respects the demands of the member institutions with different (large- and small depositor) clients, is in the focus of the strategy of the Fund.

In 1998 the Fund carried out a survey on what proportion of the premium base at member institutions (the basis for the premium payments) is protected (deposit parts up to HUF 1 million).

The survey clearly proved the assumption that the deviation between the premium base and the indemnity commitment is very different by credit institutions. The “insurance price” paid to protect a HUF 1000 deposit (indemnity commitment) is more at the member institutions with large depositors than at those with small depositors.

From 1999 the premium policy of NDIF changed significantly in order to reduce the deposit insurance “price gap”. According to the provisions of the Act on Credit Institutions, the member institutions still have to pay an insurance premium on the total sum of insured deposits, but based on the experience of the mentioned survey, the premium payment system has been further refined. Instead of the former two premium rates, the member institutions have to calculate and pay their annual premiums based on four premium rates (differentiated by size of deposit) which decrease in increments the larger the deposit. The highest premium rate is for deposits between HUF 0-1 million, since the liability assumed / insured deposit ratio is the highest for this category. The lowest rate is for deposits above HUF 4 million, given that the liability assumed / insured deposit ratio is the lowest here.

The premium rates per type of credit institution and the effect on NDIF premium income is displayed in the table below:

Type of credit institution	Premiums paid in 1998** (HUF million)	Premiums paid in 1999** (HUF million)	1998 average premium rate (%)	1999 average premium rate (%)	Premium for HUF 1000 NDIF indemnity commitment (HUF) in 1999
Bank	4.611	3.160	0.179	0.104	2.5
Savings co-op.	285	300	0.19	0.143	1.7
Home sav. bk	5	26	0.19	0.16	1.6
Credit co-op.	3	4	0.14*	0.123	1.9
Total	**4.904**	**3.490**	**0.18**	**0.107**	**2.4**

* due to mid year admission
** different from balance sheet data due to preferential and increased premiums as well as reconciling items

The average premium rates in the table are calculated as the weighted average of the individual deposit size categories of the member institutions by type. They mirror the fact that the composition of deposits by size is fairly different in the credit institution sector (banks, savings co-operatives, etc.). The average premium rate of savings co-operatives and home savings banks is high because in these two types of credit institution the ratio of HUF 0-1 million deposits within insured deposits is large compared to the other two types. However, in consequence of the differentiated premium rates and deposit size composition, the banks pay the highest premium for HUF 1000 NDIF indemnity (HUF 2.48 for HUF 1000 indemnity).

The amendment to the premium payment system was favourable to all member institutions. The highest premium rate corresponds to the previous low rate (0.16%) and the average premium rate dropped from 0.18% to 0.107%.

The premium policy of the Fund for 2000 has not changed. The premium payment system might be changed with the planned amendment of the indemnity limit.

3.3 Examination activity of the Fund

The Fund carries out examinations (on-site and off-site) of its member institutions based on an annual plan approved by the Board of Directors. By the end of 1999 on-site and off-site examinations had been performed at 9 banks, 21 savings co-operatives and 3 credit co-operatives. In addition, the Fund performed two subsequent on-site reviews too.

In line with Section 124 of the Act on Credit Institutions, on-site examinations cover three main areas:
- fulfilment of premium payment obligation, verified with numerical data (Sections 99-100, 121 of Act on Credit Institutions);
- registration and updating of client data in the manner prescribed by law, in order not to be hindered by possible client indemnity due to data or documentation discrepancies (Section 105);
- compliance with the information obligations set forth in the Act on Credit Institutions and in other resolutions of the Fund's Board of Directors (e.g. deposit register) for the purposes of depositor protection (Sections 204-205, 207-208, 211).

Both the on-site and the off-site examinations show that one of the largest problems is to interpret *deposit "registration"* in the right way.

Section 105 (4) of the Act on Credit Institutions prescribes the necessary data of registered deposits to be recorded by the deposit collecting credit institution. In addition to the name of the depositor two additional pieces of identification data prescribed by the Fund have to be recorded for the purposes of clear determination of entitlement to the indemnity.
The examinations revealed, however, that some member institutions make it possible for the depositor only to give a name (even as a password). The credit institution does not request any further data or, it acknowledges that the client does not wish to provide any more information (the member institution does not regard such deposits as part of the premium base and considers them as payable to bearer). During the examinations the Fund always represents the stance previously approved by the Board that a deposit certificate with the name of the depositor qualifies as registered (own name cannot be accepted as a password!) and forms part of the premium base.

