

14th MEETING OF THE ASSOCIATES

- Tallinn, Estonia, 6 June 2002 -

MINUTES**ITEM I – OPENING AND WELCOME**

Mrs Katrin TALIHARM, Managing Director of the Estonian Banking Association, chaired the meeting.

Mr Nikolaus BÖMCKE, Secretary General of the European Banking Federation, welcomed the participants in Tallinn, the home city of the Estonian Banking Association.

A list of participants is attached.

ITEM II – MINUTES OF THE PREVIOUS MEETING

The members approved the minutes of the 13th Joint Meeting of the Associates and the Pre-Accession Committee, which was held in Brussels, Belgium, on 6 December 2001.

ITEM III – BANKING SYSTEM IN ESTONIA

- a) Mr Andres SUTT, Deputy Governor, Central Bank of Estonia presented an overview on the current situation in the Estonian financial sector.

The main priorities of the Estonia regarding the economic policy are conservative fiscal policy, continuation with structural reforms, successful conclusion of the EU accession negotiations and implementation of the pre-accession economic program. The most important medium-term objective for the financial sector is joining the European Economic and Monetary union.

Estonia has a currency board arrangement since the early 90's and its national currency – Estonian krona has been pegged to DEM and later to the EUR. In general, the Euro-based currency board framework is acceptable for participation in the Exchange Rate Mechanism 2nd level (ERM II). Already now the currency exchange operations between the Central Bank of Estonia and any of the commercial banks regarding the exchange of Estonian krona to EUR and vice versa is done free of charge.

No remarkable institutional or structural changes have been observed in domestic market since the middle of 2000 as far as for concentration of banking sector and foreign ownership is concerned. The two largest banks (out of 7) of Estonia represent around 80% of the market share in terms of assets. There is a very high degree of foreign ownership in Estonian financial sector. Banks' capital adequacy ratio has been stabilized at about 3-5% points above the minimum requirement of

10%. During the last years banks have been working with significant profits and relatively low level of non-performing loans (Less than 3% of the loans are overdue for more than 60 days). E-banking is becoming very popular within the country, as already 96% of the payment transactions handled by the banks are electronic ones.

Debt securities market is a very limited one in Estonia, as the Government is not issuing any bonds or treasury bills. As a result main players in debt security market are private companies, mainly foreign credit and financial institutions, but, nevertheless, the share of domestic enterprises debt securities' issues is increasing.

Estonian stock market had a capitalization of around 2 billion EUR as for the end of 2001. The biggest part of the foreign investors came from Sweden 54%, followed by USA (10%), Finland (10%) and UK (9%). Recently the Tallinn Stock Exchange has been affiliated with the HEX.

Mandatory funded pension scheme was introduced very recently, with the passing of the Funded Pensions Act on September 2001, which will become fully effective from July 2002. Currently, 15 mandatory pension funds managed by 6 pension fund asset management companies are available across the country.

From January 2002, the consolidated Financial Supervisory Authority (FSA) has been operational in Estonia.

- b) Mr Ingmar MATTUS, Estonian Banking Association, continued with an overview on the latest developments of Estonian banking system and Estonian Banking Association.

For the last 4 years the number of the banks operating in the Estonian financial market has not changed. Since 1998, altogether 7 banks are licensed to do their business in Estonia. This in comparison to 41 banks operating just 10 years ago - in 1992. The minimum equity capital requirement for commercial banks has been increased from 1 million Euros in 1994 to 5 millions starting from 1999. The consolidated assets of the banking sector of Estonia have been growing rapidly and have reached 6.5 billion Euros compared to just 0.5 billions in 1995. By far the biggest bank in Estonia and in the whole Baltics is "Hansapank" with 4.6 billions euros in assets as for the end of 2001. The calculated market share of this bank is exceeding 70%!. The total net income of the Estonian banking sector reached 1.9 billion Euros in 2001.

Following the development of the banking sector as well as the tighter competition, the average interest rate for the loans issued in Estonian krona has reduced gradually from above 20% in 1994 to around 9-10% as for the end of 2001.

The Deposit Guarantee Fund is operational in Estonia and currently the maximum guaranteed amount is set at 2,550 EUR. By the end of 2010 the maximum refundable amount will be increased to 20,000 Euros. The Deposit Guarantee Fund is funded by contributions of Estonian banks. Currently, the ceiling of the annual contributions is set to 0.5% of banks' deposit base.

