

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY

H-1027 Budapest, Horvát u. 14-24.

ANNUAL REPORT 2003

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NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY
BALANCE SHEET (assets)

(Data in THUF)

ASSETS	31.12.2002	Adjustment	31.12.2003
A. Fixed assets	93 103		128 829
I. Intangible assets	50 390		86 221
1. Capitalised value of formation, transformation	0		0
2. Rights and concessions	0		0
3. Intellectual property	50 390		86 221
4. Advances on intangible assets	0		0
5. Upwards revaluation on intangible assets	0		0
II. Tangible assets	36 422		37 921
1. Land and buildings and related rights and conc.	0		979
2. Equipment, fittings, vehicles	36 422		36 942
3. Assets under construction	0		0
4. Payments on account	0		0
5. Upwards revaluation of tangible assets	0		0
III. Investments	6 291		4 687
B. Current assets	41 810 162		43 238 840
I. Stocks	17 300		100
1. Materials	0		0
2. Commercial goods	17 300		100
3. Mediated services	0		0
4. Advances on stocks	0		0
II. Receivables	5 278 014		198 951
1. Receivables from member institutions	5 192 701		174 778
a) premium receivables	10 361		323
b) receivables transferred to Fund	5 182 340		174 455
c) premiums on onerous obligations	0		0
2. Other receivables from credit institutions	51 313		5 339
3. Receivables from depositors	0		0
4. Receivable from the State	0		0
5. Other receivables	34 000		18 834
III. Securities	36 512 065		43 027 923
1. Government securities	36 512 065		43 027 923
2. Other securities	0		0
IV. Liquid assets	2 783		11 866
1. Cash, cash equivalents	31		123
2. Bank deposits	2 752		11 743
C. Prepaid expenses and accrued income	24 031	869 769	1 275 421
TOTAL ASSETS	41 927 296	869 769	44 643 090

Budapest, 31 March 2004


 Daniel Jánosy
 Managing Director

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY
BALANCE SHEET (equity/liabilities)

(Data in THUF)

EQUITY/LIABILITIES	31.12.2002	Adjustment	31.12.2003
D. Equity	41 856 618	869 769	44 491 919
I. Registered capital	837 582		861 082
II. Reserves	34 854 823		41 888 805
III. Valuation reserve	0		0
IV. Retained profit for the year	6 164 213	869 769	1 742 032
E. Provisions	0		0
F. Liabilities	60 321		142 496
I. Long-term liabilities	0		0
II. Current liabilities	60 321		142 496
1. Liabilities to member institutions	0		0
2. Short-term loans	0		0
3. Liabilities to depositors	0		76 681
4. Liabilities to State	0		0
5. Other current liabilities	60 321		65 815
G. Accrued expenses and deferred income	10 357		8 675
TOTAL EQUITY AND LIABILITIES	41 927 296	869 769	44 643 090

Budapest, 31 March 2004



Dániel Jánosy
Managing Director

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY
PROFIT AND LOSS STATEMENT (total cost method)

(Data in THUF)

	Description	2002	Adjustment	2003
01.	Premium income from member institutions	3 071 612		1 239 437
02.	Premium income from receivables recovered on behalf of depositors	0		0
03.	Commission income from the reimbursement of State-guaranteed deposits	0		0
04.	Other deposit insurance income	609 985		153 450
I.	Deposit insurance income (01+02+03+04)	3 681 597		1 392 887
II.	Other income	26 974		964
III.	Non-deposit insurance income	0		0
IV.	Income from financial transactions	3 225 454	869 769	3 256 885
V.	Extraordinary income	0		0
05.	Expenses on the payments of frozen deposits	0		73
08.	Other deposit insurance expenses	362		17 360
VI.	Deposit insurance expenses (05+08)	362		17 433
VII.	Other expenses	56 926		49 754
VIII.	Non-deposit insurance expenses	0		0
IX.	Expenses on financial transactions	431 531		2 522 038
X.	Extraordinary expenses	0		0
09.	Material-type expenses	92 731		90 704
10.	Staff costs	173 941		206 388
11.	Depreciation	14 321		22 387
XI.	Operational costs (09+10+11)	280 993		319 479
A.	Retained profit for the year (I+II+III+IV+V-VI-VII-VIII-IX-X-XI)	6 164 213	869 769	1 742 032

Budapest, 31 March 2004



Dániel Jánosy
Managing Director

1. General

1.1 Presentation of National Deposit Insurance Fund of Hungary

Name of organisation:	National Deposit Insurance Fund of Hungary
In short:	the NDIF or the Fund
Registered office:	H-1027 Budapest, Horvát utca 14-24.
Method of foundation:	Act XXIV of 1993
Date of foundation:	31 March 1993
Members of the Board of Directors:	Administrative Under-Secretary of the Ministry of Finance , Vice-President of the National Bank of Hungary , President of the Hungarian Financial Supervisory Authority , Secretary-General of the Hungarian Banking Association , President of the National Federation of Savings Co-operatives , Managing Director of the NDIF and their permanent deputies.

Members of the Management:

Mr. Jánosy, Dániel <i>Managing Director</i>	Tel.: + 36 (1) 214-0661/211
Mr. Fekete-Győr, András dr. <i>Deputy Managing Director</i>	Tel.: + 36 (1) 214-0661/217
Mr. Gálfalvi, Géza dr. <i>Chief Legal Advisor</i>	Tel.: + 36 (1) 214-0661/218
Ms. Vankó, Gabriella <i>Chief Accountant</i>	Tel.: + 36 (1) 214-0661/222
Mr. Lőrinc, Péter dr. <i>Chief Economic Advisor</i>	Tel.: + 36 (1) 214-0661/214

1.2 Establishment of the Fund and taxation issues

The National Deposit Insurance Fund was founded on 31 March 1993 and launched its deposit insurance activities on 1 July 1993. The legal status, operations and tasks of the NDIF are regulated by Act CXII of 1996 on Credit Institutions and Financial Enterprises, as amended (hereinafter referred to as: the Credit Institutions Act).

Section 108 (3) of the Credit Institutions Act prescribes that the National Deposit Insurance Fund is not obliged to pay any corporation tax, local tax or duties on its own assets, revenues and income.

1.3 Mandates and powers

One of the tasks of the NDIF, as prescribed in Section 105 (1) of the Credit Institutions Act, is to start paying compensation on the deposits insured by the Fund to depositors within fifteen days after the deposits are frozen.

A task of equal importance is to prevent the insolvency of the credit institution and therefore the freezing of deposits. Section 104 of the Act on Credit Institutions prescribes the crisis-prevention activity of the Fund stipulating that the Fund is obliged to choose the solution incurring the lowest long-term loss.

