HUNGARY

BANKING

SUMMARY

Until 1987, the Hungarian National Bank conducted all banking operations. In that year, the Hungarian government established a two-tiered banking system by separating the function of commercial banking from the National Bank through the creation of five state-owned commercial banks.

Hungary's biggest bank problems began in the early 1990s when macroeconomic conditions worsened and GDP dropped rapidly (18 percent from 1990-93). The state-dominated corporate sector regularly defaulted on loans, and the government borrowed tremendous sums of money from the state-owned banks to serve the debt-ridden welfare system. In 1992, operating losses at state-owned banks stood at US$4 billion or 11 percent of GDP. In 1992, approximately US$3 billion in loans were considered problematic.

The privatization process began in 1994 and has continued through 1998, with nearly all of the Hungarian banking sector assets transferred to the private sector and to foreign banks by year-end 1996. The law on commercial banking required a reduction in state ownership in all banks to less than 15 percent by the end of 1997, except for special purpose institutions and banks holding more than 25 percent of the retail banking market. Foreign participation represented more than 60 percent of the capital in the banking sector by the end of 1997. Foreign banks held more than 50 percent of total assets in the Hungarian banking system. (Included in these figures is Budapest Bank, in which General Electric Capital Corporation holds a large minority stake.) The privatization of Hungary's largest banks and the entry into the system by several foreign banks has contributed to substantial improvement in the condition of the banking system.

While other Hungarian banks began to show signs of stability in 1997, Postabank ran into problems. Established in 1988, in cooperation with the Hungarian Postal Service, the bank's problems first surfaced with a HUF 25 billion (US$125 million) run on deposits in February 1997. In July 1998 the government acquired a sufficiently large stake and removed the bank's management, to begin a final cleanup of the institution.

As of August 1998, two U.S. financial institutions (Citibank and General Motors Acceptance Corporation) operated in Hungary through three wholly-owned bank subsidiaries. In addition, General Electric Capital Corporation holds a large minority shareholding (27.62 percent) in a locally incorporated bank, and Bankers Trust established a wholly-owned financial subsidiary that operates by choice under a corporate license.

Foreign banks may establish direct branches, bank subsidiaries, and joint venture banks in Hungary. They may also acquire shares in locally incorporated banks. Hungary has relatively liberal banking entry requirements; however, foreign banks were only allowed to establish in branch form since January 1, 1998. No foreign bank has established a direct branch as of October 1998. There are no branching restrictions on foreign banks in Hungary. The requirements for merger or acquisition are the same for foreign and locally incorporated banks. There are no specified limits to foreign ownership levels in joint ventures, nor specific investment levels. The licensing requirements are the same as for the establishment of any other new credit institution. There are four sectoral exceptions to the principle of national treatment: ownership of arable land by mortgage bank branches, custodial and asset management services in relation to collective investment institutions, and asset management services in relation to pension schemes.

DESCRIPTION OF THE MARKET

Structure of the Market

Like other countries in the former Soviet bloc, Hungary's biggest bank problems began in the early 1990s when macroeconomic conditions worsened and GDP dropped rapidly (18 percent from 1990-93). The state-dominated corporate sector regularly defaulted on loans, and the government borrowed tremendous sums of money from the state-owned banks to serve the debt-ridden welfare system. In 1992, operating losses at state-owned banks stood at US$4 billion or 11 percent of GDP. In 1992, approximately US$3 billion in loans were considered problematic.

The privatization process began in 1994 with the sale of the Hungarian Foreign Trade Bank (MKB) and continued in 1995 with the sale of Budapest Bank to a U.S. investor, GE Capital, and the European Bank for Reconstruction and Development (EBRD). In 1996, another big retail bank, Hungarian Credit Bank (MHB) was sold to the Dutch firm ABN AMRO. Authorities also decided to sell Takarekbank, K&H, Mezobank, Penzintezeti Kozpont (PK Bank), and the Polgari Bank in 1997. The law on commercial banking required a reduction in state ownership in all banks to less than 15 percent by the end of 1997, except for special purpose institutions and banks holding more than 25 percent of the retail banking market. Thus, the government sold its 25 percent stake in the National Savings Bank (OTP), leaving only one golden share remaining in state hands, and the National Bank of Hungary sold its 34 percent stake in the Central European International Bank to COMIT Holding, a fully-owned subsidiary of Banca Commerciale Italiana.

