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The Hungarian Financial Supervisory Authority Established 90 Years Ago

The Hungarian Financial Supervisory Authority (HFSA), Hungary's financial market watchdog, was established in early 2000 that placed the crown on a centuries-long development process. The evolvement of today's supervisor of financial institutions was the outcome of efforts by over a thousand members of our profession who took the matter systematically forward, building it "on the back of generations." Thus, we at HFSA feel that a community, which does not respect its past, does not deserve the present, and is certainly unable to find its future. This is the reason why each autumn we take advantage of the *Prudentia Prize* to publicly honor our colleagues who devoted decades to promoting the advance of the Hungarian system that supervises financial institutions. This modest remembrance is a way of respectfully bowing before all the financial professionals, both the well known and the undeservedly forgotten members of the community, who helped in any way to establish the current supervisory system.

PRECONDITIONS OF THE ESTABLISHMENT OF THE SUPERVISORY AUTHORITY*

Since *(Saint) Stephen I* founded the Hungarian nation and public administration, there was both state and church (sacral) supervision of professional financial management and personnel performing financial transactions.[1] After 1526, Hungary's unique historical development involved a forced entwinement of the Kingdom of Hungary and the Habsburg Empire, but sadly, the kingdom was compelled to develop in subordination to the interests of the empire.

That being the case, it was no surprise that *the first (imperial) regulation calling for supervision over financial institutions*, or more specifically, over the privately owned financial institutions operating *on Hungarian soil, was an Austrian edict dating back to September 26, 1844.* This directive contained measures on the founding, structure, and supervision of savings banks.[2] A document dating back to *July 22, 1847,* addressed by the court chancellery to the royal Hungarian governing council, became an important measure in the history of professional finances for reasons of principle. In this document, Vienna proposed that from then on the basic rules controlling financial institutions should be approved in Buda (the Hungarian capital), and the personnel appointed as commissioners to supervise the branches should be "highly professional and respected individuals who are completely independent of the savings banks." It was stated that the positions were prestige posts and not to be paid for.[3] This proposal, which at the time was submerged beneath an infinite exchange of documents, later did have an effect on the organizational framework.

THE SIGNIFICANCE OF 1848

Act III of 1848 established, or rather re-established an independent Hungarian state structure after a lapse of over three centuries

* This study is but one chapter in a larger effort called "The Cultural History of the Bodies Supervising Financial Institutions." It has been re-written in honor of the first (celebratory) issue of the renewed Public Finance Quarterly. The parts of the study called "The World of Supervision or the Evolvement of the World of Supervision," and "The History of Hungarian Financial Supervision to 1848" are organic (historical and logical) precedents to this article. Their continuation is included in the chapters called "The 20th Century History of Supervision" and "Opportunities and Limits of 21st Century Supervision."

indicates decades of preparation by the best of a great reformer generation, and a willingness to compromise that reflects the conditions of the time. The First Hungarian (Prime) Ministry (the cabinet, to use today's terminology), headed by *Lajos Batthyány,* established eight responsible ministries. One of them, headed by *Lajos Kossuth*, was the Finance Ministry, made up of five divisions and employed 414 people including the people who worked in institutions under the ministry. A transitional directive, issued by the minister related to administration, ordered that all documents that had been handled by the former royal court Chamber were to be transferred and assigned to an "assistant counselor with knowledge of the law" working in one of the new divisions of the ministry.[4] To our knowledge, the assistant counselor, who began to work at the *No. 5 National Auditing Department of the Finance Ministry* in Buda on *May 1, 1848, was the first member* of an independent and responsible Hungarian state supervisory body over financial institutions (banks and insurance companies). *Bernát Weisz (1800-1880)* became *the first director of the* 30-employee *division,* who was a wholesaler from Pest and who earlier worked for an insurance firm. The first head of this department was considered having a similar rank as today's deputy state secretary.