1.4 Governance arrangements

1.4.1 The Board of Directors

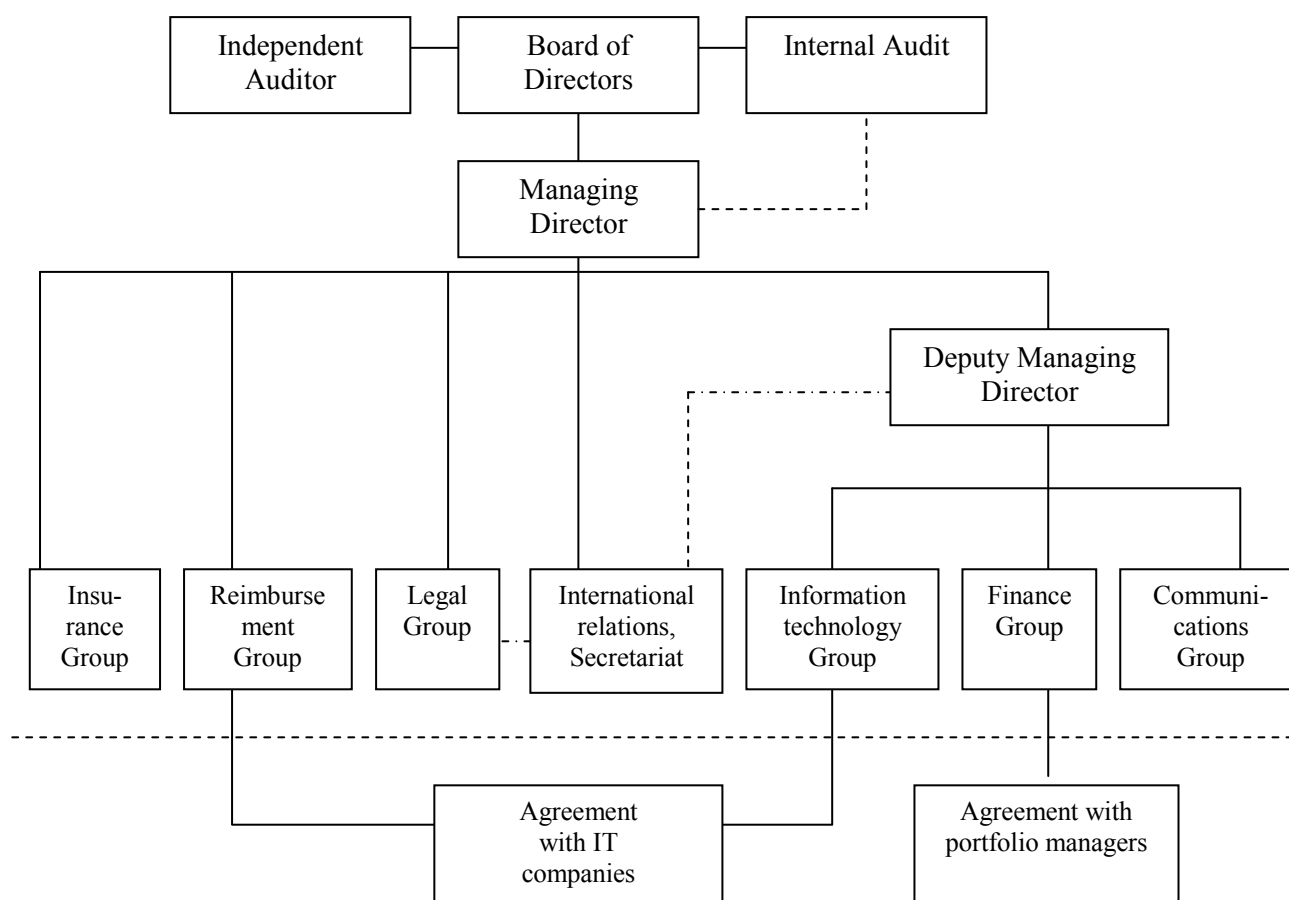
According to Section 110 (1) of the Credit Institutions Act, the governing body of the Fund is the Board of Directors whose members are as follows: the Vice-President of the National Bank of Hungary (NBH), the Administrative Under-Secretary of the Ministry of Finance, the President of the Hungarian Financial Supervisory Authority (HFSA), two persons designated by the organisations representing credit institutions and the Managing Director of the Fund.

The Board of Directors elects a Chairman and a Vice-Chairman annually from its members. In 2003 the chairman's duties were fulfilled by Mr. Kálmán, Tamás dr. Managing Director of the NBH, as the permanent Deputy of the Vice-President of the NBH, while the Vice-Chairman's duties were carried out by Mr. Nyers, Rezső dr. the Secretary-General of the Hungarian Banking Association.

1.4.2 Control of the Fund

According to Section 109 of the Credit Institutions Act, the Fund's financial-accounting audit is performed by the State Audit Office.

1.5 Organisation chart of the Fund



1.6 Economic and financial environment

According to the report of the Economic Research Institute, the gross domestic product (GDP) rose by 2.9%, which is high by international comparison (economic growth in the eurozone in 2003 was 0.4%).

Consumption increased by 8.8%. Economic investments expanded by 3% (and corporate investments rose at an even greater rate). Industrial production grew by 6.4%. Both exports and imports rose at a slower rate than the previous year (4.1% and 5.8%). Import growth outstripped that of exports (just like in 2002), which caused the foreign trade balance to deteriorate (by 0.9 billion euros), to stand at 4.3 billion euros.

Average gross wages increased by 12%, well in excess of the 5.7% increase in the consumer price index. The unemployment rate dropped steadily from the 5.9% recorded at the end of 2002 to 5.5% in December 2003.

The current account deficit totalled 4.2 billion euros, which was 1.4 billion euros more than one year previously. Services (for example tourism), which traditionally improve the balance, did not fulfil their customary role in 2003.

The budget deficit (cash flow basis, without local governments) amounted to HUF 1,054 billion. The input of external resources in satisfying the financing requirements of the

economy rose during the year. The population moved from being net savers to being net borrowers.

Total assets of banks and specialised credit institutions (based on the Supervisory Authority report) reached HUF 12,860 billion at the end of 2003, surpassing the 2002 year-end value by 18.8%. The rise in total assets is principally due to the increased lending. Retail lending expanded the most (by 67.8%), which was chiefly attributable to the keen demand for mortgaged housing loans. Pre-tax profit totalled HUF 215.9 billion, up by HUF 60.4 billion (38.8%) on 2002.