The Estonian Banking Association (EBA) was founded in July 1992 by 21 commercial banks operating in Estonia at that time. EBA became an Associated member of the European Banking Federation in June 1996. Currently, 6 of the 7

banks operating in Estonia are members of the Association. EBA is employing 5 persons.

The main mission of the EBA is (quoting) “to promote the development of banking activities, to improve the banking operations of its member banks and to institute good business practices and ethics”.

Current activities of the EBA include:

- Cooperation with the Consumer Protection Board;
- Preparation of the new General Conditions for Banks and Standard Contractual Terms (e-banking, loans, bank cards, payments, phone banking);
- Implementation of the Money Laundering Prevention Act, effective since mid 1999) and amendments regarding the second EU Directive;
- The Good Banking Practice code;
- Pre-filled income tax forms;
- Amendment of regulation on bureaux de change.

Another very important field of activities is the service of information. The main source of information is the homepage of the EBA. In addition, an annual magazine and an annual report are published.

ITEM IV – PROPOSED AMENDMENTS AND LATEST CHANGES IN THE EU DIRECTIVES FOR THE FINANCIAL SECTOR

Mr Elmars KRONBERGS, Adviser at the European Banking Federation, presented a third report on the latest developments in the EU legislation concerning the financial sector.

He outlined seven recently adopted regulations – the Directive on financial collateral arrangements, 2 Directives on solvency margins for insurance undertakings (“Directive on solvency margins for life assurance insurance undertakings” and “Directive on solvency margins for non-life insurance undertakings”), 2 Directives on harmonized investment funds, the EC regulation on charges for cross-border payments in euros and the EC decision on standard contractual clauses for the transfer of personal data to third countries.

Mr. Kronbergs continued his report on the European Commission’s proposals covering the Regulation on the application of International Accounting Standards, the Directive on Supplementary Supervision of Financial Conglomerates, the Directive on Market Manipulation and Insider Dealing and the Directive on Single Prospectuses for Issuers. As the last but not the least issue, the recent proposal for the Insurance Mediation Directive was presented.

Among the most important European Commission’s consultations, highlighted in the presentation, were the ones regarding the second consultation on updating the Investment Services Directive (ISD) and the 2nd consultation on the transparency obligations on publicly traded companies.

It was stressed that an update on the latest developments in the EU legislation concerning the financial sector should be included in the Agenda of the next meeting of the Associates.

ITEM V – UTILISATION OF BANKING PARAMETERS IN INTERPRETING ECONOMIC TRENDS AND BUILDING ECONOMIC FORECASTING MODELS

Mr Martin LINDPERE, Central bank policy department, Central Bank of Estonia, presented an overview on the issue in four main sections:

- 1) Main economic indicators of Estonia;
- 2) The role of the banking sector in Estonian economic development;
- 3) Forecasting exercise at the Bank of Estonia;
- 4) Banking sector indicators in forecasting.

In general, Estonia is a small and open economy driven by the domestic and foreign investments. As Estonia is a net borrower, the investor confidence is a crucial factor. Estonia has been relatively resistant to the latest global economic slowdown and has been able to maintain high pace of economic convergence, but, nevertheless, its economic growth in 2002 has been lower than in the two previous years. Despite the existing strong expectations of improvement in general world economic outlook, the overall recovery still involves certain risks.

Companies' owners' equity, which depends highly on foreign direct investments, is the main source of investments in fixed assets. Although the majority of invested funds are not debt creating, the role of the banking sector is increasing continuously as the total volume of savings as well as the loans increase significantly.

The forecasting exercise mainly consists of the forecasting procedure, infrastructure and instrumentarium. The forecasting exercise combines both, the forecast of the Bank of Estonia macroeconomic models and expert opinions. The real sector is central in the existing macro model, because the integration of the financial sector into macro model has not given satisfactory results. Financial sector experts are involved at different stages of the forecasting exercise – at assumptions on exogenous variables and scenarios, at preliminary forecast and at risk assessment.

Regarding the banking sector indicators, just a few of them are formed based on expert opinions. The main channels connecting the real and banking sectors are capital accumulation and technological innovations. The main indicators that have been modelled so far for the banking sector are interest rates, credit (supply versus demand side approach; credit to the private sector as a function of resources available at the banking sector and interest rate; domestic demand as a function of credit), money supply and demand.