The Ministry of the War of Independence took its *first independent Hungarian* (State and Finance Ministry) *decision* regarding bank supervision on *June 17, 1848*. Kossuth, who had contracted with the Pest Hungarian Trade Bank (the first Hungarian-owned bank that have been registered in Hungary in 1841) to print bank notes, responded to a proposal from bank president *József Havas*, and appointed four new supervisory commissioners. These members were added to the twelve older board members, who were already recognized (permitted) by the Finance Ministry. *The first commissioners* charged with bank supervision were – in chronological order – *Károly Conlegner, János Krusz, and Ferdinand Libashinsky.* They supervised the printing of bank notes. Banker *Sámuel Wodianer* was responsible for issuing the bank notes; the commercial corporate manager was *Vince Weinzierl*, and Finance Ministry counselor was *János Fogarasi.*[5] In an indirect move related to the regulation of monetary turnover, on September 9, 1848, Kossuth, who was about to resign, appointed *Antal Vörös*, a chief archivist at the Finance Ministry to the post of *government commissioner* "to make certain that the bank note operations underway and the financial value thereof be assured in as consistent a way as possible..."[6]

THE BACH ERA AND THE COMPROMISE AGREEMENT OF 1967

Following the *defeat of the War of Independence*, and the "New Year's Eve Ruling" of 1851, supervision of privately owned financial institution was legally restored to the imperial chamber. Control of (state) financial institute activity connected to Hungarian nationhood became the task of a Hungarian financial administration that was reorganized to conform to the Bach regime (1851-1859). It tended to deliberately overemphasize contradictory Josephinist (referring to Austria's Josef II: 1765-1790) principles "as punishment."[7] "Bach's ideal was a bureaucracy such as that of *Josef II*, but Bach's bureaucracy was not independent; its only power came from the military and the gendarmerie," wrote *Henrik Marczali.*[8] *Gyula Kautz* wrote about the general situation that had evolved in his major analysis of the ideologies of the era. He stated "We suffered many disadvantages at the time because of an invasion of *Austrian financial and political* ideals and regulations. They were a heavy burden and we were heavily weighed upon in all efforts to put the economy into motion by the petty supervision *that interfered with everything*. It put its yoke of control on the financial institutions and forced the national legislature into idleness. In addition, we had to face the objectionable circumstance that most regulations were not intended to benefit the public at all, but to demonstrate and reinforce the absolute power of the state, the interests of the treasury, and the prestige of the military and the war machine."[9]

Submissions to the General-Government of Buda were handled – or left untouched – by officials, none of whom were Hungarian. They were principally from the more advanced Bohemian regions and refused to speak any language other than German. That public administration, which cost five times the amount of the "revolutionary" budget, truly presented the Hungarians with "the curse of bureaucracy."[10] The government conditions of the time – between 1849 and 1867 – set deliberate obstacles to prevent credit institutions and savings banks from being established and operate. For instance, in the 1850's, all applications to establish new institutions were outright rejected.[11] Not much changed regarding this type of "obstacle course" run by officials following the October 1860 Diploma or the February Regulations issued in 1861. This system was a poor substitute for "Parliamentary supervision." An Imperial Council was made up of delegates approved by the monarch and authorized to manage finances, commerce and military affairs, and state budgets. The council was made up of 343 members and included 85 from Hungary and 26 from Transylvania. From the point of view of the development of Hungary's financial system, the consequences of the new system were negligible.

Luckily, this arbitrary rule did not cause the same problems at financial institutions as it did with the banks. One form of taciturn protest against absolutism among the intellectual elite of the era was to withdraw from public office and become active in private ventures, in the non-government sphere. Therefore, it was no surprise that the owners of the First Hungarian General Insurance Company (it was really the first), established in 1857, included the cream of the top centralists who have not emigrated. Among them were *Ferenc Deák, György Apponyi, Gyula Andrássy, József Eötvös, Emil Dessewffy, Pál Somssich, György Károlyi, and Henrik Lévay who was chosen as their chief executive officer.*[12] (In fact, we do need to realize that until the early 1860's, when the period of "bargaining" began with the "Easter article," there were only three Hungarian-owned companies willing to compete with the nine foreign-owned world leaders...)