The total assets and lending activity of co-operative credit institutions expanded at the growth rate exhibited by retail clients in the banking sector. The pre-tax profit in this sector was HUF 11.2 billion, which is a 30.8% improvement on the previous year.

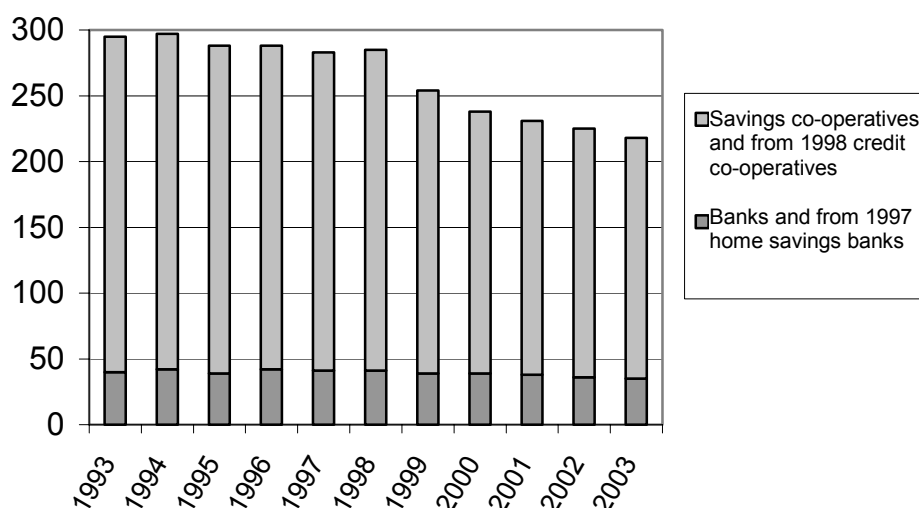
1.7 Member institutions and their deposit portfolios

1.7.1 Number of member institutions

At the beginning of 2003 the Fund had a total of 224 members, consisting of 35 banks and specialised credit institutions (including 3 home savings banks), 183 savings co-operatives and 6 credit co-operatives. During 2003 the number of the Fund's members dropped by 6.

As a result of these changes, as of 31 December 2003 the Fund had a total of 218 credit institutions, comprising 35 commercial banks and specialised credit institutions (including 2 home savings banks), 177 savings co-operatives and 6 credit co-operatives.

**Number of NDIF member institutions
at insurance year-end**



1.7.2 Development and composition of total savings and deposits

When the report was compiled, suitable balance sheet data was available for the end of 2002, which mirrored the opening data for 2003.

Savings lodged in credit institutions totalled HUF 7,891 billion at the beginning of 2003, up by 13% on the previous year. Looking at the breakdown of savings by credit institution, the proportion of co-operative credit institutions (mainly savings co-operatives) rose from 8.4% to 9.9%, while the volume of deposits at banks declined.

Breakdown of savings by type of credit institution

Table 1

Description	2002 opening	2003 opening	2003 opening	
	Portfolio (THUF)	Portfolio (THUF)	Ratio %	
			Banks and building societies	Co-operative credit institutions and credit co-operatives
Deposits	6,484,204,486	7,227,192,935	91.5	8.5
Of which:				
savings deposits	757,883,166	809,855,178	59.0	41.0
other deposits	5,726,321,320	6,417,337,758	96.0	4.0
Securities	417,747,301	597,706,283	81.4	18.6
Interest payable	65,030,332	66,476,482	75.1	24.9
TOTAL	6,966,982,119	7,891,375,700	90.1	9.9

The share in total deposits insured by the NDIF at credit institutions increased to 81.4% by the beginning of 2003, while the portfolio guaranteed by the State fell to 3.6% and the non-insured portfolio to 15.0% (Table 2).

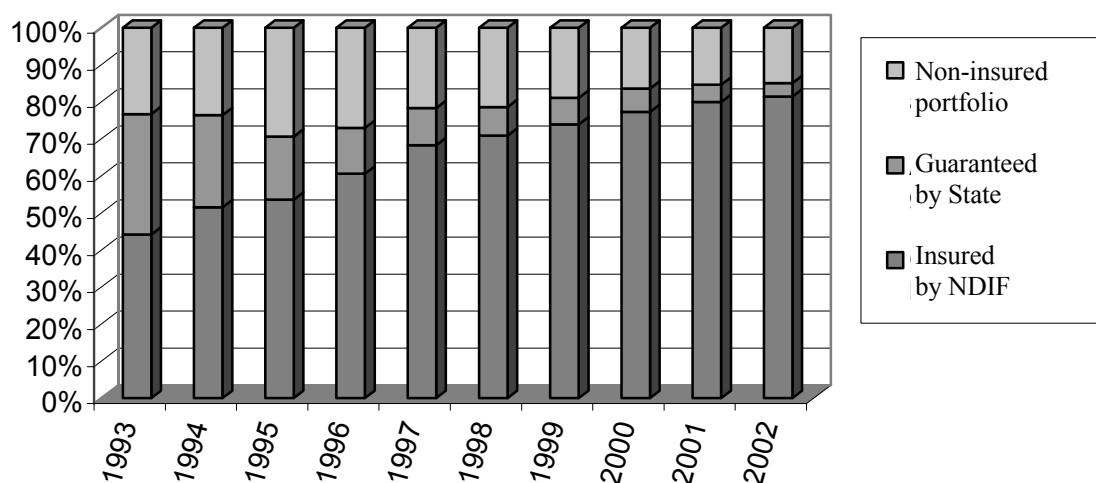
The growth in the share of deposits insured by the NDIF was mainly due to the more than 20% rise in the proportion of insured savings deposits, thanks to the legal regulation on the prevention of money laundering and the action taken to eliminate anonymous deposits.