ITEM VI - UNFAIR TERMS IN CONSUMER CONTRACTS

The greater range and complexity of products and, in some areas, concerns about more aggressive selling practices, have led to an increased focus on consumer protection. This has resulted in new consumer credit regulation and new rules for disclosure, codes of conduct and dispute resolution in the EU.

Issues related to unfair terms in consumer contracts have been regulated through the EU Council Directive 93/13/EEC. The main purpose of the Directive is "to approximate the laws, regulations and administrative provisions of the Member States relating to unfair terms in consumer contracts". Main arguments, why such Directive was necessary were:

- At that time the laws of Member States in this field showed many disparities and market divergences;
- Consumers do not know the rules of the law which govern contracts for the sale of goods and services in other Member States;
- The need to facilitate the establishment of the internal market by harmonizing the legislation (adopting uniform rules of law);
- The need to safeguard the consumers from the abuse of power by the seller of goods or supplier of services.

The main conclusions on the current situation concerning the implementation of requirements under the Directive in banking systems of the Candidates and Members are as follows:

1. None of the respondents has indicated that the customers of their financial institutions were suffering significantly from unfair terms in consumer contracts. However, some complaints are arising from time to time almost in every respondent's country (For example: the implementation of the default interest rates on credit cards was quite a problem in Turkey recently).
2. In general, there are two groups of the countries in the respect of equal or a higher level of protection provided by the national law. One group, which seems to be a minority – has implemented the Directive as written, respectively providing equal level of protection as required by the Directive.
Second, the largest group has some national provisions that provide a higher level of protection. However, the scale and the particular aspects of the higher level of protection are very different, depending on how the numerous details of the Directive were incorporated in the national law in every particular country.
3. The implementation of the Directive was rather technical as many Member States already had a general provision on unfair terms in their national legislation in one way or another. As a result, it did not caused many problems or major changes in banks' everyday work, except Greece where the law introduced a radical change in the field of consumer protection that resulted in some recent judgements of the Supreme Court of Greece, which have caused serious concerns to the banks.
4. One of the results of the implementation of the Directive was the necessity to make some consequent changes in standard contract forms used by financial institutions in their everyday work (like contracts on current accounts, deposits, etc.). This is the field where the national banking associations could (and in many cases they did) make their significant contributions to the process.
5. Another field that could require some efforts and could bear potential risk is the obligation for banks to determine in each individual transaction, whether or not their customers are acting as consumers.

ITEM VII - CONSUMER CREDIT

The greater range and complexity of products and, in some areas, concerns about more aggressive selling practices, have led to an increased focus on consumer protection. This has resulted in new consumer credit regulation and new rules for disclosure, codes of conduct and dispute resolution in the EU.

Issues related to the consumer credit have been regulated through the EU Council Directive 87/102/EEC, amended with the directives 90/88/EEC and 98/7/EEC. The main purpose of this set of Directives is to harmonise the rules governing consumer credit while ensuring a high level of consumer protection.

Directive 90/88/EEC sets out a single mathematical formula for calculating the annual percentage rate of charge throughout the EU and determines credit cost items to be used in the calculation.

Directive 98/7/EC focuses on the calculation of the annual percentage rate of credit charge.

The main conclusions on the current situation in the implementation of requirements of the Directive in banking systems of the Candidates and Members are as follows:

1. Customer over indebtedness is a well-known issue in all respondent countries. The dimension or intensity of the cases of customer over indebtedness can be described as rare in some countries to often and even problematic in others.
2. National legislation's provisions in most of the countries are stricter and sometimes even considerably stricter than those provided by the Directive. From 9 Member States who responded to the questionnaire, just two have **not** chosen to adopt stricter provisions (Greece and Luxembourg).
3. In most of the cases mortgage credits (home-loans) are also covered by the national legislation on consumer credit.
4. One of the problem for the banks seems to be the introduction of the complicated method for the calculation of the consumer Annual Percentage Rate of Charge (APRC). Besides the additional workload and costs for the banks to operate the system calculating APRC, the vagueness of the criteria to be included in APRC calculation could raise some concerns for the banks.
5. Also the very wide and strict obligation for the banks to give very detailed information on loans has an impact on banks everyday work as well as on costs.
6. In many countries, a common database for consumer credits does already exist. Usually these databases are operated by private companies. In general, EU Member States have put in place a common database, but only a few EU Candidate countries have such centralised register. In some countries, instead of an overall database, the register or a "black list" for the "bad customers" has been developed. However, some countries do have neither the centralized database nor the common "black list".
7. One potential problem (at least a short-term one) for the countries deciding to introduce the common register for the loans could be the tremendous amount of additional work caused by the necessity to register a huge amount of deals into a comparatively short period of time.

