

NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY

ANNUAL REPORT

2004



NATIONAL DEPOSIT INSURANCE FUND OF HUNGARY

Responsible Editor:

Dániel Jánosy

© National Deposit Insurance Fund of Hungary

Printed by Rózsa Gábor

2005

TABLE OF CONTENTS

Additional Supplement	8
1.1. General characteristics	8
1.1.1. Company data	8
1.1.2. Characteristics of the Fund	8
1.1.3. System of operation	8
1.1.4. Accounting policy	8
1.1.5. The scope of activity of the Fund	9
1.1.6. The governing body and the controlling of the Fund	9
1.2. Economic and financial environment in 2004	9
1.2.1. Member institutions of the Fund and their deposit portfolio.	10
1.2.2. Reimbursement commitments of the Fund	13
1.3. Premium income of the Fund	14
1.4. Fund ratio	16
1.5. The Fund's assets, financial position, and the result of its operation	17
1.5.1. Description of the securities portfolio and the evaluation of the activity of the assets managers	17
1.5.2. Summary evaluation of the profit	18
1.5.3. Trends of the Fund's equity and profits from its foundation up to 2004.	19
Supplementary information and reference data	20
2.1. The institutional communication of NDIF	20
2.2. Examination activity of the Fund	21
2.3. Events related to liquidation in progress	22
2.4. Legal matters	23
2.4.1 Pending litigations	23
2.4.2 Other commitments	23
2.6. International activities	24
2.7. Tasks defined by the Board of Directors of NDIF, and their implementation	25
Business Report	26
3.1. Expectations for trends of savings and the yield of government securities for 2005	26
3.2 Strategic goals for 2005	26
Independent Auditor's Report	27

BALANCE SHEET – ASSETS					
Description (in THUF)			2003	Effect of revision	2004
1	A	FIXED ASSETS	128,829	0	120,642
2	I.	Intangible assets	86,221	0	78,818
3	I.1	Capitalised value of formation and transformation			
4	I.2	Rights and concessions			
5	I.3	Intellectual property	86,221		78,818
6	I.4	Advance payments for intangible assets			
7	I.5	Revaluation of intangible assets			
8	II.	TANGIBLE ASSETS	37,921	0	38,461
9	II.1	Lands and buildings and rights to immovable	979		4,286
10	II.2	Equipment, fittings, vehicles	36,942		34,175
11	II.3	Assets under construction			
12	II.4	Payments on account			
13	II.5	Adjusted value of tangible assets			
14	III.	INVESTMENTS	4,687		3,363

Done on 4 February 2005

AUTHORIZED REPRESENTATIVE



Dániel Jánosy
Managing Director

According to the Audit Report, I hereby certify:

REGISTERED AUDITOR

4 February 2005



Dr. Serényi Iván
bejegyzett könyvvizsgáló
s.sz.: 003687
k.t.sz.: 003607

BALANCE SHEET – ASSETS					
Description (in THUF)			2003	Effect of revision	2004
15	B	CURRENT ASSETS	43,238,840	0	50,271,265
16	I	Stocks	100	0	100
17	I.1	Materials			
18	I.2	Commercial goods	100		100
19	I.3	Mediated services			
20	I.4	Advances on stocks			
21	II.	RECEIVABLES	198,951	0	201,606
22	II.1	Receivables from member institutions	174,778	0	188,993
23	II.1.a	Premium receivables	323		
24	II.1.b	Receivables transferred to the Fund	174,455		188,993
25	II.1.c	Premiums on onerous obligations			
26	II.1.d	Other receivables from member institutions			
27	II.2	Other receivables from credit institutions	5,339		
28	II.3	Receivables from depositors			
29	II.4	Receivables from the state			
30	II.5	Other receivables	18,834		12,613
31	III.	SECURITIES	43,027,923	0	50,068,270
32	III.1	Government securities	43,027,923		50,068,270
33	III.2	Other securities			
34	IV.	LIQUID ASSETS	11,866	0	1,289
35	IV.1	Cash, cheques	123		445
36	IV.2	Bank deposits	11,743		844
37	C	Prepaid expenses and accrued income	1,275,421		1,517,938
38		TOTAL ASSETS:	44,643,090	0	51,909,845

Done on 4 February 2005

AUTHORIZED REPRESENTATIVE



Daniel Jánosy
Managing Director

According to the Audit Report, I hereby certify:

REGISTERED AUDITOR

4 February 2005



Dr. Serényi Iván
bejegyzett könyvvizsgáló
s.sz.: 003687
k.t.sz.: 003607

BALANCE SHEET– EQUITY AND LIABILITIES					
Description (in THUF)			2003	Effect of revision	2004
39	D.	EQUITY	44,491,919	0	51,782,976
40	I.	Registered capital	861,082		861,082
41	II.	RESERVES	41,888,805		43,630,837
42	III.	REVALUATION RESERVE			
43	IV.	RETAINED PROFIT FOR THE YEAR	1,742,032	0	7,291,057
44	E.	PROVISIONS			
45	F.	LIABILITIES	142,496	0	90,098
46	I.	LONG-TERM LIABILITIES			
47	II.	SHORT-TERM LIABILITIES	142,496	0	90,098
48	II.1	Liabilities towards member institutions			
49	II.2	Short-term credits			
50	II.3	Liabilities towards depositors	76,681		76,659
51	II.4	Liabilities towards the state			
52	II.5	Other short-term liabilities	65,815		13,439
53	G.	ACCRUED EXPENSES AND DEFERRED INCOME	8,675		36,771
54		TOTAL EQUITY AND LIABILITIES	44,643,090	0	51,909,845

Done on 4 February 2005

AUTHORIZED REPRESENTATIVE


Dániel Jánosy
Managing Director

According to the Audit Report, I hereby certify:

REGISTERED AUDITOR

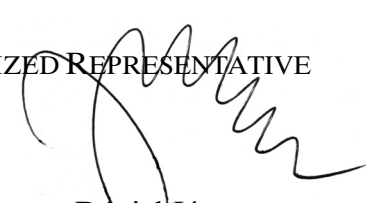
4 February 2005


Dr. Serényi Iván
bejegyzett könyvvizsgáló
s.sz.: 003687
k.t.sz.: 003607

PROFIT AND LOSS STATEMENT					
Description (in THUF)			2003	Effect of revision	2004
1	1	Premium income from member institutions	1,239,437		1,342,262
2	2	Premium income from receivables recovered by depositors' instructions			
3	3	Commission income derived from the reimbursement of deposits guaranteed by the State			
4	4	Other income derived from deposit insurance	153,450		61,387
5	I.	Income derived from deposit insurance (01+02+03+04)	1,392,887	0	1,403,649
6	II.	Other income	964		966
7	III.	Non-deposit insurance income			
8	IV.	Income from financial transactions	3,256,885		6,328,385
9	V.	Extraordinary income			
10	5	Expenses on the payments of frozen deposits	73		
11	6	Expenses on receivables collected on behalf of the depositors			
12	7	Expenses incurred by the payment of deposits guaranteed by the State			
13	8	Other expenses on deposit insurance	17,360		151
14	VI.	Expenses on deposit insurance (05+06+07+08)	17,433	0	151
15	VII.	Other expenses	49,754		42,594
16	VIII.	Non-deposit insurance expenses			
17	IX.	Expenses on financial transactions	2,522,038		59,492
18	X.	Extraordinary expenses			
19	9	Material-type expenses	90,704		106,211
20	10	Costs on the personnel	206,388		210,914
21	11	Depreciation	22,387		22,581
22	XI.	Operation costs (09+10-11)	319,479	0	339,706
23	A.	Retained profit for the year (I+II+III+IV+V-VI-VII-VIII-IX-X-XI)	1,742,032	0	7,291,057