Breakdown of savings by type of protection

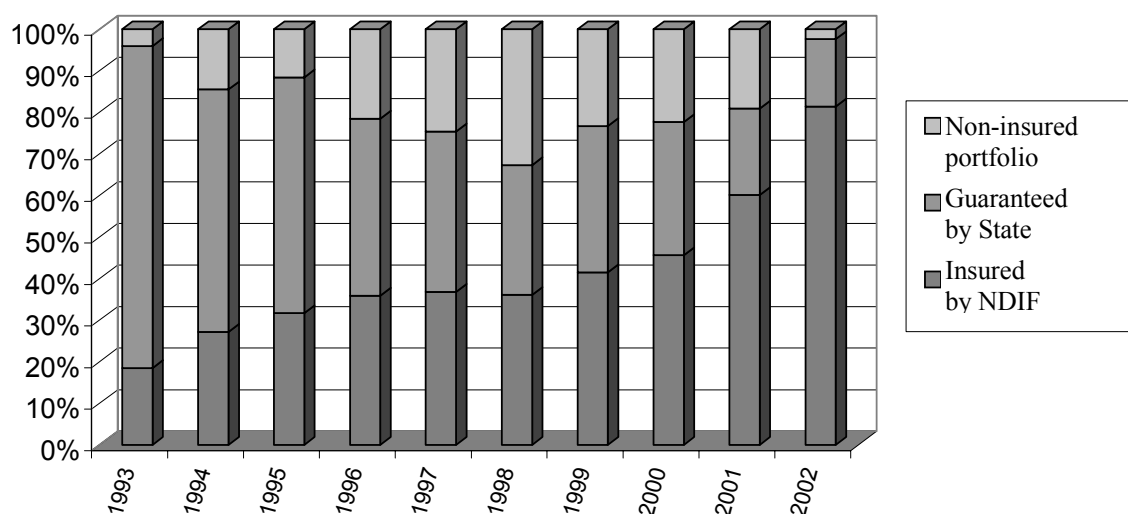
Table 2
(Data in %)

Description	2002 opening			2003 opening		
	Insured by NDIF	Guaranteed by State	Not insured	Insured by NDIF	Guaranteed by State	Not insured
Deposits	84.3	4.0	11.7	86.8	3.2	10.0
of which:						
savings deposits	60.1	20.8	19.1	81.4	16.2	2.4
other deposits	87.5	1.8	10.7	87.5	1.5	11.0
Securities	16.4	13.6	70.0	19.5	7.5	73.0
Interest payable	55.0	13.1	31.8	52.6	14.9	32.5
TOTAL	79.9	4.7	15.4	81.4	3.6	15.0

**Composition of savings portfolio by protection
at end of insurance year**



**Composition of savings deposit portfolio by protection
at end of insurance year**



1.8 Reimbursement commitments of the Fund

The potential reimbursement commitment of the NDIF for the insured portfolio is reduced by the reimbursement limit set per individual and per credit institution. (The latter was HUF 3 million from 1 January 2003.) This caused the reimbursement commitment of the NDIF to rise by almost 150 percent within the insured portfolio.

The joint coverage of 44% from the NDIF insurance and the State guarantee essentially means that , around half of the savings at credit institutions are protected either by the Fund or

the a State guarantee (40.4% and 3.6% respectively as shown in Table 3), which strengthens the confidence of depositors and provides a good basis for the smooth operation of credit institutions.

Reimbursement and guarantee commitments for credit institution savings

Table 3

Description	Start of insurance year	Insured by NDIF	Guaranteed by State	Non-insured or non-guaranteed portfolio	Total (%)
Breakdown of total savings by type of protection	1993	44.2	32.5	23.3	100.0
	1998	68.3	10.0	21.7	100.0
	1999	70.9	7.7	21.4	100.0
	2000	73.9	7.2	18.9	100.0
	2001	77.3	6.3	16.4	100.0
	2002	79.9	4.7	15.4	100.0
	2003	81.4	3.6	15.0	100.0
Ratio of reimbursement or guarantee commitments within the insured* or guaranteed portfolio (for NDIF, up to HUF 1 million)	1993	n.a.*	100.0	0	-
	1998	48.0	100.0	0	-
	1999	45.0	100.0	0	-
	2000	39.8	100.0	0	-
	2001	35.8	100.0	0	-
	2002	35.1	100.0	0	-
	2003	49.6	100.0	0	-
Ratio of reimbursement or guarantee commitments within the savings portfolios of all NDIF member institutions	1993	n.d.	32.5	0	n.d.
	1998	32.8	10.0	0	42.8
	1999	31.9	7.7	0	39.6
	2000	29.4	7.2	0	36.6
	2001	27.7	6.3	0	33.3
	2002	28.0	4.7	0	32.7
	2003	40.4	3.6	0	44.0

* The insured portfolio is the same as the NDIF premium base

1.9 Premium income of the Fund

According to Section 119 of the Act on Credit Institutions, own revenue sources of the Fund include one-off admission fees, regular and extraordinary premium payments paid by the members, returns on investments and the return from receivables transferred to the Fund. These funds can be supplemented by loans drawn by the NDIF.

a) Admission fee

A credit institution which receives license to collect deposits must pay a one-off admission fee to the Fund upon becoming a member institution. The admission fee corresponds to 0.5% of the subscribed capital of the member institution. Such revenue for the Fund totalled HUF 23.5 million in 2003, due to the entry of Bank of China (Hungária) Rt. and Sopron Bank Rt.

a) Annual premium payment

Section 121 (1) and (2) of the Act on Credit Institutions specifies the upper limit for the statutory annual premium to be paid by the members as 0.2% of the deposit portfolio of the member institution insured by the Fund as at 31 December of the previous year. This statutory ceiling has never been used by the Fund since it was founded: until 1998 the premium rate was 0.18 percent on average, then by 2001-2002 the premium rate had fallen gradually to 0.06 percent, in line with the growth in assets. Premium income started at 1 billion forints, reaching the top at 5 billion forints by 1998 and then falling to 3 billion forints in 2002.

The premium rates applied for the deposit categories which are defined by the size of the deposits continued to fall in the 2003 insurance year. The average premium rate fell to around one third of the previous year's value. As a result, the premium income of HUF 1.3 billion generated in 2003 barely exceeds the 1994 level.

When assessing the 2003 premium rates, the NDIF ensured that the fund ratio indicator outlined in detail in Section 1.10 (ratio of NDIF assets to its reimbursement commitment) would still exceed 1% after the reimbursement limit was raised to HUF 6 million. The premium rates declined substantially – on average by two-thirds – under this strategy. Table 4 presents the premium rates for 2003.

Premium rates for 2003**Table 4**

	Premium categories	Premium rate (%)	
		2002	2003
Deposit size	under HUF 1 million	0.12	0.05
	between HUF 1 and 6 million	0.09	0.03
	above HUF 6 million	0.02	0.005
Average premium rate		0.059	0.021

c) Increased premiums and preferential premium

Besides the normal premium payment obligations, the Fund may set increased or preferential premiums. Increased premiums can be set if a member institution did not comply with the prescribed capital adequacy ratio and/or met its premium or advance premium payment requirement with a delay of more than 30 days or perhaps carried out a particularly risky activity. (Section 121 (6) and (7) of the Credit Institutions Act). None of the member institutions had to pay increased premiums in 2003.

Preferential premiums are paid by all member institutions which are members of an institutional protection fund – licensed by the Supervisory Authority – as prescribed in Section 121 (1) of the Act on Credit Institutions. In 2003 there were 176 savings co-operatives who enjoyed the preferential premium totalling HUF 114 million.