ITEM VIII - EMU – OPPORTUNITY FOR THE BANKING SYSTEMS AND THE ECONOMIES OF NEW POTENTIAL MEMBERS OF THE EU?

After the last of the European Commission's regular progress reports issued in November 2001, it becomes clear that, in a short time period, a first wave of candidate countries will join the EU. The number of the new EU members could be rather large. It could well be close to 10!

The goal of admitting the first wave of new members before the European Parliament elections in 2004 is still an ambitious one, but, nevertheless, it is a very realistic target that is within reach.

This year the accession negotiations have approached its most difficult and politically sensitive phase. The issues at stake will have a direct impact on the lives of citizens in the accession countries. One of the key question to answer is "whether to join the

ERM¹ and later EMU with eventual introduction of Euro or not” and if the answer is yes, then which will be the right moment to do it!

According to the existing rules, the earliest possible time to join the EMU for the potential new Members of the EU would be 2 years after accession to the EU. (Shortly after the accession to the EU, new Member country could join the ERM II phase. After the joining to the ERM II phase, minimum 2 more years will be necessary for the new Member of the ERM II to prove its ability to maintain financial and economic stability and to cope with the new challenges as well as to satisfy the convergence criteria set by the Maastricht Treaty. After a successful “trial” period the new Member state could finally join the EMU and Euro zone.)

The main conclusions on the recent experiences and views of the existing Member States as well as on views and expectations of the potential new Members of the EU regarding this issue are as follows:

1. All of the responded potential New Members of the EU indicated their willingness to join the EMU in a comparatively short time - from 2 [earliest possible time] to 3 - 4 years [slight delay, but, nevertheless, a very short time as well] after the accession to the EU.
2. General experience gained by the countries that most recently have joined the EMU is a very positive one, despite some short-term problems and inconveniences, which have arisen at the initial stage in several most vulnerable areas.
3. Main benefits from joining the EMU could be as follows:
 - the prospect of monetary and macroeconomic stability would have the following long-term beneficial effects on investment and growth:
 - a) gradual reduction of interest rates and inflation with eventual stabilization of before-mentioned on low levels;
 - b) one side effect of the lowest interest rates will be a sharp reduction in public debt service and private debt service payments;
 - c) another side effect – cheaper mortgages will become available and most probably highly popular;
 - d) increased efficiency and competitiveness of financial markets in long run;
 - e) development of deep and liquid capital markets;
 - f) increased export and trade possibilities for new Members;
 - g) increased credibility of national banking system;
 - this could offer the greater opportunities to increase the living standards in new Members of the EMU, especially in those countries where currently GDP per capita is much lower as in average in the EU;
 - increased economic discipline (especially in government spending) that could result in extraordinary fiscal tightening in some countries. This could be seen as a serious challenge, especially in a short-term perspective, but at the end of the day it should prove to be more of a healthy discipline than a real problem;
 - the transaction costs and the exchange rate risks for companies should diminish.

¹ ERM = Exchange Rate Mechanism

4. Main challenges or drawbacks from joining the EMU could be as follows:
 - considerable legal and institutional changes;
 - certain loss of “sovereignty”, especially regarding the National Central Banks’ whose independent monetary policies will be eliminated. As a result, the domestic monetary policy will disappear as an instrument to stabilise the economy;
 - a significant and rapid increase of inflation will cause a serious headaches for the first couple of years, especially for countries with comparatively lower GDP per capita (and lower overall prices for goods and services in general). This challenge, potential problem for some new potential Members, is well known also in Spain and Ireland.
 - competition in banking industry will increase further:
 - a) banks will loose a certain portion of income from foreign exchange operations (mainly in national currency – Euro dimension and vice versa) despite the certain economy of scale;
 - b) tighter interest rate margins and competition will considerably decrease net interest margins and put pressure on banks’ profit margins;
 - c) this could lead to a wide range consolidation process and thus should eventually increase efficiency, which is a very positive outcome after all;
 - significant one time (once-off) costs to banks arising from the fundamental changes across the broad range of banking business;
 - loss of jobs in non-competitive industries could cause a short-term problems, but in long run the economic effect should be positive as the overall competitiveness of the national economy will increase;
5. Despite the possible challenges and threats arising from the membership in EMU, the overall general feeling is that the economic (and not only) benefits arising after admission will prevail on the possible disadvantages.
6. As the information regarding the ERM and EMU is largely technical and very often highly specific and therefore not easily understandable by the general public, the majority of the population is not aware of those issues. However, the majority of the public understand the basic principles and is well informed about the Euro. As the trust in the Euro currency is already on a high level, also in potential new EU Member countries, the Euro optimists already form a majority, and their number is still growing.