Done on 4 February 2005


AUTHORIZED REPRESENTATIVE


Dániel Jánosy
Managing Director

According to the Audit Report, I hereby certify:

REGISTERED AUDITOR

4 February 2005


Dr. Serényi Iván
bejegyzett könyvvizsgáló
s.sz.: 003687
k.t.sz.: 003607

ADDITIONAL SUPPLEMENT¹

1.1. General characteristics

1.1.1. Data

Name:	National Deposit Insurance Fund of Hungary	
Type:	Code No.: 916 – Other, non-profit oriented organisation	
Tax number:	10830516-2-41	
Statistical number:	10830516-6713-916-01	
Date of foundation:	31 March 1993	
Subscribed capital:	at the time of foundation:	HUF 609,544,000
	by the end of business year:	HUF 861,082,000
Activity:	Core activity	Deposit insurance
	Supplementary activity:	–
Network	Headquarters:	H-1027 Budapest, Csalogány u. 9-11.
	Other premises:	–

1.1.2. Characteristics of the Fund

Authorised to sign the Report:	Mr. Dániel Jánossy
Board of Directors	Mr. István Farkas, Dr. Mrs Kálmán Tóth, Dr. Rezső Nyers, Dr. Tamás Kálmán, Dr. István Salgó
Auditor:	Audit Service Ltd. /Dr. Iván Serényi /
Legal representation:	Dr. Géza Gálfalvi
The information domain related to the specific activity and stipulated by legal acts: Government Regulation No. 214/2000	

1.1.3. System of operation

The operation and ownership relations are regulated by Act CXII of 1996. The operation of the Fund is in compliance with the provisions of this Law.

The observation and recording of the daily transactions are done by a computerised program-system (Microsoft Navision program) that guarantees the closed processing of the data.

1.1.4. Accounting policy

Currency used in accounting:	Hungarian forint
Accounting system:	Book-keeping by double entry
Business year:	2004
Usual date of making the balance sheet of the company:	31 January 2005
Closing date of auditing:	4 February 2005
Form of obligatory reporting:	Other report, its type: decreed by Government Regulation No. 214/2000 for deposit insurance funds

¹ This is a shortened version of the Annual Report. The full Report approved by the Board of Directors of NDIF is available in Hungarian language at the Headquarters of NDIF

1.1.5. The scope of activity of the Fund

On the one hand, the task of the Fund is to reimburse depositors in case the deposits kept at the member institutions and insured by the Fund are frozen, commencing within fifteen days as stipulated by para. 105 (1) of the Act on Credit Institutions and Financial Enterprises (hereafter *Act on Credit Institutions or the Act*).

In addition to pay-out, another task of the Fund is the prevention of the freezing of deposits in accordance with para. 104 of the Act. According to this provision the Fund is obliged to select the prevention method that involves the least long-term loss.

1.1.6. The governing body and the controlling of the Fund

1.1.6.1. The Board of Directors

As stipulated by para. 110 (1) of the Act on Credit Institutions the governing body of the Fund is the Board of Directors that consists of the Vice President of the National Bank of Hungary, the Administrative State Secretary of the Ministry of Finance, the President of the Supervisory Council of the Hungarian Financial Supervisory Authority, and two representatives delegated by the credit institutions, as well as the Managing Director of the Fund.

Every year the Board of Directors elects a Chairman and a Vice-Chairman from its members. In 2004 the Chairman's post was held by Dr. Rezső Nyers, the Secretary General of the Hungarian Banking Association, while the Vice-Chairman's duty was carried out in the first part of this term by Dr. Károly Szász, and later he was succeeded by Mr. István Farkas.

1.1.6.2. Controlling of the Fund

In accordance with para. 109 of the Act the financial and accounting audit of the Fund is performed by the State Audit Office.

1.2. Economic and financial environment in 2004

In 2004 the gross domestic product of Hungary rose by 4% (exceeding the growth in the previous year). The economy has been set on a course determined by export and investment. The deficit in foreign trade was lower than in 2003. Despite the slight decrease in real wages, retail trade rose by 6% that could – partially – be contributed to the over-heated home building activity, having preceded the tightening of allowances. Consumer's price index rose by 5.5%.

The institutional concentration of credit institutions has increased further. According to the data collected by the end of September 2004, more than 80% of the assets of the banking sector was concentrated in ten banks. Although in the sphere of co-operative credit institutions the concentration – calculated by similar method – was smaller (20%), in comparison to 2003 in this area further concentration was also detected. Hungary's mid-year accession to the European Union has not led to the emergence of any major new market actor in the sector of credit institutions.

1.2.1. Member institutions of the Fund and their deposit portfolio

1.2.1.1. Number of member institutions

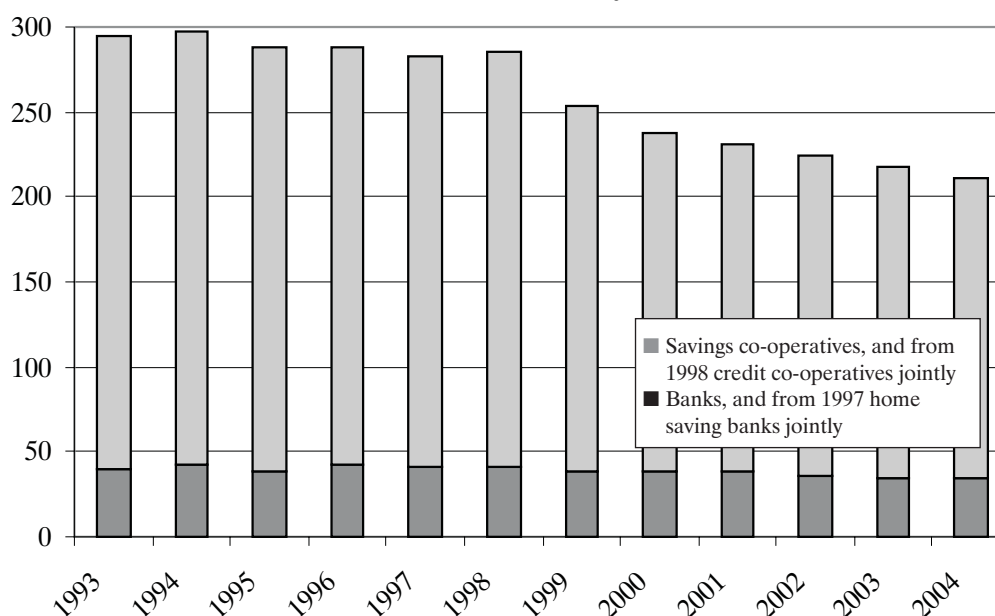
In early 2004 the Fund had 218 members, including 35 banks and specialised credit institutions (while from amongst the latter ones two were home savings banks), 177 saving co-operatives, and 6 credit co-operatives. In the course of 2004 the number of members of the Fund decreased by seven due to the following reasons:

- Post Bank has been merged into Erste Bank, and Konzumbank into Hungarian Foreign Trade Bank.
- Four savings co-operatives have been merged into another savings co-operative. (That is how the membership of the Savings Co-operatives of Újpetre, Csepreg, Fehértó, and Nagymaros was terminated.)
- The Credit Co-operative of Kárpátia was closed after the full settlement of the accounts.