1.10 Fund ratio

Fund ratio is the internationally accepted indicator of the asset position of deposit insurers, which, as of the same date, compares the potential reimbursement commitments of the Fund at member institutions to the liquid assets of the Fund. In international terms, the fund ratio between 1-1.5% can be considered as sufficient. The fund ratio of the NDIF was 1.6% at the beginning of 2002, which provided a solid basis for increasing the reimbursement commitment from 1 January 2003 to HUF 3 million. The 2003 fund ratio remained above the 1% threshold. An important criterion of the premium policy going forward is for the HUF 6 million reimbursement limit – which takes effect from EU accession – not to pull this ratio down under the threshold in subsequent years.

Fund ratio between 2000 and 2003

Table 5

Description	2000 actual	2001 actual	2002 actual	2003 actual
NDIF reimbursement commitment (HUF billion)	1,585	1,711	1,957	3,186
NDIF assets* (HUF billion)	19.3	25.5	31.3	37.4
Coverage ratio (%)	1.22	1.49	1.60	1.17
Average premium rate (%) **	0.102	0.06	0.059	0.021

* Fair value including interest of NDIF liquid assets embodied by securities – at end of year preceding current year (current year opening value)

** The average premium rate data – in contrast to the balance sheet data – does not contain the impact of the different premiums (increased and preferential rates).

The average size of deposits placed at credit institutions rose from THUF 535 at the beginning of 2002 to THUF 562 at the beginning of 2003.

2. Financial position and the results of operations

2.1 Three-column balance sheet and profit and loss statement

When the 2002 balance sheet was compiled, the pro-rated interest accumulated on the stock of year-end securities was not accrued. This accrual was remedied in 2003, but the difference exceeds the 'significant' level prescribed by the Act on Accounting, therefore in accordance with Section 19 (3) of the Act, a balance sheet and profit and loss statement had to be compiled containing these adjustments in separate columns.

In the text part of the statements, the 2002 figures affected by the change have been adjusted accordingly.

2.2 Changes to and composition of balance sheet total

The balance sheet total surpassed the figure at 2002 year-end by 4%, thus outstripping the 3% current asset growth. The relatively insignificant fixed asset portfolio rose by 38% and prepaid expenses/accrued income by 52%. The following table shows the composition of assets and liabilities, as well as the direction and size of changes to the individual components:

Table 6

Description	31.12.2002 (THUF)	31.12.2003 (THUF)	Change (%)
Fixed assets	93 103	128 829	38%
Current assets	41 810 162	43 238 840	3%
Prepaid expenses and accrued income	893 800	1 275 421	43%
TOTAL ASSETS	42 797 065	44 643 090	4%
Equity	42 726 387	44 491 919	4%
Liabilities	60 321	142 496	136%
Accrued expenses and deferred income	10 357	8 675	-16%
TOTAL EQUITY AND LIABILITIES	42 797 065	44 643 090	4%

Equity rose by 4% (THUF 1,765,532), constituting the basis for current asset growth. Liabilities, which are in any case low, more than doubled in value, up by THUF 82,175, while accrued expenses/deferred income fell by THUF 1,682 on the previous year.

2.3 Summary evaluation of profit

Profit in the current year amounted to THUF 1,742,032, well below the THUF 7,033,982 retained profit from 2002. The following table illustrates the main factors behind the substantial decline.

Table 7
(Data in THUF)

Description	2002	2003	Difference
Income from deposit insurance	3,681,597	1,392,887	-2,288,710
Other income	26,974	964	-26,010
Income from financial transactions	4,095,223	3,256,885	-838,338
<i>Total income</i>	<i>7,803,794</i>	<i>4,650,736</i>	<i>-3,153,058</i>
Expenses on deposit insurance	362	17,433	17,071
Other expenses	56,926	49,754	-7,172
Expenses on financial transactions	431,531	2,522,038	2,090,507
<i>Total expenses</i>	<i>488,819</i>	<i>2,589,225</i>	<i>2,100,406</i>
Operational costs	280,993	319,479	38,486
<i>Total expenses and operational costs</i>	<i>769,812</i>	<i>2,908,704</i>	<i>2,138,892</i>
Retained profit for the year	7,033,982	1,742,032	-5,291,950

The HUF 5.3 billion drop in the retained profit is largely due to changes in two factors.

1. The income - chiefly premium income - from deposit insurance fell by HUF 2.3 billion, which is principally thanks to the premium policy adopted by the Board of Directors and the result of the lower premium rates.
2. The adverse market developments surrounding government securities – which peaked at the end of 2003 – afflicted the aggregate government security portfolio of the NDIF on several occasions and in a manner that could not be anticipated. Income from financial transactions fell by HUF 0.8 billion, while expenses on financial transactions rose by HUF 2.1 billion, which had a combined effect of reducing the profit by HUF 2.9 billion.

The negative turns of other components in the profit played a negligible role in the decline of the retained profit.

The impact on profit of the change in operational costs continues to be minor, similar to previous years.

2.4 Reversal of impairment

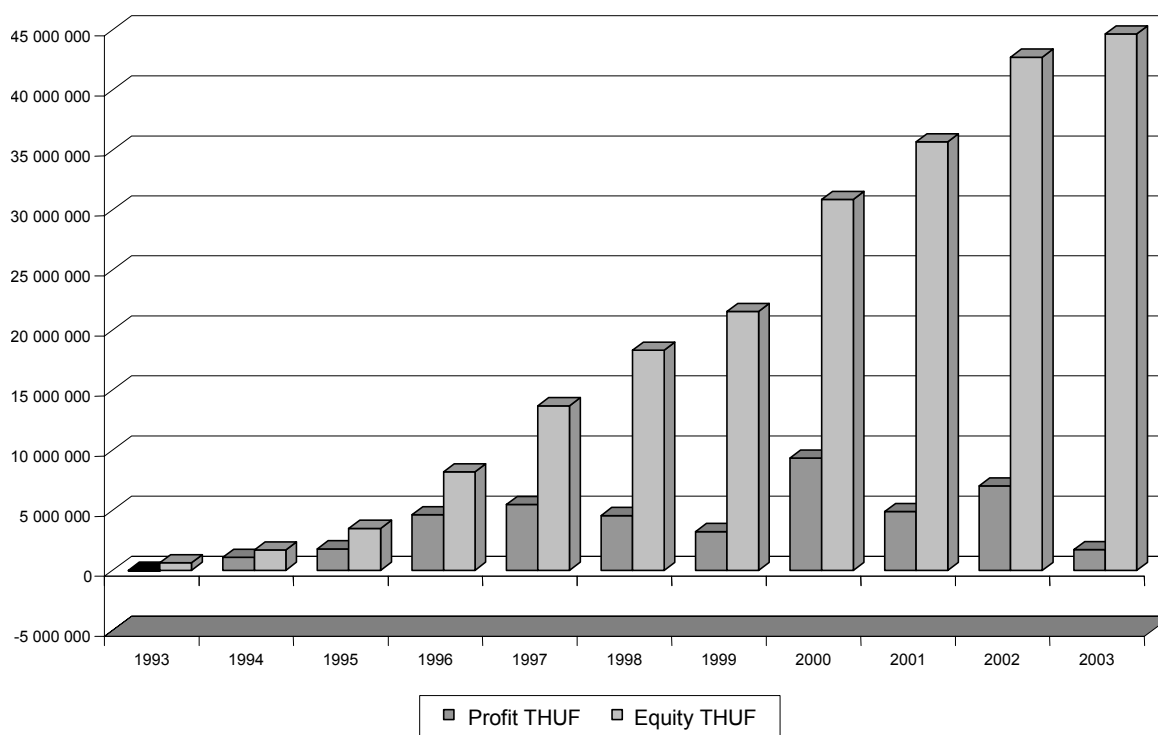
Based on information from the liquidator, the impairment previously allocated on receivables transferred to the Fund due to reimbursement and on other receivables from credit institutions due to the additional costs of payments was reviewed as of the balance sheet date.