The review in 1999 of the member institution self-assessments, which form the basis for setting *premium payment requirements*, did not find any irregularities that had to be amended. However, depending on the level of development of the member institution's registration system, the premium payment documentation is sometimes insufficient.

The examinations' experience concerning the *recording of clients' data* is not reassuring. The problem is mainly found at savings co-operatives and credit co-operatives which have somewhat less financial muscle and for this reason the information technology systems used do not comply with modern registration requirements (do not allow application of product and client oriented registration system). Thus these member institutions do not have a standard, client-data registration system either, which means that clearly defining depositor entitlement to indemnity within reasonable time limits is doubtful and only possible with surplus costs.

During the inspection of the *business regulations, deposit contracts and deposit documents* at the reviewed member institutions numerous inaccuracies were found from a deposit insurance point of view: for example, in different documents references were found to laws which were repealed at the end of 1996. In the summary reports prepared on the reviews, the Fund always draws the attention of the member institutions to the necessary amendments on an item by item basis.

Acceptance of the *deposit register* at the member institutions – based on inspection experience – was positive. However, due to teething troubles with its introduction, the deposit product lists prepared by some of the member institutions and registered by the Fund (provided with an NDIF identification number) did not always tally with the list of deposits actually handled by the member institutions.

3.4 Developments related to the crisis management and liquidation of Realbank Rt.

The Hungarian Banking and Capital Market Supervision revoked the licence of Realbank Rt. to operate with effect from January 14th 1999 and ordered a prohibition on payments, thus the approximately HUF 5 billion indemnity obligation of NDIF, in accordance with the Act on Credit Institutions, set in.

NDIF published its announcement related to the Realbank depositor indemnity in two national newspapers and the main county newspapers set up an indemnity database and concluded the necessary agreements with partners co-operating in the indemnity process. The indemnity of depositors began on February 17th 1999, within the regulatory deadline.

- A HUF 5.7 billion insured deposit portfolio was frozen in Realbank, of which HUF 5.1 billion was made up of deposits under HUF 1 billion.
- The depositors lodged around 15,000 claims during 1999. Cash payments were performed by the Kereskedelmi és Hitelbank Rt., and transfers by NDIF from an account at the National Bank of Hungary.
- NDIF effected the payments throughout 1999 (and to a small extent in 2000 as well) as follows: THUF

Legal title of payment ***Payer***	***Capital***	***Interest***	***Total***
Realbank Rt. und. liq. (advance payment)	20,958	214	21,172
K&H Bank Rt.	3,186,502	171,479	3,357,981
Total cash	*3,207,460*	*171,693*	*3,379,153*
Amount transferred by NDIF	*1,608,025*	*70,399*	*1,678,424*
Total	***4,815,485***	***242,092***	***5,057,577***

NDIF notified the liquidator of Realbank Rt. of the above amount and the liquidator confirmed it as a receivable in line with Paragraph d) of Section 57 (1) of Act IL of 1991 on Bankruptcy Proceedings, Liquidation Proceedings and Voluntary Dissolution (Act on Bankruptcy).

- The breakdown of *additional costs* related to deposit insurance which arose in 1999 in connection with Realbank deposit indemnity is as follows:

Communications	25 %
Information technology	44 %
Submission of claims	25 %
Payments	6 %
Total	*100 %*

In accordance with the legal regulation referred to above, the liquidator accepted a small part of the costs as a rightful creditor claim in the f) category, it disputed or refused the rest of the costs, particularly in relation to information technology and communications. By the time this report was prepared, there had been no legally binding court resolution in the matter.

Taking into account the financial situation of Realbank Rt. (under liquidation) as well as the legally binding court resolution in the matter of bondholder claims, NDIF as creditor moved for the liquidator to effect interim payments based on the interim balance sheet. (On the basis Section 50 of the Act on Bankruptcy.)

3.5 Pending litigation

In 1999 NDIF was the defendant in 6 legal cases, of which 3 were related to the Realbank, one with Dunabank, one with Iparbankház and one with Heves and Environs Savings Co-operative.

From the Realbank cases – whose joint amount in dispute totals around HUF 72 million – one was closed res adjudicata, the court did not establish the payment liability of the Fund for the Reallízing ’96 and Reallízing 2000 bonds, the total principal amount of which is approximately HUF 1.5 million.

The Dunabank case –HUF 1 million in dispute – was discontinued following a 6-month break.