Having raised its capital and obtaining the permission of the Supervisory Authority the First Home Credit Co-operative (Első Lakáshitel Takarékszövetkezet) has continued its activity in the form of a bank. This change, however, did not modify the number of member institutions.

Thus, on 31 December 2004 the Fund had 211 credit institutions as its members. 34 of those was commercial banks and specialised credit institutions (including 2 home savings banks), 172 savings co-operatives and 5 credit co-operatives.

Number of the Fund's member institutions by the end of the insurance year



1.2.1.2. Trends and composition of savings and deposits

The stock of savings held at the credit institutions was HUF 8,837 billion which shows a close to HUF 1,000 billion (12%) increase. In comparison to the previous year, no significant changes could be observed in the distribution of savings among the credit institutions. (90,5% of the savings was held in the banks and home savings banks, while 9,5% in the co-operative sector.) The average size of deposits placed at credit institutions rose from HUF 535 thousand to HUF 562 thousand.

The volume of savings and their distribution among the major credit institutional sectors**Table 1**

Description	Stock of savings HUF billion		2003=100%	2004 opening	
	2003 opening	2004 opening		of which (%)	
				Banks and home savings banks	Savings co-operatives and credit co-operatives
Deposits	7,227	8,054	11	91,3	8,7
Of which: saving deposits	810	872	8	56,6	43,4
other deposits	6,417	7,182	12	95,5	4,5
Securities	598	693	16	81,9	18,1
Interest payable	66	90	36	81,2	18,8
TOTAL	7,891	8,837	12	90,5	9,5

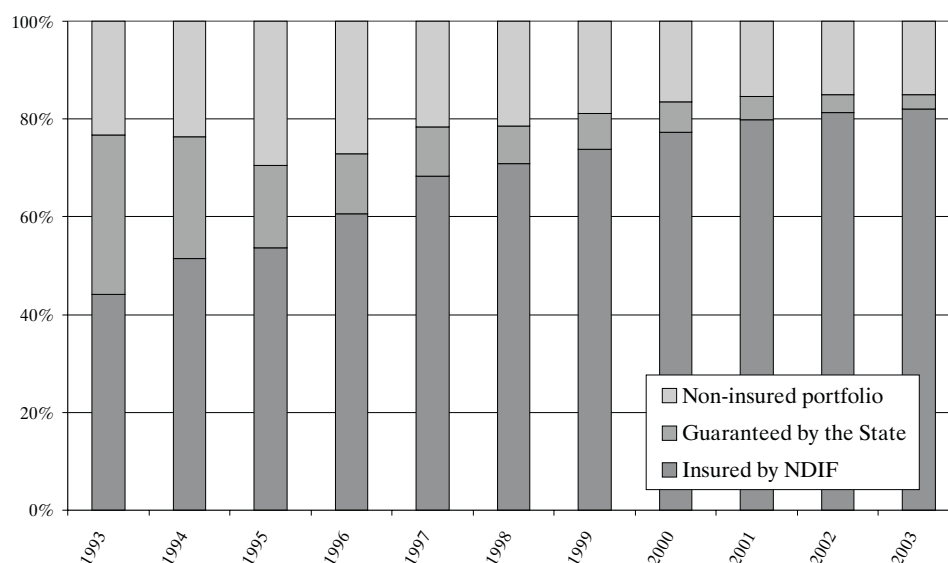
1.2.1.3. Breakdown of savings by types of protection

By the beginning of 2004, the ratio of savings insured by NDIF rose to 82,1% The stock guaranteed by the State fell to 2,8%, while the non-insured portfolio remained practically at the previous level.

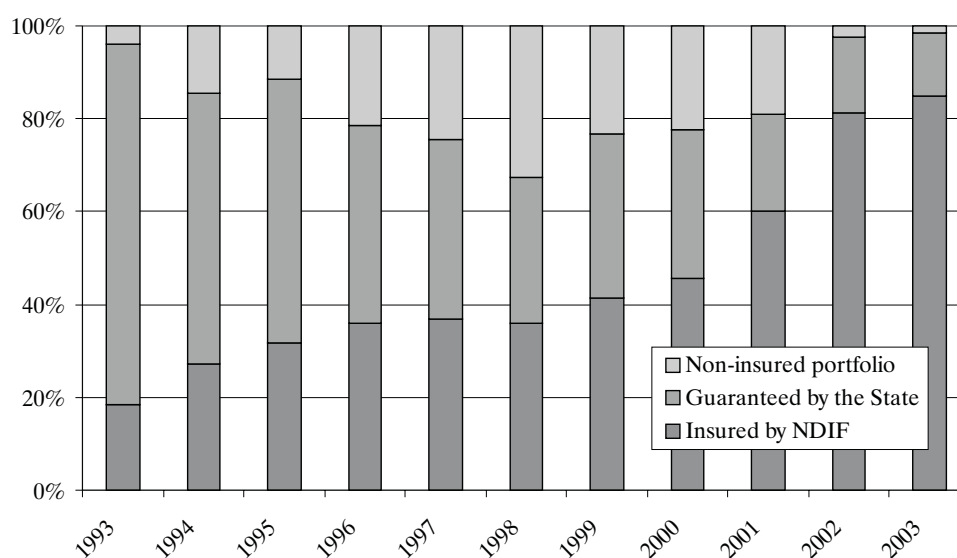
Table 2
(Data in %)

Description	2003 opening			2004 opening		
	Insured by NDIF	Guaranteed by the State	Not insured	Insured by NDIF	Guaranteed by the State	Not insured
Deposits	86,8	3,2	10,0	87,8	2,4	9,8
Of which: saving deposits	81,4	16,2	2,4	84,8	13,6	1,6
other deposits	87,5	1,5	11,0	88,1	1,0	10,9
Securities	19,5	7,5	73,0	19,2	5,9	74,9
Interest payable	52,6	14,9	32,5	61,5	12,0	26,5
TOTAL	81,4	3,6	15,0	82,1	2,8	15,1

Breakdown of savings portfolio by type of protection at the end of the insurance year



Breakdown of savings deposit portfolio by type of protection at the end of the insurance year



At the beginning of 2004, the NDIF protection level of the co-operative credit institutions was higher (92,9%) than that of the banking sector, where – including the home savings banks – this level was 81%. The NDIF protection coverage of the deposits in the banking sector rose by 0,5 percentage point in comparison with the basic year, and in the co-operative sector this indicator rose by 2 percentage point. The proportion of the non-insured savings in the banking sector is relatively high (16,4%, while the same ratio in the co-operative sector is 3,4%) and this can be attributed to the fact that in the banking sector the number of depositors not being insured by legal acts is much higher than in the co-operative sector.