According to the liquidator, the recovery prospects of the Fund's receivables from the Rákóczi credit co-operative have improved, therefore THUF 69,772 was reversed from the impairment previously accounted. The Fund's receivable from Realbank Rt. less impairment was recovered in full at the beginning of 2003. According to information from the liquidator, further recovery is expected in relation to the additional costs of deposit payments, therefore the impairment previously booked on this receivable was reversed by an amount corresponding to the anticipated recovery (THUF 5,339).

Table 8
(Data in THUF)

Description	Total receivable	Impairment 31.12.2002	B/S value 31.12.2002	Rise in receivable in 2003	Receivables recovered in 2003	Impairment in 2003	Impairment reversed in 2003	B/S value 31.12.2003
Receivables transferred due to deposit payment related to Heves and Environs Savings Co-operative	262,127	262,127	0	0	0	0	0	0
Receivables from Iparbankház Rt.	727,255	727,255	0	0	0	0	0	0
Receivables from Rákóczi Credit Co-operative	303,423	198,756	104,668	17	0	1	69,771	174,455
Accumulated receivables transferred due to deposit payments related to Realbank Rt.	5,077,672	0	5,077,672	0	5,077,672	0	0	0
Accumulated receivables from Realbank Rt. due to additional costs of deposit payments	58,302	6,989	51,313	0	51,313	0	5,339	5,339
Total	6,428,779	1,195,127	5,233,653	17	5,128,985	1	75,110	179,794

2.5 Changes to equity and profit from the establishment of the NDIF up to the balance sheet data



When examining the diagram, it must be noted that the equity contains the profits of previous years and the current year profit, therefore the extent of its growth is influenced by fluctuations in profit.

The retained profit has fluctuated since 1998, mainly in relation to how the recovery prospects of the Realbank Rt. liquidation were evolving.

The change in premium policy initiated from 1999 has become a crucial factor in earnings in recent years, which has impacted on profits through the ever-declining premium income. However, the falling premium income was until now more or less compensated for by the rising financial profit.

2003 was the first year when the profit was not influenced significantly by factors dependent on reimbursement and related recovery prospects. An unfortunate and unprecedented change was that this year the fall in premium income was accompanied by a sharp drop in the result on financial transactions, which overall caused a significant decrease in the profit (for details see Section 2.3.).

3. Supplementary information and additional data

3.1 Ten-year anniversary

A grand event in the last year attracting the interest of the financial profession was the celebration of the establishment in 1993 of the NDIF, which was held at the National Bank of Hungary. Almost one hundred invited guests participated in the event: senior dignitary in the Ministry of Finance, heads and experts of partner institutions, theoretical experts who played an important role in the founding and running of the Fund. Representatives of the media were also present. The Fund's publication 'Ten Years in Retrospect: 1993-2003' was at the centre of this anniversary event. The publication which reviews and analyses the period since the Fund's establishment and presents the first decade and experience of institutionalised deposit insurance could serve as a basis for information and analysis for a long time to come.

The guests were welcomed by the host, Mr. Bod, Péter Ákos (university lecturer, first Chairman of the NDIF Board of Directors) and he was the first to speak in appreciation of the book and accordingly the results achieved by the NDIF in its first ten years. Thereafter, the Editor in Chief Mr. Jánosyó, Dániel NDIF Managing Director, introduced the book before Ms. Király, Júlia (CEO of International Training Center for Bankers Rt., who revised the publication) gave an evaluation, highlighting its wealth of information and presenting the crisis management cases. Speeches were also given by Mr. Terták, Elemér (the first Managing Director of the NDIF), Mr. Szász, Károly (the President of the Hungarian Financial Supervisory Authority) and Mr. Nyers, Rezső (the Secretary General of the Hungarian Banking Association). A reception followed the exchange of opinions at the presentation, which was hosted by Mr. Erdei, Tamás the Chairman of the Hungarian Banking Association.

To meet the international interest exhibited towards Hungarian deposit insurance the publication was translated into English ('Ten Years in Retrospect: 1993–2003'). Although the publication on the ten years of deposit insurance is principally directed at a professional readership, taking a broad view on the target readership both the Hungarian and English language versions were made accessible in full for interested parties on the website of the Fund (www.oba.hu or www.ndif.hu).

3.2 Public awareness

Communications in the first half of 2003 were essentially determined by the obligation to provide information on the legal regulation changes related to deposit insurance that entered into force from 1 January 2003.

There were three main changes: the reimbursement limit was raised from one million to three million forints, a 10% depositor co-insurance was introduced, and the scope of protection was expanded to include bank bonds and certificates of deposit.

A further task for 2003 was preparing for European Union accession. The main task was to prepare the communication for the changes in May 2004 (EU accession) from a professional and technical perspective.

In September 2003 – similar to 1996 and 2001 – the Fund carried out a survey among depositors and bank administrators to find out the level of knowledge on deposit insurance. The most important finding of the survey was that the less than one year up until the survey was performed was insufficient to familiarize the change in the reimbursement limit and to make it as known as the one million forint limit used before. Furthermore, deposit insurance knowledge of both the public and bank administrators proved to be extremely low.