A special case in the banking sector has been Postabank, created in 1988, in cooperation with the Hungarian Postal Service. Post offices throughout the country, some 3200 of them, became bank branches, immediately making Postabank Hungary's second-largest bank. It opened with a simple majority of private owners, as well as shares held by state entities such as the Hungarian Pension and Health Funds and the Hungarian Postal Service. Postabank ran into problems, which first surfaced with a HUF 25 billion (US$125 million) run on deposits in February 1997. In July 1998 the government acquired a sufficiently large stake in the troubled bank to begin a final cleanup of the institution. Most importantly, as clear majority owner, the government removed Postabank's management. Thus began what should be the last significant bank bailout in Hungary. The cost to the government is not yet known, but the consolidation may run as high as US$500 million by current estimates. Nonetheless, the rest of the Hungarian banking system remains sound, and the workout of Postabank (and several smaller associated banks) should clean up the last blight on the banking landscape.

Until the Postabank buyout, only the Hungarian Development Bank and the Hungarian Eximbank remained fully state-owned as special purpose institutions. As a consequence, the share of private ownership was almost 80 percent in the Hungarian banking sector, with foreign participation representing more than 60 percent of the capital in the banking sector by the end of 1997.

Ownership Structure of Hungarian Banks

Owners	HUF Millions	Percent
State ownership	62.4	20.7
of which:		
APV Rt (State Privatization and Holding Co.)	*47.6*	*15.8*
Domestic private ownership	49.7	16.5
of which:		
Financial institutions	*16.7*	*5.5*
Insurance firms, investment funds	*5.9*	*2.0*
Other	*27.1*	*9.0*
Total domestic ownership	112.1	37.1
Foreign ownership	184.8	61.2
of which:		
financial institutions	*147.7*	*48.9*
other	*37.1*	*12.3*

Owners	HUF Millions	Percent
Preference shares	2.9	1.0
Own shares	2.1	0.7
TOTAL	301.9	100.0

Source: National Bank of Hungary

As of July 1998, there were 44 financial institutions in Hungary, including five state-owned banks (the central bank, Hungarian Development Bank, EximBank, Postabank, and a small home mortgage bank), nine locally incorporated private banks, and 30 foreign banks. This compares to 40 financial institutions as of year-end 1993, including 17 state-owned banks, 4 locally incorporated private banks, and 19 foreign banks. The 44 banks in Hungary serve the personal and business needs of both domestic and international clients. Total assets amounted to about HUF 4,460 billion (US$22.3 billion, or 50 percent of GDP) at the end of 1997. About 64 percent of assets are concentrated in the six largest banks, about average for the region, but low in comparison with smaller EU countries. The assets-to-GDP ratio, as well as that of lending-to-GDP (around 25 percent) would seem to indicate that Hungary is relatively under-banked.

OTP, Hungary's largest bank, held about 25 percent of total assets in the banking system as of year-end 1997. The retail banking sector is dominated by OTP and Postabank, which held an additional 8 percent. OTP's position is strengthened by its majority share of the municipal banking market, while Postabank's extensive branch network makes it the leader for banking services to individuals. The asset shares of the next five largest banks average around 7 percent each. Although the total number of banks has been stable since 1994, some small domestic banks have exited the market and were replaced by new foreign banks. The corporate banking sector is more advanced than the retail sector, but efforts are being made to bring retail services up to EU standards. Banks operating in Hungary, in a legal sense, are not universal banks. They can offer investment services only with some restrictions. However, they can have 100 percent owned subsidiaries which deal with the whole range of investment services (such as Citibank does). New legislation on the Hungarian financial services sector adopts a number of EU directives to a introduce system based on the use of trading books. Thus in the near future credit institutions can obtain universal banking licenses.

Demand for electronic bank services, such as automated teller machines (ATMs) and Internet access to accounts, exploded in the mid-1990s. Hungarian banks responded to this demand by updating services and equipment. For example, there were a total of 54 ATMs in Hungary in 1992. As of December 31, 1997, there were 1,553 ATMs. Investment funds have also become more popular and Hungarian banks have responded by offering both private and corporate investment services.