1.2.2. Reimbursement commitments of the Fund

The theoretical reimbursement commitment of the NDIF for the insured portfolio is reduced by the reimbursement limit set per individual and per credit institution. Since 1 May, that is since the country's accession to the EU this limit has been raised to HUF 6 million, and it is supplemented by the 10% own contribution (co-insurance) in case of deposits exceeding HUF 1 million. In 2003, due to the raising of the reimbursement limit up to HUF 3 million the proportion of the NDIF reimbursement commitment rose from 28% to 40% on the total savings, and as a consequence of the additional increase to HUF 6 million this ratio further rose by 7 percentage points.

Reimbursement and guarantee commitments for savings held in credit institutions

Table 3

Description	Start of insurance year	Insured by NDIF	Guaranteed by the State	Non-insured or non-guaranteed stock	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
	2004	82,1	2,8	15,1	100,0
Ratio of reimbursement or guarantee commitments within the insured* and the guaranteed stock	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	—
	2004	48,5	100,0	0	—
Ratio of reimbursement or guarantee commitments within the full savings stock of the NDIF member institutions	2004	57,1**	100,0	0	—
	1993	n.a.	32,5	0	n.a.
	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
	2004	39,8	2,8	0	42,6
	2004	46,9**	2,8	0	49,7

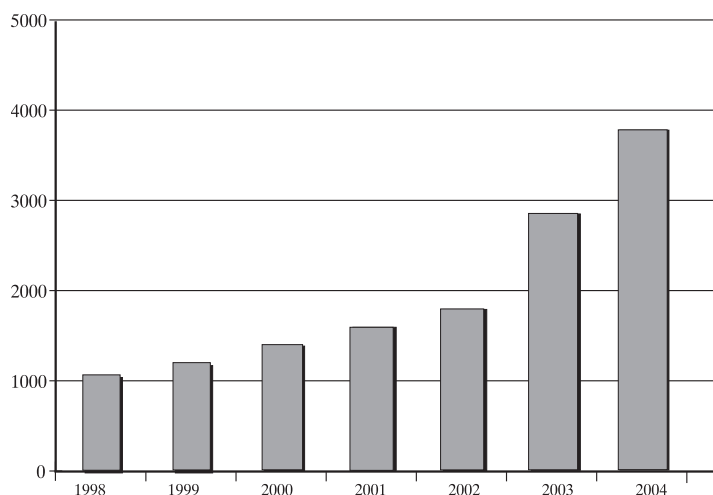
* The insured stock is the same as the NDIF premium base

** By the HUF 6 million reimbursement limit, introduced after EU-accession

The 49,7% joint coverage level of deposits by NDIF insurance and state guarantee essentially indicates that reimbursement commitment or State's guarantee covers half of the savings held in credit institutions, in order to ensure the unhindered functioning of the system of credit institutions and to strengthen the confidence of depositors. According to our latest data, within this ratio 46,9% is taken up by NDIF insurance and 2,8% by the State's guarantee commitment. (Table 3)

The gross value of NDIF indemnification commitment is shown in the following graph:

The trend of NDIF reimbursement commitment (HUF billion)



The reimbursement limit being in force till 2002 and making the pay-out obligatory till HUF 1 million meant that in international comparison Hungary's reimbursement commitment/GDP per capita indicator corresponded to the average of the European countries. The value of the indicator having been around 1 characterised not only Hungary's position but the deposit insurance practice of most of the then EU Member States. After the value limit had been raised in two steps and in congruence with EU norms, Hungary, with its 4,6 multiple reimbursement commitment /GDP per capita indicator got well above the average (probably together with the other newly acceded countries). Taking into account the differences in income levels, this is understandable.

1.3. Premium income of the Fund

According to Para. 119 of the Act on Credit Institutions, the own revenue resources of the Fund consist of the one-off admission fee, the regular and extraordinary contributions paid by the member institutions, the returns on financial investments of the Fund, as well as the portion recovered from receivables transferred to the Fund. These revenues can be supplemented by NDIF through borrowing.

a) Admission fee

Credit institutions that have been licensed to collect deposits are required to pay a one-off admission fee to the Fund upon becoming its member institution. The admission fee equals 0,5% of the registered capital of the member institution. In 2004 the Fund did not have any revenue from such fees.

b) Annual premium payment

As specified by Para. 121 (1) and (2) of the Act, the upper limit for the statutory annual regular premium to be paid by members is 0,2% of the deposit portfolio of the member institution insured by the Fund as of 31 December of the year preceding the year under review. This statutory ceiling has never been fully exploited by the Fund.

Since 1999 the premium rate applied has been gradually decreased in several steps, last time in 2003. Then the average value of the premium rate was reduced to approximately one third of the previous year's value, to 0,21 per mil. As its consequence, the premium income in 2003 (HUF 1,3 billion) hardly exceeded the income of 1994. The premium rates did not change in 2004 and the premium income rose slightly to HUF 1,36 billion. The premium rates for 2004 are shown in Table 4.

Premium rates for 2004**Table 4**

Premium categories		Premium rates (%)	
		in 2003	in 2004
Deposit size	Under HUF 1 million	0.5	0.5
	Between HUF 1 and 6 million	0.3	0.3
	Above 6 million	0.05	0.05
Average premium rate		0.21	0.20

The specific rate of reimbursement per commitments worth HUF 1,000 is, by and large, balanced among the credit institutional sectors, and that justifies the maintenance of the present premium category system. In 2004 the specific rate was slightly reduced but only at the savings co-operatives. (Table 5)

Development of the specific rates in 2004**Table 5**

Credit institution	Premium paid in 2003* (HUF million)	Premium paid in 2004 (HUF million)	Premium paid / HUF 1000 theoretical indemnification commitment/	
			2003	2004
Bank	1,077	1,158	0.42	0.42
Savings co-operative	234	271	0.43	0.41
Home savings bank	37	43	0.49	0.49
Credit co-operative	2.7	3.4	0.41	0.41
Total:	1,351	1,475	0.42	0.42

* Data do not indicate the deviations originating from preferential or increased rates, as well as from corrective items. The balance sheet data are modified according to the positive or negative sum of the factors mentioned.

c) Increased premiums and preferential premiums

Besides the regular yearly payment obligations, the Fund may also set increased and preferential rates. Increased premium can be charged if a member institution did not comply with the prescribed capital adequacy ratio, and/or met its premium or advance premium payment obligations with a delay of more than 30 days, or perhaps carried out exceptionally risky activity. (Para. 121 (6) and (7) of the Act). None of the member institutions had to pay increased premiums in 2004.

Preferential premiums are paid by those member institutions that are members of voluntary deposit insurance and institutional protection fund, permitted by the Supervisory Authority mentioned in Para 121. (1) of the Act. In 2004 168 savings co-operatives enjoyed such preferential premium to the total value of HUF 132,4 million.