The latent extraordinary events in the banking system demand swift, professional information providing from the NDIF as well. To meet this requirement NDIF has to broaden the basis of its information resources. Bearing this in mind the Fund entered into bilateral information agreements in 2003 with the communications managers of the main institutions in the financial sphere, namely the Supervisory Authority, the Ministry of Finance and the National Bank of Hungary. Besides these partner institutions, a communications agreement was also signed with the member institutions that boast the largest branch networks and clientele.

3.3 Examination activity of the Fund

Within the framework of its on-site examinations, the NDIF reviews the accuracy of the premium declarations of the member institutions and - in the interests of depositors - the data recording system (depositor registration) at the member institutions as well as their compliance with the obligations prescribed in the Credit Institutions Act to provide information to clients.

Since the on-site examinations began in 1996, 214 member institutions have been reviewed.

The main findings of on-site examinations performed in the second half of 2003 and the first quarter of 2004 are:

- ❑ the accuracy of the premium declarations has improved;
- ❑ the member institutions are striving to modernise their data recording systems (information technology), as their financial means allow;
- ❑ member institutions follow legal regulation provisions during mergers;
- ❑ the provisions of the law on impeding and preventing money laundering that relate to deposit insurance (e.g. identification of anonymous deposits) have been implemented at the examined member institutions;
- ❑ references are still made in depositing procedures, management orders and deposit contracts to legal regulations that are no longer in force;
- ❑ member institutions have improved their provision of information to clients in connection with deposit insurance.

Besides the on-site examinations, the NDIF carried out expedient special examination in 2003 to explore the reasons for the substantial fall noted in the deposit portfolios in the premium declarations, which also affects the base for the premium payment. This review revealed no irregularities.

3.4 Events related to liquidation proceedings in progress

Heves and Environs Savings Co-operative 'under liquidation'

There is still nothing of note to mention in the liquidation of Heves and Environs Savings Co-operative 'under liquidation', which was launched on 25 November 1993. The first interim balance sheet has, to the Fund's knowledge, still not been approved.

From the beginning of the liquidation up to the closing of the balance sheet, reimbursement of HUF 262,126,706 was paid, which was reported to the liquidator as a creditor receivable. No further reimbursement was made in 2003, the afore-mentioned creditor claim of the NDIF is still not expected to be recovered.

Iparbankház Rt. 'under liquidation'

Most of the legal proceedings underway when the liquidation was ordered have now been closed.

No further reimbursement was made in the current year. The following payments were made (and reported to the liquidator) by the balance sheet date:

Table 9
(Data in THUF)

Description	Deposits as of 03.07.1996	Deposits paid from start of liquidation to 31.12.2003	Remaining deposit portfolio
Insured by NDIF	11 530	2 310	9 220
Not insured by NDIF	13 510	0	13 510
Total	25 040	2 310	22 730

Realbank Rt. 'under liquidation'

By the balance sheet date of this report, the liquidator of Realbank had prepared six interim balance sheets from 19 January 1999. Based on the approved interim balance sheets, the liquidator paid a total of HUF 13,808 million in categories 'b-f' to the creditors, of which the NDIF received HUF 5,206 million. The sixth and final interim balance sheet compiled as of 31 October 2003 was sent by the liquidator to the creditors at the beginning of March 2004.

A positive development for the NDIF is that the liquidator has made another recommendation for asset distribution given the improving financial situation of Realbank Rt. 'under liquidation'.

Accordingly, the liquidator is now recommending that payments in category 'f', which were already approved and paid in 2003 up to 87.39%, should now be settled up to 96.35%. This means that should the Court lend its approval, of the HUF 59 million receivable of the NDIF in category 'f', payment of a further HUF 5,339,335 is expected over and above the HUF 52 million paid in 2003, bringing the recovery up to 96.35%.

Rákóczi Credit Co-operative 'under liquidation'

By the time the NDIF balance sheet was closed, only the first interim balance sheet closing the first year of the liquidation of the credit co-operative as of 31 October 2001 had been approved by the court.

The liquidator confirmed that in its records the NDIF has a total receivable in category 'd' of HUF 292,613,917 – taking paid and payable reimbursement into consideration – and a further HUF 12,666,189 in category 'f' related to reimbursement paid by 28 February 2004.

The liquidator made an estimate on the recovery of the Fund's receivables in a letter dated 26 February 2004. On this basis, the anticipated payment in category 'd' improved vastly on the previous year, and looks like being around 60-65%. The recovery of the additional costs related to deposit payments included in category 'f' remains unlikely.

Deposit payments of HUF 290,758,967 were made and reported to the liquidator by the balance sheet date.

3.5 Legal matters*3.5.1 Pending litigations*

In 2003 the NDIF was the defendant in 6 legal cases, of which five were related to Realbank, and one to Iparbankház.

3 new legal actions began in 2003 related to Realbank; in one of the previous cases, the court decided in favour of the Fund, and the review procedure launched by the claimant is now underway. The case is at the Court of First Instance.

The proceedings related to Iparbankház were completed in the current year with the Fund again winning the case.

3.5.2 Other commitments

The Fund is not aware of any other liabilities with the exception of the customary - e.g. trade - liabilities included in the financial statements.

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

3.6 Human resources data

Breakdown of staff as of 31 December 2003:

Group of staff	Number
Senior managers	2
Junior managers	4
Employees:	
higher education	7
secondary education	4
TOTAL	17

3.7 International activities

The multi-lateral international co-operation of deposit insurers continued successfully in 2003.

The *International Association of Deposit Insurers* (IADI) held its second annual general meeting in Seoul in October 2003, with the NDIF participating. At the general meeting, new members of the executive council were elected. Changes in the Hungarian representation were as follows: Mr. Fekete-Győr, András dr. Deputy Managing Director of the NDIF was elected by the general meeting as a council member for three years, to replace Mr. Jánosy, Dániel Managing Director, who did not renew his one-year mandate in the council. The general meeting expressed its appreciation to Mr. Jánosy, Dániel – together with the other members leaving the executive council – for his work in establishing the international association.

Two seminars were organised jointly by the IADI and the EBRD in Basel for professionals from Central Asian and Western Balkan countries. The deputy managing director of the NDIF gave presentations at both events, providing information to participants on the experience gained during the 10 year operation of the NDIF as well as the structure and the technical and security parameters of the NDIF reimbursement system.

The *European Forum of Deposit Insurers* supported the work of its members by exchanging experiences through electronic communication channels, in accordance with the principle declared in its constitution.

At the initiative of the NDIF, a collection of basic information presenting the deposit insurance systems of 18 EFDI member states was prepared, which can be found at www.ndif.hu.

The participants from 18 countries attending the International Open House event organised by the Canadian Deposit Insurer (including the economic advisor of the NDIF responsible for international relations) gained valuable experience on the structure and operation of the Canadian Deposit Insurance Corporation (CDIC).