However, Hungarian banks have been slow to meet the demand for other types of bank services. For example, lending is largely limited to providing financing for Hungarian and foreign blue chip firms, granting credit for vehicle purchases, and lombard loans (loans collateralized by securities portfolios). More recently banks have begun to offer housing loans and credit for purchasing consumer goods, but the need for increased lending services still exists. Competition is building for retail customers, as interest rates continue to fall with inflation, the average income in Hungary rises, and banks seek potential clients in the medium-sized enterprise sector. Several banks are actively pursuing OTP's previously captive municipal government clientele. As for the future of Postabank, the government is determined to ensure that it returns to viability as a strong retail bank. Reorganization has only just begun, and is expected to take between 18 months and two years. The decision as to whether to keep the bank in state hands or to privatize it is not likely to be made until mid- to late-1999.

In general, banking sector portfolio quality has improved steadily since 1994. At the end of 1997, the State Banking and Capital Markets Supervision (APTF) rated 92 percent of the banking sector's portfolio as problem free, 5.1 percent required special watching, 1 percent was substandard, 0.8 percent doubtful, and 1.2 percent non-performing. In 1994, nearly 13 percent of the sector's portfolio was substandard or worse.

Regulatory Structure

The 1996 Act on Credit Institutions and Financial Enterprises, effective January 1, 1997, merged the State Banking Supervision and the State Securities and Stock Exchange Supervision to create the APTF, which regulates the banking sector and reports to the Finance Minister. This step was taken as the separation of banking and securities activities will be gradually phased out and universal banking is implemented.

The law on commercial banks, effective since 1992, established capital adequacy levels along the guidelines of the Basle standards. The capital adequacy ratio averaged 18 percent at the end of 1997, and only one bank did not meet the 8 percent minimum requirement at year-end 1997.

Banking regulations stipulate a two-step licensing regime for the establishment of banks, including branches of nonresident banks, which is the same for both domestic and foreign investors. Banks may operate as joint stock companies or, as of January 1, 1998, as branches. The minimum registered capital of a bank operating in either structure is HUF 2 billion. For the establishment of a bank, the subscribed capital must be paid in cash at credit institutions with a registered seat in Hungary which are not involved in the establishment.

Capital requirements (and legal lending limits) for foreign branches are based on the local capital of the branch. To date, no foreign bank has established a branch.

Hungary provides deposit insurance for individual deposits of up to HUF 1 million per registered account. The insurance is financed through retail bank-paid fees, and supplemented if necessary from the central budget. It is administered jointly by the National Bank of Hungary, the Ministry of Finance, and the Hungarian Banking Association.

As of year-end 1997, foreign banks held more than 50 percent of total assets in the Hungarian banking system. Foreign banks held around 80 percent of corporate deposits and 30 percent of retail deposits. Included in these figures is Budapest Bank, in which General Electric Capital Corporation holds a large minority stake (27.62 percent).

Percent Market Share of Foreign Banks in Hungary as of December 31, 1997

	Domestic Banks	Foreign Banks	Total *	U.S. Banks**
Total Assets	42.9	57.1	100.0	6.3
Loans	36.8	63.2	100.0	7.1
Corporate Deposits	20.1	79.9	100.0	12.6
Retail Deposits	70.4	29.6	100.0	3.8

* With savings cooperatives
** Citibank, Budapest Bank, Opel Bank
Source: State Banking and Capital Markets Supervision (APTF)

U.S. PRESENCE IN THE MARKET

Foreign banks have increased overall market share since 1994 in total assets, loans, corporate deposits, and retail deposits. They have the dominant share in the first three categories; Hungarian banks still dominate retail deposits. As of August 1998, two U.S. financial institutions operated in Hungary through three wholly-owned bank subsidiaries – Citibank through Citibank Budapest and the European Commercial Bank; General Motors Acceptance Corporation through Opel Bank Hungary Ltd. In addition, General Electric Capital Corporation holds a large minority shareholding (28 percent) in a locally incorporated bank, and Bankers Trust established a wholly-owned financial subsidiary that operates by choice under a corporate license.