In 2004 the member institutions of voluntary deposit insurance and institutional protection fund, which have met the conditions set by NDIF in its bye-laws, could get the preferential premium in a more favourable way, by deducting it from their quarterly advance payment, as against the practice of the previous years when the return from preferential premium was paid by NDIF in one single amount at the end of the year.

1.4. Fund ratio

Fund ratio is the internationally accepted indicator of the asset position of deposit insurers, which, as of the same date, compares the liquid assets of the Fund to the potential reimbursement commitments of the Fund at member institutions. At the beginning of 2003 the fund ratio of NDIF was 1,17% and this fund ratio already reflected that the reimbursement commitment level had been raised to HUF 3 million.

In 2004, the reimbursement commitment level was raised to HUF 6 million due to our EU accession and as its consequence the fund ratio just slightly exceeded the 1% threshold.

Development of the fund ratio between 2001 and 2004 (year opening data)

Table 6

Description	2001	2002	2003	2004
NDIF reimbursement commitment (HUF billion)	1,711	1,957	3,186	4,147
NDIF assets ^{a)} (HUF billion)	25.5	31.3	37.4	44.3
Fund ratio (%)	1.49	1.60	1.17	1.07^{c)}
Average premium rate (thousandth)^{b)}	0.60	0.59	0.21	0.20

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

b) 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).

c) Calculated as if the HUF 6 million reimbursement commitment level had been in force by the end of 2003 or early 2004.

1.5. The Fund's assets, financial position, and the result of its operation

1.5.1. Description of the securities portfolio and the evaluation of the activity of the assets managers

By the end of the previous year, the book value of the (opening) stock of the securities had reached HUF 43,027,923 thousand. At the end of the year concerned, the value of securities (closing stock) in the balance sheet was HUF 50,068,270 thousand. Of this value HUF 40,157,424 thousand was taken up by the closing stock of Hungarian government securities, and HUF 9,910,846 thousand of discount treasury bills.

The impact of the activity of the assets managers on the results of the basic year's balance sheet is shown in the following table

Table 7
(Data in THUF)

Description	Income	Expenditures	Profit
Exchange rate profit and loss on government bonds	2,432,623	59,440	2,373,183
Profit on interests of government bonds	2,702,189	0	2,702,189
Exchange rate profit and loss on discounted government bonds	1,193,500	0	1,193,500
Interests on provisionally non-invested financial means	44	0	44
Expenses on portfolio management	0	38,645	-38,645
Charges of custodian services	0	2,573	-2,573
Total	6,328,356	100,658	6,227,698

Last year, the Hungarian government securities market, which has been the exclusive area where the Fund hitherto realised investments was balanced. Due to this fact, in the course of the year the portfolio managers achieved 13,95% gross yield on the full portfolio, exceeding by 50 basic points the requisite MAX-C reference index. That implied a 7% real return. Thus in 2004 the administration of the assets resulted in an increase of the retained profit of the year by HUF 6,228 million. Around 43% of this growth originated from the yields of the government securities' interest, while 57% was derived from the exchange rate profit on government bonds and discounted government bills. In 2004, the total number of transactions involving securities was 566, which means a decline in comparison to 2003.

The earnings derived from the management of portfolios were curtailed by the remuneration paid to the managers of both the portfolios and the custodian. In comparison to the figure for the previous year, the total expenditures originating from the administration of the portfolios were reduced by 20%, while the volume of the securities managed increased by 16%.

In the course of 2004 the assets were not redistributed among the portfolio managers. 40% of the portfolio was managed by CA IB Értékpapír Befektetési Alapkezelő Rt. (CA IB Securities Investment Fund Corp.) 40% by OTP Alapkezelő Rt. (OTP Fund Corp.) and 20% by CIB Befektetési Alapkezelő Rt. (CIB Investment Fund Corp.).

In the year concerned the results of two portfolio managers exceeded the level of yield of the reference index. CA IB Értékpapír Befektetési Alapkezelő Rt. achieved an annualised gross yield

of 13,58%, while CIB Befektetési Alapkezelő Rt. achieved 13,37% and OTP Alapkezelő Rt. 14,60%. At the same time the seasonal value of Max-C was 13,48%.

Like in the years before, investing into foreign government bonds were considered too risky by our portfolio managers. Thus – in spite of the fact that investment directives would have allowed it – no investment was made into foreign government securities.

1.5.2. Summary evaluation of the profit

In 2004 the profit amounted to HUF 7,291,057 thousand, exceeding significantly, by HUF 5,5 billions the retained profit of 2003. The main factors behind this change are illustrated in Table

Table 8

Description THUF	2003	Impact of revision	2004	Change		Indicator for 2004 %
				THUF	%	
Income from deposit insurance	1,392,887	0	1,403,649	10,762	100.77	19.25
Other income	964	0	966	2	100.21	0.01
Income from financial transactions	3,256,885	0	6,328,385	3,071,500	194.31	86.80
Total income	4,650,736	0	7,733,000	3,082,264	166.27	106.06
Expenses on deposit insurance	17,433	0	151	-17,282	0.87	0.00
Other expenses	49,754	0	42,594	-7,160	85.61	0.58
Expenses of financial transactions	2,522,038	0	59,492	-2,462,546	2.36	0.82
Total expenses	2,589,225	0	102,237	-2,486,988	3.95	1.40
Operating costs	319,479	0	339,706	20,227	106.33	4.66
Total expenses and operating costs	2,908,704	0	441,943	-2,466,761	15.19	6.06
Retained profit for the year	1,742,032	0	7,291,057	5,549,025	418.54	100.00

The increase in retained profit can be attributed to the modification of two factors that can be found in two different lines of Table 8.

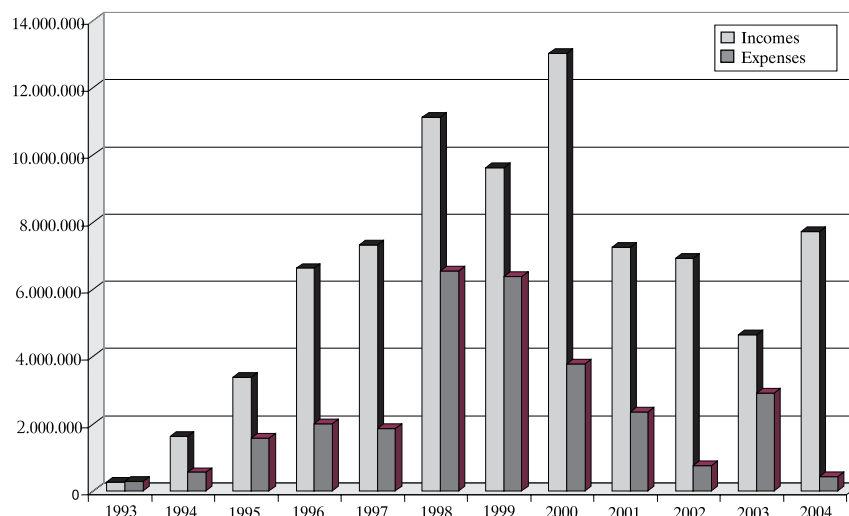
1. Due to the favourable market trends of government securities, the income derived from financial transactions rose by HUF 3,1 billion in comparison to the preceding year.
2. It was also due to the profitability of the portfolio management that the expenses of financial transactions, and mainly the exchange rate loss, declined by HUF 2,5 billion. This development in the current year resulted in the increase of earnings by the same level.