The American Financial Services Volunteer Corps (FSVC) requested that the experts of the NDIF act as consultants for the launch of the *Albanian* deposit insurance system. The management of the NDIF had discussions with the staff of the Albanian deposit insurer in Tirana, and then the Albanian colleagues participated in a one-week consultation in Budapest. Both visits were organised and financed by the FSVC.

The Slovakian deposit insurance institution also initiated discussions with the NDIF. The discussions in Budapest covered the following subjects: presentation of the NDIF's reimbursement system, the forms of payments to depositors used by the NDIF and the role of the Fund in the management of insolvent banks.

Beside participating in the Euromoney conference organised in Vienna, the economic advisor of the NDIF responsible for international relations held discussions with the managing director of the Deposit Insurance Institution of Austrian Private Banks on the possibility of a bilateral co-operation agreement in accordance with Directive 94/19 (EC) on deposit insurance. (The aim of these bilateral agreements is to ensure that in the event a bank collapses in an EU member state, reimbursement to depositors who placed deposits in one of the bank's branches in another member state ensues smoothly.)

Strategic goals in 2004

Insurance service, communication ,reimbursement

2004 is the year of EU accession. The related communication project will be carried out in 2004, as designed in 2003. A new element in communications is that the Fund must widen its horizons from Hungary to the EU thanks to cross-border deposit insurance, and in the future count on other EU deposit insurers operating in Hungary as well as an increasing number of non-Hungarian (native language) clients.

The main communication channels are the member institutions, and this fact is likely to stimulate, broaden and personalise relationships with the member institutions. The remote-learning administrator IT toolkit developed in connection with EU accession can become a permanent element in the relationship and exchange of information with the member institutions. Besides the flow of deposit insurance information towards the member institutions, direct communication with depositors remains important, which the Fund is gearing up for with a renewed toolkit (guide, deposit register, website, etc.).

To fulfil its indemnifier role at a high level, a continuous revision and improvement of technical and human skills are necessary. To this end, the trial operation and testing of the NDIF's new reimbursement system under experimental circumstances – which has not yet been used live – will become a regular occurrence.

Member institution examinations

2004 will bring a change to the Fund's member institution examination practice. Since most of the one-off reviews of the member institutions have been completed, it is now justified to place the emphasis on *special-purpose reviews*. Compiling the review plan was a relatively easy task so far. Without being too simplistic, a member institution was put on the list of institutions to be reviewed if no review had been performed there before. In future reviews, greater emphasis will be placed on the *planning* of the review, the selection of member institutions to be reviewed based on careful monitoring, and the purposeful choice of topics to be reviewed in reaction to developments on the banking market.

Asset policy

A key issue is to monitor the adequacy of asset coverage with the increased reimbursement limit, and to initiate corrective (premium policy) action if necessary.

Another strategic issue in connection with asset policy is asset management: due to the shift in the structure of NDIF income over the past few years, the weighting of the elements of the triple liquidity – security – yield requirement must be reviewed, and on this basis the investment policy should be modified if necessary. The Fund's aim is to improve the profitability achieved in portfolio management, without adversely affecting the liquidity risk of the portfolio. To achieve this NDIF intends utilising new methodology applications, to act as a guide in establishing proper sub-portfolios and maximising yields.

Developing the institution

Both the spread of malevolent IT practices and the increasingly complex system applications of the NDIF justify action taken to prevent and eliminate risks inherent in information technology. This is particularly true for the NDIF, as an institution that is designed to support security within the financial system. 2004 is the first year of regular due diligence type reviews and continuous IT security reviews.

Bearing in mind the changing regulatory requirements and the NDIF profile, duties and 'image', the Fund is planning to modernise its data protection rules in harmony with the requirements of confidentiality and transparency.

Further development targets are the modernisation of file management and storage procedures. This is aimed partly at 'putting the house in order', i.e. scrapping of documents accrued over ten years, secure and cost-efficient storage of those to be kept, and partly at introducing a file management system that meets the requirements of even the strictest international standards.

International relations

Co-operation with European and particularly EU deposit insurers will increase in importance to lay the foundations for providing information on cross-border deposit insurance and, if necessary, the operative framework. One form of this is *bilateral* co-operation or consultation relations. The creation of the European Forum of Deposit Insurers (EFDI) provided the framework for *multi-lateral* co-operation; the Fund takes an innovative and pro-active part in this forum. The International Association of Deposit Insurers (IADI) furnishes an appropriate institutional framework for co-operation with deposit insurers *around the world* and facilitates the exchange of experience.

Foreign Exchange Information

The official foreign exchange rates of the major foreign currencies registered by the National Bank of Hungary on the balance sheet date (31 December, 2003) were as follows:

Currency (1 unit)	EUR	USD	GBP	CHF
HUF	262.23	207.92	370.66	168.30



Audit

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Independent Auditors' Report

To the Board of Directors of National Deposit Insurance Fund of Hungary

We have audited the accompanying balance sheet of National Deposit Insurance Fund of Hungary ("the Fund") as at 31 December 2003 which shows total assets of THUF 44,643,090 and a retained profit for the year of THUF 1,742,032, the related profit and loss account for the year then ended and the supplement, being components of the Fund's 2003 Annual Report. The Annual Report and the Business Report is the responsibility of the Fund's management. Our responsibility is to express an opinion on the Annual Report based on our audit. In addition, it is our responsibility to assess whether the accounting information included in the Business Report is consistent with that contained in the Annual Report.

We conducted our audit in accordance with Hungarian Standards on Auditing issued by the Hungarian Chamber of Auditors, which are substantially consistent with International Standards on Auditing, and applicable law and regulations in Hungary. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Annual Report is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Annual Report. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Annual Report presentation. Our work with respect to the Business Report was limited to the aforementioned scope, and did not include a review of any information other than that drawn from the audited accounting records of the Fund. We believe that our audit provides a reasonable basis for our opinion.

We have audited the Fund's Annual Report, its components and elements and their accounting and documentary support in accordance with Hungarian Standards on Auditing and gained sufficient and appropriate evidence that the Annual Report has been prepared in accordance with the provisions of the Act on Accounting and accounting principles generally accepted in Hungary. In our opinion, the Annual Report gives a true and fair view of the financial position of National Deposit Insurance Fund of Hungary as at 31 December 2003 and of the result of its operations for the year then ended. The Business Report corresponds to the disclosures in the Annual Report.

March 31, 2004

KPMG Hungária Kft.

Chamber registration number: 000202

Hénye István

Partner, Registered Auditor

Identification number: 005674