There was no significant change in the HUF 91 million case with Iparbankház and in the HUF 600,000 case with Heves and Environs Savings Co-operative in the current year.

Although NDIF does not appear as one of the litigation parties in the case launched by shareholders to render the Realbank Rt. general meeting held on September 4^{th} 1998 invalid, its outcome could affect NDIF. There has been no decision of note in the proceedings and the amount in dispute cannot be established.

The Fund is a plaintiff in two litigation cases.
In the case against Iparbankház Rt. the Fund is claiming capital of around THUF 458.

In the indemnity proceedings of Realbank Rt. depositors, the Fund submitted a claim for the issuance of a payment order against a depositor for the repayment of around THUF 800. The defendant was late in submitting an appeal against this payment order and therefore the court in a resolution refused it. An appeal can be launched against the court resolution and presumably for this reason we do not yet have a legally binding order for payment.

The Fund is not aware of any other claims submitted against it, with the exception of the usual trade creditors, etc. disclosed in the annual report.

The Fund has not issued any guarantees, which could give rise to payment obligations.

Further legal proceedings are being reviewed in which NDIF does not appear as a litigation party but the outcome of the case could influence the refunding of claims by NDIF in respect of Realbank. The subject of these proceedings is the enforceability of Reallízing ’96 bond claims in the liquidation. Depending on the result of the proceedings, the submitted claim could be reimbursed in one indemnity category with the claims resulting from NDIF indemnity payments, or in a less favourable category, identical to the costs related to NDIF indemnity payments, in accordance with the relevant payment ratio.

3.6 Human Resources

In 1999 the average staff number of the Fund was 15.9 persons. During the year, one new employee joined the Fund.

71% of employees are graduates of higher education, 29% have secondary education certificates. Seven of the Fund’s employees have language proficiency certificates.

The breakdown of staff as of December 31st 1999 was as follows:

Personnel	Number
Senior managers	2
Junior managers	4
Employees:	
higher education	6
secondary education	5
TOTAL	17

3.7 International activities of NDIF in 1999

Experience gained from deposit insurance institutions in developed countries significantly aided the institutional and professional development of NDIF. In recent times, international relations of NDIF have become more balanced in the sense that besides using foreign expertise, the Fund shares its seven years of experience with new deposit insurance institutions in other countries.

Upon the request of the American East-West Management Institute and under its organisation, NDIF’s managing director held a presentation in *Kazakhstan* on the Hungarian experience of deposit insurance. An American consultant built up his knowledge about the regional deposit insurance at NDIF before taking his consultative job on in Bosnia. Following this, the managers of the Bosnian deposit insurance fund – which had been founded but was not yet in operation – visited NDIF for the purposes of gaining experience.

The interest of the delegation from the *Bulgarian* deposit insurance Fund – being in operation for one year – visiting NDIF extended besides the Hungarian deposit insurance payment system and finances to crisis management co-operation with the supervisory authority and the central bank. In the *Ukraine* the legal and institutional preparations for the deposit insurance system are being carried out in tandem. At the beginning of 2000, the managers of the Ukrainian deposit insurance institution who visited NDIF got an extensive overview of the operating conditions of the Fund.

In Vienna at the deposit insurance institution of private Austrian banks the delegation of NDIF gathered information on the problems affecting deposit insurance caused by Austria's EU membership (e.g. non-registered deposits).

The IMF Monetary and Foreign Exchange Department included NDIF in the development of the "Code of Good Practices on Transparency in Monetary and Financial Policies". The recent Far-East and Russian financial crises make the development of this codex timely. The first regional evaluation of responses to questionnaires took place in Basle, with the participation of NDIF's deputy managing director and economic advisor.

Recognised international credit rating agencies, which deal with the evaluation of institutions in the Hungarian financial sector, such as Standard & Poor's, regularly request information from NDIF.

In October 1999, within the framework of regular and close Canadian-Hungarian deposit insurance co-operation, which has been ongoing since the foundation of NDIF, Mr Jean Pierre Sabourin, president and CEO of the Canada Deposit Insurance Corporation visited the Fund.