Other components of the earnings, namely the growth in income from deposit insurance and the reduction of expenses, the decrease of other expenses and the increase of operating costs had negligible impact on the development of the retained profit for the year.

The following graph illustrates the total income and total expenses of NDIF as showed in the balance sheets from the Fund's foundation in 1993 up to 2004.

1.5.3. Trends of the Fund's equity and profits from its foundation up to 2004

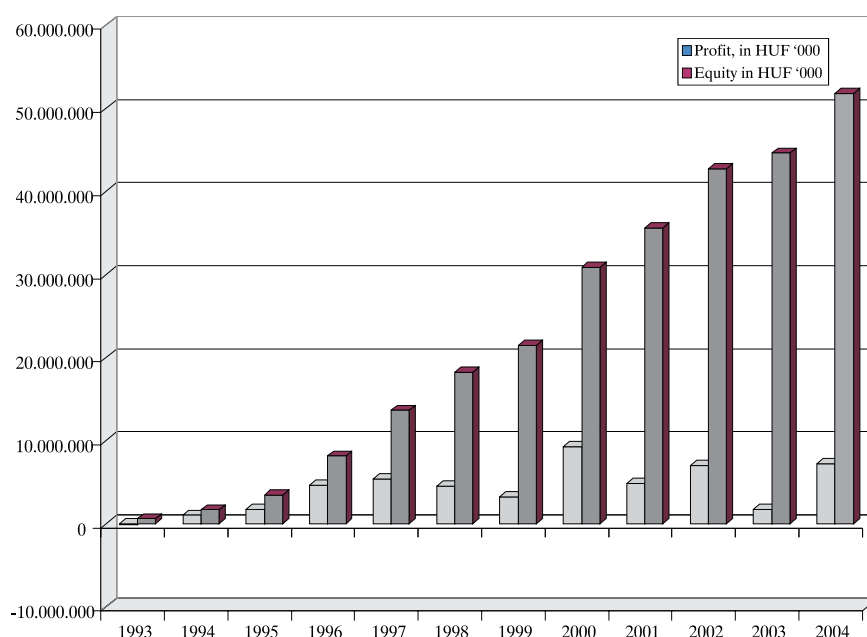
Incomes and expenses of NDIF 1993–2004



When examining this table, it must be taken into consideration that the equity contains in an accumulated manner the profits of the preceding years and also the profit of the current year, therefore the extent of equity's growth is influenced by the fluctuation of profit.

The fluctuation of profit – experienced from 1998 – could be attributed until 2002 to the recovery prospects connected with the liquidation of Realbank Rt. Afterwards these fluctuations were the result mainly of the development of yields originating from the government securities market.

Besides these factors, in the last years the development of the profit was decisively influenced by the premium policy introduced in 1999, in consequence of which the income from premium is declining year by year. This decreasing premium income has already been compensated by the returns from securities portfolio.



SUPPLEMENTARY INFORMATION AND REFERENCE DATA

2.1. The institutional communication of NDIF

In January 2004 the updating of the homepage of the Fund that had been started in the previous year was completed. As its consequence the new communication service domain, initiated in 2003 in order to serve the member institutions, was accomplished in 2004. Thanks to the technical development the homepage of the Fund was modernised and turned into a portal-type structure.

The structure of the new homepage became more transparent and our customers find easier the information looked for. The homepage was enriched with a Press Room dedicated to journalists and a Deposit Insurance Calculator. Using this inter-active calculator the customers can calculate how much reimbursement can be expected from NDIF in case of a possible bank failure, after deducting the co-insurance. On the homepage special attention was paid to the information related to cross-border deposit insurance regulations and to regulations applied in the European countries.

In 2004 the communication activity of NDIF concentrated mainly on the dissemination of information on the new regulations that were to enter into force after our accession to the EU. In 2004 the staff members of NDIF – in co-operation with the interest representative groups of the credit institutions* – organised four training programs at external venues. In these training courses 23 staff members of credit co-operatives and 26 administrators from savings banks, as well as the 157 managers of credit institutions were participating in the 2-days assembly of OTSZ. In the deposit insurance training courses the representatives of NDIF provided information on the legal changes that were to enter into force in May 2004 by way of disseminating information on the legal background, giving advice on the application, and making reference to practical cases.

In June 2004 NDIF presented its newly developed e-learning system, based on internet technology to the front desk staff of the member institutions. Its success was reflected by the fact that within a short time almost 400 applicants showed interest in the program. Of those interested, 131 represented credit institutions, 12 credit co-operatives, 6 home savings banks, and 232 savings co-operatives.

According to the indications of the applicants the system was found very useful mainly by the administrative staff coming from the country-side.

In addition, we also made the system accessible to those having no Internet-connection. Since May 2004 we have posted the e-learning system of NDIF in CD format to more than fifty branches.

The e-learning system of NDIF based on Internet was widely acclaimed by professional circles. Half a year after its introduction our teaching material entitled “Savings your Savings Together” took the third place in the “E-learning” category of the eFestival Hungary, organised by the Hungarian Association Content Developers in 2004. Having gained this price, our educational system worked out in co-operation with our partner, Mimóza Kft became eligible to bear the title “Awarded digital media appliance”.

In co-operation with the member institutions we sent an information letter to the account holders of member institutions, informing them on the modified deposit insurance conditions coming into force on 1 May. In accordance with the regulatory changes in May, we updated the content of “Savings your Savings Together” In order to facilitate the circulation of information on cross-border deposit insurance, since 1 May the “Savings your Savings Together” has been made available also in English and can be loaded free of charge from the home-page of the Fund.

Last September, with the help of the Hungarian Banking Association we organised a meeting with the communication and marketing managers of the banks. At the meeting we gave an account of the actual changes in deposit insurance, and at the same time we requested the assistance of the participants to enhance quality information on deposit insurance at branch level.

In 2004, the administrators of credit institutions were informed on the current questions of deposit insurance through our NDIF Newsletter published three times a year, and also through our On-line Newsletter.

Within the framework of direct public information our Voice Mail service has been refreshed and it can be reached already by preferential tariff (through the so called Blue number).

2.2. Examination activity of the Fund

Within the framework of its on-site examination NDIF examined the accuracy of the premium declarations of the member institutions and – in the interest of the depositors – the deposit registry, applied by the member institutions, as well as the institutions’ compliance with the obligations prescribed in the Act on Credit Institutions to provide information to clients. In 2004 special emphasis was laid on target-oriented examination, which was directed to examine the congruence of specific elements to the relevant deposit insurance regulations, and which is typically carried out not on-site but at the Fund and based on the documents requested and supplied.