ITEM IX - FIGHT AGAINST TERRORISM AND THE BANKS’ RESPONSE

The 11th September 2001 tragic events that took place in the USA have changed the world in many aspects. Those events have initiated many changes in international regulations and practices as well as in national legislation and many of those changes are affecting the financial institutions.

The main conclusions on the current situation and the latest developments in this field in the countries of the FBE Associates and Members are as follows:

1. In most of the respondent countries’ legislation several changes or amendments have been made since the 11 September terrorist attacks, in

order to bring national legislation in line with the latest international initiatives in this field.

2. Most of the countries have before the 11th of September established separate bodies involved in money laundering prevention as well as in various activities aimed at fighting the use of the financial system to finance terrorism.
3. One of the key issues for the banks is the obligation and the ability to trace and to identify accounts and payments, which are used for the financing of terrorist or criminal activities, and to freeze suspicious funds if necessary. In this respect, banks have several serious concerns:
 - numerous lists of various sources containing the information on suspected individuals often are not electronically processable. Also the details of listed individuals and entities are often insufficient, incomplete and imprecise; therefore it is very often nearly impossible for the banks to identify with certainty, whether the listed person or entity is a customer or not;
 - bank employees in their everyday work have to undertake much stricter identification procedures, especially in cases of large amounts involved. This means that the additional workload has been imposed on banks by means of record keeping, follow-up and staff training;
 - the lack of clear definition of "freezing of funds" and existing procedural difficulties could cause problems as well;
 - by implementing all these requirements banks, are facing the considerable increase in paperwork, time-consuming search and research, and this all results in a significant increase in administrative and other costs.
4. Normally, National Central Banks (NCB's) are not involved directly in the fight against terrorism financing. Nevertheless, their role in the coordination and supervision of this process is usually very significant. In addition, NCB's very often act as an information and contact points for commercial banks. They also regularly issue new regulations, circulars, instructions and other documentation of regulatory and informing character.
5. Most of the NCB's have been developing their own internal security policy and a contingency plan, concerning the terrorists' attacks paralyzing the payments system infrastructure.
6. The overall co-operation with the different authorities responsible for the fight against money laundering and terrorism has intensified and improved a lot during the last year, including the co-operation across the borders; however, in many respects there are still a lot of things to improve.

ITEM X - ANY OTHER BUSINESS

a) BASEL II

Mr Elmars KRONBERGS presented the latest proposals on the capital adequacy framework by the Basel Committee and the possible time schedule of the future events regarding the issue.

In general the proposed new Accord puts more emphasis on banks' own internal methodologies, supervisory review and market discipline. The new Accord is intended to be more risk sensitive and to capture the other risks that were not considered in the 1988 Accord.

The new proposed Accord is based on three main pillars: minimum capital requirements, supervisory review process and market discipline.

The second consultation document has a far more concrete character than the one that was issued in June 1999. The major changes include:

- for the standardised approach to credit risk measurement banks and corporates can now receive a more favourable risk weight than their sovereign;
- for the IRB approach to credit risk measurement , two options (foundation and advanced) are provided;
- for the measurement of other risks, Pillar One now focuses on operational risk;
- far more specific criteria have been provided for Pillars 2 and 3.

Nevertheless, many issues of the New Capital Adequacy Accord still are raising major concerns of the European banking industry. The main problem areas are:

- Retail and small and medium sized enterprises,
- Securitization,
- Specialised lending,
- Foundation and advanced IRB,
- Maturity.

ITEM XI - PREPARATION OF THE NEXT MEETING

The next meeting (the 15th joint meeting of the FBE Associates and the Pre-accession Committee with the participation of the Executive Committee) will take place on 5 December 2002 in Brussels, Belgium.

Besides, it was announced that the next “outdoor” meeting (16th joint meeting of the FBE Associates and the Pre-accession Committee with the participation of the Executive Committee) will be hosted by the Slovakian Banking Association. The exact date and place for this meeting will be announced later.

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Enclosure: 1