For the purposes of promoting international financial stability, the finance ministers and central bank chairmen of the G 7 (seven most industrialized countries in the world) initiated the establishment of a Financial Stability Forum. This Forum set up study groups for the purposes of drawing up proposals related to various current topics, including deposit insurance. Mr Sabourin was elected as chairman of the deposit insurance study group, which comprised representatives from 12 countries in four continents, including NDIF's managing director as well as experts from the IMF and World Bank. The study group, which had three sessions between December 1999 and March 2000, summarised the following in its report

- good and bad experience of deposit insurance systems in operation,
- the shift from implicit blanket guarantees introduced in many countries due to the crisis in the Far-East to limited coverage deposit insurance, and
- the main features of effective deposit insurance.

The study group considered the development of internationally valid deposit insurance guidelines to be useful and possible.

4. Strategic goals of NDIF in 2000

The future aims and action of NDIF in 2000 are mostly shaped by the planned amendments to the Act on Credit Institutions, including the change in the insurance amount limit, and the international aspects of deposit insurance. At the same time, the realisation of some goals targeted in 1999 continues:

a) Payment system

The concept and a tender for a new payment system were prepared in 1999. However, it was expedient to postpone the calling of the tender until 2000, because in 1999 some issues related to the Credit Institution law amendment that were material to the payment system remained unresolved.

b) Examination

In 1999, the examination activity was a strategic aim, partly due to the expansion of the areas to be reviewed (deposit register) and partly due to the plans to increase the number of member institutions to be examined. For several reasons these aims were not achieved to the desired extent (the indemnity of Realbank depositors withdrew human resources from the supervision; the differentiated deposit range of integrated savings co-operatives unexpectedly multiplied the tasks related to the deposit register). The amendment of the Act on Credit Institutions provides a new challenge for the examination activity, for example, the provisions related to registration of depositors. The examination handbook was completed, which besides supporting the work of NDIF's examination team enables the examining capacity to be expanded by means of outsourcing (National Savings Co-operatives' Institution Protection Fund, Hungarian Banking and Capital Market Supervision, National Bank of Hungary). The purpose of the formation of the examination team within the organisation structure is the efficient use of the examining capacities of NDIF and a modest increase in personnel (1-2 persons). Therefore, the aim for 2000 is to increase the number of reviewed member institutions.

c) Risk monitoring at member institutions

Based on the preparations for the amendments to the Act on Credit Institutions the indemnity limit could be markedly increased in the near future. This lends more importance to the fact that NDIF should be capable of predicting the occurrence of financial liabilities, including their size and probability, and be able to possibly influence them. The increase in the deposit insurance amount will put emphasis on early detection of risks involved in the behaviour of depositors and deposit taking institutions ("moral hazard"). In 1999 a new risk-monitoring methodology concept was on the whole completed. The task for 2000 is to refine this methodology, to have it consulted with the professional community and to commence its utilisation in some areas (examination, premium policy, assessment of necessary NDIF assets) thereafter.

d) Communication

If the Credit Institutions Act amendment enters into force from 2001, the task for 2000 will be propagating the changes affecting deposit insurance and exploiting the depositor confidence-boosting effect of the changes. The attainment of the examination, premium and asset policy goals must be supported through communication with the member institutions.

In line with the challenges for the year 2000, in the spirit of a refreshed PR policy NDIF's Internet Website will be modernized. This will reflect the change in emphasis and attitude in the daily communication of the Fund. The website will serve as an information databank, where professionals and the public can draw on current information with some interactive elements regarding issues related to the daily work of NDIF and to deposit insurance in the financial sector.

e) Preparation of deposit insurance for "internationalisation"
The regulatory framework is either already in place or will soon be created for foreign banks to be interested in opening branches in Hungary and for Hungarian banks to be interested in opening branches abroad. This involves the fact that NDIF must prepare for possible relations with foreign parent banks and foreign depositors, bearing adherence to EU guidelines in mind.

f) International professional relations
The development of NDIF's international relations was given a boost in 1999 by the Fund being included in the deposit insurance study group established for the Financial Stability Forum. The study group will continue its work in 2000 for the purpose of drawing up an international deposit insurance guidance. Comprehensive international agreement on these guidelines may contribute to the further strengthening of regional relations. Through its international activities – based on seven years of experience and practice – NDIF may become a renowned source world-wide for deposit insurance expertise.

Foreign Exchange Information

The official foreign exchange medium rates of the major foreign currencies registered by NBH on the statement day (31 December, 1999) were as follows:

Currency (1 unit)	**EUR**	**USD**	**DEM**	**ATS**	**GBP**	**CHF**	**FRF**
HUF	254.92	252.52	130.34	18.53	408.30	158.85	38.86

Independent Auditors' Report