The annual Plan of Examination prepared by the Management of the Fund is approved by the Board of Directors of NDIF and it covers the second half of the current year and the first half of the following year. Based on its Plan of Examination for 2004–2005 NDIF carries out target-oriented inspection at ten member institutions, and in co-operation with the National Saving Co-operatives Institution Protection Fund altogether 25 member institutions will be involved in its on-site examination activity within the period concerned. The major findings of the inspections having been closed so far are as follows:

- The accuracy of the premium declarations is appropriate. There was some inaccurate premium declarations due to the false interpretation of the legal provisions (especially that of the premium reducing items), but because of the small value of distortions no new premium declaration was required.
- Member institutions are continuously modernising their data recording system and thus the recording of deposits meets the expectations.
- False interpretation of legal provisions, reference to invalid legal provisions regulating the deposit sector, administrative instructions, and deposit contracts, still can be observed.
- The dissemination of information on deposit insurance to clients, through the information materials displayed in the visitors’ area, is appropriate.

* HBA – Credit Co-operatives’ First National Voluntary Deposit Insurance and Institution Protection Fund; TÉSZ – National Interest-Representation Association of Savings Co-operatives; OTSZ – National Association of Saving Co-operatives

2.3. Events related to liquidation in progress

Heves and Environs Savings Co-operative 'under liquidation'

In 2004, according to the report received from Concordat Liquidator Ltd (Concordat Felszámoló Kft), there was nothing that was worth to mention in the liquidation case of Heves and Environs Savings Co-operative which started on 25 November 1993. We still do not have information on the presentation of the liquidation's closing balance sheet.

Since the commencement of the liquidation up till the closing of the balance sheet NDIF paid an indemnification of HUF 262,126,706 that was reported to the liquidator as a credit receivable. We note that due to the assets of the savings co-operative and the classification of NDIF's creditor claim no recovery of the losses can be expected.

Iparbankház Rt. 'under liquidation' (Industry bank)

The liquidation process commenced on 4 July 1996 is still underway, as the closing balance sheet of the liquidation and the assets sharing proposal presented to the Metropolitan Court of Justice by the liquidator on 28 February 2003 were commented by two of the creditors. The liquidator did not report any meaningful events in 2004.

Besides the return already reaching 97,5%, we do not count on any further return on the Fund's creditor claims presented.

Up to the balance sheet turning date deposit reimbursements to the value of HUF 2,309,729 were realised, and reported to the liquidator.

From the claims taken over from Iparbankház in 1996, HUF 150 thousand was returned from the employee's home credit scheme but no real income could be derived as this claim had been calculated earlier at the same value.

Realbank Rt. 'under liquidation'

Since the commencement of liquidation on 19 January 1999 up to the balance sheet turning date six interim balance sheets were prepared. Based on the approved interim balance sheet the Fund's claims in category "d" were 100% reimbursed, while the creditor's claim categorised as "f" was reimbursed in 96,35%.

In 2004 Realbank Rt. carried on recovering its claims and selling them through public tenders. Legal and non-legal actions against Realbank have not been closed, yet, and the reserves required to meet reimbursement obligations – as stipulated by the Act on Liquidation – are available. According to the information provided by the liquidator, Credit Institution Liquidator PBC, taking into account the assets of the debtor the liquidator attempts to cover the creditors' claims also up to 100% in category "f", but it does not plan to make another interim balance sheet and an asset-distribution proposal before the presentation of the closing balance sheet planned for 2005.

Rákóczi Credit Co-operative ‘under liquidation’

The No. 1 interim balance sheet drawn up for the turning date of 31 October 2001 and closing the first year of the liquidation process did not contain proposal for the distribution of the assets.

The liquidator – Credit Institution Liquidator PBC. – forwarded its No. 2 interim balance sheet to the Metropolitan Court of Justice in June 2004. In this paper it recommended a 47,697 % partial distribution of assets in category “d”. Due to the lack of assets it did not make any recommendation concerning claims in category “f”.

Till the turning date of the balance sheet reimbursement to the value of HUF 290,758,967 was paid by the Fund and reported to the liquidator.

The Metropolitan Court of Justice has not yet approved the balance sheet forwarded. Thus the liquidator has not yet realised reimbursements. In the balance sheet it is proposed that for the “d” category creditor’s claim of NDIF HUF 139,568,081 be reimbursed. The claim of NDIF in category “f” is worth HUF 12,666,189.

The value of assets of the credit co-operative at the time of the calculation of the balance sheet was HUF 293,017 thousand that promises a probable further 18–20% reimbursement for the creditors’ claim in category “d”.

2.4. Legal matters***2.4.1 Pending litigations***

In 2004 the NDIF was the defendant in five legal cases related to Realbank.

In the course of current year, of the five cases one was closed by favourable conclusive judgement in favour of the Fund and the claimants did not submit an appeal. The other legal cases are still at the Court of First Instance. In a separate part of one of these cases a verification decision was already taken in favour of the Fund.

2.4.2 Other commitments

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

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

2.6. International activities

In the international relations of NDIF ever decisive role is played by the co-operation within the international organisations.

The International Association of Deposit Insurers (IADI) held its third annual assembly in Brunnen (Switzerland) in October 2004 with the participation of the Deputy Managing Director of the Fund. Besides the regular agenda points, such as the adoption of the report and the balance sheet for 2003, the assembly increased from 21 to 23 the number of the members of the Executive Council. The meeting was followed by a conference. In one of its sections, the Managing Director of NDIF delivered a lecture. It still concerns the Association, that in May, the Managing Director of NDIF participated – as a moderator – in the Euro-Asian Regional Conference of the Association in Kiev.

In August, the European Forum of Deposit Insurers (EFDI), comprising the European deposit insurance institutions held interim elections for the posts of president and vice-president. Mr. Roberto Moretti, Secretary General of the Italian deposit insurance organisation was elected by unanimous vote to the President of the Forum, and Ms. Marianna Berg, economic councillor in charge of international affairs of NDIF was elected as Vice-President.

EFDI held its first professional seminar in Budapest. It was dedicated to the implementation of the European Union's 94/19/EC directive on deposit insurance in the new Member States of the EU. At the seminar the Hungarian Vice-President of EFDI also gave a lecture, while the Managing Director of the Fund introduced the Hungarian deposit insurance system. Among others, the experts of the EU Commission on deposit insurance matters, the Round-Table of European Financial Services, the EU Association and Commission of Bank Associations and Bank Supervisory Bodies, as well as the representative of the European Central Bank took the floor.

The Forum held its bi-annual Assembly in Padova in October 2004. NDIF was represented by the Vice-President of the EFDI. The Assembly discussed the question of turning EFDI into an association bearing legal personality, the advantage of which can be summed up in the fact that thus EFDI could become one of the advisory bodies of the EU's competent professional committee on deposit insurance matters. In the course of the conference that followed the Assembly, lectures were given on the relations and co-operation between the deposit insurance institutions and the supervisory authorities, as well as, on the bilateral co-operation agreements described in 94/19/EC directive of the EU. At the end of November another professional seminar was held by EFDI in Rome, which was dedicated to the probable consequences of Basle 2 and its impact on supervisory activity and deposit insurance systems.

The Federal Reserve Bank of Chicago organised a conference under the title "Financial crisis – crisis management of large banks". The Deputy Managing Director of NDIF participated in the conference which enhanced our knowledge – among other items – on cross-border financial challenges.

On the occasion of the 10th anniversary of the foundation of the Czech deposit insurance organisation a seminar and celebration was held in Prague where the Deputy Managing Director of NDIF represented the Fund and gave a lecture on reimbursement procedures.