Citibank Budapest Rt. was first established in December 1985 by the Citibank Overseas Investment Corporation (80 percent) and the National Bank of Hungary (20 percent). This was the first venture of its kind in Central and Eastern Europe and it commenced operations on January 1, 1986. In 1991, the Act on the National Bank of Hungary was passed, forcing the National Bank to sell its holdings in all foreign banks, including Citibank. In 1993, the Citibank Overseas Investment Corporation purchased the remaining 20 percent of shares and became the sole owner of the bank. Citibank launched retail services in 1995 and began to focus on increasing market share in 1996. Its main services include corporate and personal deposits and lending, foreign exchange transactions, letters of credit, guarantees, prompt payment orders, bank account keeping, and custodial services. Citibank was named "the best foreign bank in Hungary" in 1996 by Central European Magazine. It operates two branches as well as its headquarters. In August 1998, Citibank completed the purchase of the formerly Italian/Austrian owned European Commercial Bank. Citibank also owns a fully licensed securities company and a leasing company.

Budapest Credit and Development Bank (Budapest Bank) was established in January 1987 as a commercial bank in Hungary's two-tiered banking system. As of June 1998, the European Bank for Reconstruction and Development held 32.4 percent of the share capital; General Electric Capital Corporation, the leading non-institutional shareholder, held 27.62 percent; and the Hungarian Ministry of Finance owned 23 percent. The remaining shares are listed on the over-the-counter market. Budapest Bank offers a wide range of services to both corporate and private clients including account keeping, securities transactions and management of investment funds (through its brokerage subsidiary), bank card services, short- and medium-term loans, and foreign exchange account keeping. Budapest Bank deals with domestic and international clients and puts special emphasis on business development and product development. Its corporate clientele continues to play a decisive role in the bank's balance sheet and income. Alongside its existing large, corporate clients, the bank intends to strengthen its position in the sphere of small- and medium-sized business. The importance of the retail sector as a focus clientele is continually growing in the bank's strategy and operation. The bank is also trying to attract new clients by upgrading facilities and offering fast and flexible services. Budapest Bank is headquartered in Budapest and operates 74 branches throughout Hungary.

Opel Bank Hungary Ltd. was established in March 31, 1996 and began operations on September 6, 1996. Opel Bank is owned entirely by the U.S.-based General Motors Acceptance Corporation (GMAC), a member of the GM Corporation. The bank's organization and activities are closely related to Opel Leasing Financial Services Ltd., founded by GMAC. Like Opel Leasing, Opel Bank exists to meet the needs of firms in the Opel Franchise and their customers. It grants investment and working capital loans to authorized Opel dealers and provides consumer credits to private individuals and corporate clients. Opel Bank intends to expand its services by increasing its activities in the used car market and extending its operations to the financing of non-Opel vehicles.

Bankers Trust, which was established as a wholly-owned subsidiary in Hungary in 1991, operates by choice under a corporate license. As a corporation (not a bank), Bankers Trust concentrates on international market placements, risk management, and advisory work. Bankers Trust has chosen not to apply for a banking license because of its corporate strategy.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Foreign banks may establish direct branches, bank subsidiaries, and joint venture banks in Hungary. They may also acquire shares in locally incorporated banks. However, foreign banks were only allowed to establish in branch form since January 1, 1998, and no foreign bank had established a direct branch as of October 1998.

Nonresident investors in the banking sector are granted treatment equivalent to that given domestic financial institutions. Previous provisions requiring special prior government authorization for the establishment of banks and acquisition of shares by foreigners were abolished in 1996. No higher regulatory, material, personal requirements, or financial guarantees are imposed for the establishment and operation of branches than for domestic institutions. There are no branching restrictions on foreign banks in Hungary.

The licensing requirements for merger or acquisition and for joint ventures are the same for foreign and locally incorporated banks. Foreign banks may acquire healthy or problem banks; no preferential treatment is accorded to acquisitions of problem banks. There are no specified limits to foreign ownership levels in joint ventures, nor specific investment levels.

There are four sectoral exceptions to the principle of national treatment: ownership of arable land by mortgage bank branches, custodial and asset management services in relation to collective investment institutions, and asset management services in relation to pension schemes.

Hungary's GATS schedule of commitments, one of the most liberal offered during the GATS negotiations, is fully implemented. U.S. banks operating in Hungary state that they have received since their establishment full national treatment. It appears that the current levels of openness are fully bound in GATS. Hungary has medium term plans to eliminate three of the four sectoral exceptions to national treatment, in all likelihood by the end of the century. The most problematic, that of ownership of arable land by mortgage bank branches, is tied up in very sensitive domestic political considerations, and will not likely be relaxed except in the context of requirements for future EU membership.