The American *Financial Services Volunteer Corps* (FSVC) requested the experts of NDIF to contribute as consultants and advisers to the formation of the deposit insurance payment system of Albania. One of the senior staff-members of NDIF and an outside expert participated in this project, and then the partners from Albania paid a short visit to Budapest. Both events were organised and financed by FSVC.

Foreign interests in NDIF's professional achievements and expertise are reflected by the fact that the deposit insurance organisation of Jordan, set up in 2000, also initiated a study tour to Hungary, again with the support of FSVC. During the talks in Budapest among other items the premium payment and the reimbursement system, as well as the co-operation with other actors of the financial safety net were discussed.

2.7. Tasks defined by the Board of Directors of NDIF, and their implementation

In 2004 the Board of Directors held 9 meetings and adopted 63 resolutions on items deemed obligatory in accordance with the stipulations of the Act, and the major issues related to the functioning of the Fund. Among others the following major themes were on the agenda:

- Adoption of the 2003 report and the budget for the current year;
- Election of a new auditor;
- Appointment of a new internal auditor and of an IT security controller in communication, modification of the Rules of Internal Auditing, the adoption of the Rules on IT Security Auditing, determination of the work-plans;
- Adoption of the new rules on the reimbursement system of NDIF, and the authorisation of the Management to conclude agreements on system-monitoring and system-support;
- Screening of the information and data-protection activity of NDIF, and based on the results the adoption of the Rules on IT Security of NDIF;
- Review of portfolio management, and based on the findings, deciding on the modification of investment guidelines and the transformation of the evaluation of the performance of portfolio managers;
- Examination of member institutions (setting the forms and frames of examination, adoption of the annual plan of examination and target-inspection, evaluation of the experiences gained from examination, the identification of tasks);
- Modification of the Rules on Premium Payment and Rules on Membership;
- Decision on creating a safe page for the Board of Directors within the homepage of NDIF;
- Decision on the new headquarters of NDIF;
- Decision on the arrangement of a seminar, as hosts to be organised by European Forum of Deposit Insurers for the deposit insurance organisations of the countries that joined the European Union in 2004.

Decisions taken by the Board of Directors have been duly implemented and in accordance with their deadlines.

BUSINESS REPORT

3.1. Expectations for trends of savings and the yield of government securities for 2005

A minor (1–2 percentage point) increase in real wages is expected for 2005, savings, and among these the household savings will probably grow. It can be expected that the growth of savings will continue to appear mainly in the deposits, namely at the credit institutions, and this implies that deposit stock insured by the Fund will also increase on yearly basis. As for the investments in government securities we expect a lower level of yields in comparison to the results of 2004.

3.2 Strategic goals for 2005

The Board of Directors of the Fund met on 18 February 2005 and reviewed certain functions of the national deposit insurance system and its institution, the timeliness and the appropriateness of changes. The meeting stated that during its 12 year old existence and functioning, the Fund has proved its reliability, strengthened the trust of depositors vested in the credit institution system and has significantly contributed to the stability of the present scheme. At the same time, precisely these positive changes of the credit institutional system having taken place during the previous decade, underline the need to review and reassess the functions and institution of NDIF, founded in 1993 and the subsequent years. This is required in order to ensure the functioning of an EU-conform deposit insurance that meets Hungarian requirements and is appropriate and effective.

The Board of Directors set the directions and space of modernisation according to the followings:

The co-ordination of tasks which fall within the joint scope of activity of the Hungarian Financial Supervisory Authority (HFSA) and NDIF must be strengthened. Through the better utilisation of co-operation possibilities, the effectiveness of the functioning of the deposit insurance system must be increased. The Board is of the opinion that efficiency reserves can be found in the area of information, examination, and the handling of eventual crisis management.

Due to the co-operation with HFSA, as well as to a decrease in risks related to the emergence of credit institutional failures, the scope of functions performed by the staff members of the Fund must be tightened and thus the number of staff must be reduced. The benefits resulting from outsourcing of certain functions must be considered and exploited, where it is appropriate.

The planned deadline for the functional and organisational restructuring of NDIF is mid-2005.

It is also deemed necessary that the existing legal provisions must be modified in order to ensure that the investment of the NDIF-assets and the premium payment system could be more flexibly adjusted to the prevailing market conditions and the size of the NDIF-assets.

INDEPEDENT AUDITOR'S REPORT

To the Owners of the National Deposit Insurance Fund of Hungary.

We have carried out the auditing of the NATIONAL DEPOSIT INSURANCE FUND of HUNGARY's (hereinafter "the Fund") balance sheet as of 31 December 2004, in which the corresponding total value of assets and liabilities was HUF 51,909,845 thousand and the retained profit for the year was 7,291,057 thousand. We also examined the Fund's income statement and its additional supplements (namely the balance sheet, the income statement and the additional supplements, hereinafter "the financial statement") for the business year concerned. The results of this auditing are contained in the Report of the Fund. The preparation of the Report, which consists of the financial statement and a separate business report, is the task of the Management. The Report examined had been compiled in order to present it to the next annual assembly for approval, and as such could not take into account the probable impact of the decisions to be taken at the assembly. Our tasks comprised the evaluation of the financial statement based on our auditing, and the making of an assessment whether the accountancy data reported in the business report were consistent with those contained in the financial statement.

We conducted our audit in accordance with the Hungarian Standards of Auditing, the relevant legal acts and other legal provisions related to auditing. In compliance with these regulations, in the planning and implementation of auditing we obtained adequate evidence that no significant errors were found in the financial statement. The auditing incorporated the random sampling examination of the vouchers supporting the factual data of the financial statement. Besides it contains the evaluation of the accounting principles applied, the major estimations of the Management, as well as the presentation of the financial statement. Our activity related to the business report was limited to the area specified above and did not cover the surveying of other data related to the non-audited accounting records of the Fund. We are convinced that our work fulfilled provides appropriate basis for the presentation of the independent auditor's opinion (clause).

In the course of auditing we examined – in accordance with the provisions of the valid national auditing standards – the Report of the National Deposit Insurance Fund of Hungary of 2004, its sections and items, and whether their findings could be confirmed through book-keeping and by vouchers. We collected enough and proper evidence that the report had been made in congruence with the provisions of the Act on Accountancy and the general principles of accountancy. The Report provides reliable and real picture on the assets, the financial, and income position of the Fund. The business report corresponds to the data of the annual account.

Taking our opinion into account and in accordance with para. 154 (1) of Act C (2000) on Accountancy, which was modified on several occasions, the Fund may refrain from disclosing the additional supplements in full.

Done at Budapest, on 4 February 2005



Audit Service Ltd.
Registered auditing company
H-1022 Budapest, Bimbó út 3. I/5
Reg. No. 001030

AUDIT SERVICE KFT
bejegyzett könyvvizsgáló cég
ny.sz.: 001030



Dr. Iván Serényi
Registered auditor
H-1022 Budapest, Bimbó út 3. I/5
Acc. Reg. No. 003607

Dr. Serényi Iván
bejegyzett könyvvizsgáló
s.sz.: 003687
k.t.sz.: 003607