It was also possible to take advantage of the fact that residents – particularly the German-speaking ones – were comparatively flexible in accepting innovations. This is the reasonn why *credit cooperatives* developed. The Saxons of Transylvania (today Romania) were the first to take advantage of these opportunities in Beszterce (today Bistrita). This was followed by the establishment of cooperates in Megyes (Mediaş), Segesvár (Sighisoara), Nagyszeben (Sibiu), and Szentágota (Agnita), between 1862 and 1864. Creditanstalt of Vienna opened a branch in Brasso (Brasov) in 1857, and a credit bank opened in Kolosvár (Cluj) that same year.[13] However, even until the last days of the monarchy, the companies established by Hungarians did not present a serious threat to the financially strong Austrian financial institutions. This is the reason why these institutes were willing to tolerate the establishment and unsupervised operation of savings banks, credit cooperatives, and similar institutions, which at this time only operated to redistribute money. Nevertheless, more significant banks that were authorized to print money and insurance companies that operated as shareholder corporations required special permits according to the rules of the imperial government, and their operations were more restricted. (This is one reason why Hungarian insurance companies were half a century behind foreign insurers in getting started in the "competition of the free market.") Consequently, the Austrian supervisory system had some unusual aspects. For instance, until 1892 central government commissioners or regional supervisors started monitoring a savings bank only when a serious problem arose.[14] In Hungary, only the lowest level of supervision recognized by monitoring theory was required. It was called "*publicity*" and consisted of a requirement that simply called for publication of annual financial results. This was very much in the interests of the foreign firms that had more practical experiences.[15]

The factors that defined *supervision of Hungarian financial institutions* for the following half century rested on the works of *Gyula Kautz, who designed its basic principles* *(concepts)*. His work clearly formulated the desirable (Hungarian) position as early as *1863*, according to which, "we can finally summarize the attitude of the welders of power towards the banks and the main principles of bank management and leadership as follows:

a) Permission to establish a bank of issue should only be granted if the charter of the bank association has been investigated and is known to the providers of primary security.

b) In all cases, professionals who are known to be of sound character should be appointed by the associations to manage each bank, and they shall operate in accordance with the administrative council and under the supervision of a general meeting of shareholders.

c) The banks should not become involved with ventures where there is a high risk of damage/loss (railway construction, trade with colonies, mining, etc.).

d) They should not issue bank notes of very low value, because that would take the place of silver coins.

e) A government supervisor should always have the right to attend bank meetings; however that person's agreement should not be required for internal banking decisions.

f) The citizens should be completely free to accept or not accept the notes issued by a bank; under any circumstance or for any reason state coercion is not allowed in this area.

g) The bank's board of directors should be required to make public the results of bank transactions and its financial status etc. from time to time.

h) All appropriately managed banks should have a reserve fund to be used in extraordinary circumstances.

i) Both the state and the association should finally realize that strict order and honesty, the principles of conservatism and respect for the law must dominate all banking operations and they must never consider venturing into operations that might cause damage to or infringe on the interests of the state or the citizens."[16]

This chain of thought was original, thorough, consistent, and outstanding by international standards. In fact, we cannot add more to it after 150 years.

SUPERVISION IN THE LATE MONARCHY

However, it took a long time before more advanced principles of supervision, monitoring methods, and organization took root in Hungary. The Compromise Agreement brought additional and new problems to the Hungarian financial sector. This time marked the start of a wave of new banks and funds, and "laissez faire" competition. There was "no longer a requirement" for any type of permit, which led to the growth of the more advanced and better-capitalized institutions and failure of the smaller ones. The ensuing wave of concentration was beneficial to the larger financial institutions and to the stock holders. (The situation was made even more complicated by the "wide-spread liberalism" that, under Act 31 of 1868, went as far as eliminating the ban on usury interest rates, which ban was not restored until 1883 "to hinder speculator-actions"). The situation was similar with the Hungarian insurance industry, which also underwent sudden growth. The difference here was that the competitors from the Monarchy were challenged by the more significant British and French companies on the market, who also wanted to take part in the action. However, as far as both types of financial institution were concerned, interests were sharply violated by Act 12 of *1867*, adopted during the Compromise Agreement. It established the guidelines for general and principal equality, which allowed the *free settlement* of a company in another country or region without requiring a permit, as well as permitted *services across the border*. Moreover, it included several paragraphs – these were also included in specific laws that passed later – that Austria was able to use to its advantage from the very beginning.[17] Another major disadvantage of the time was the agreement to operate a joint Ministry of Finance in the areas of military and foreign affairs and jointly cover their costs.

The result was that representation of the specific interests of the Hungarian financial institutions became a secondary concern and was left to other ministers with less authority.

Given these chaotic conditions, the financial crisis of *1869* hurt the large number of savings cooperatives and funds that had been established in the meantime, as well as the Hungarian banks that became involved in speculation. Novelist, *Mór Jókai,* who at the time was a Member of Parliament representing the "Terezvaros" section of Pest, made a proposal adopted by the legislature to send a separate "*national investigations-committee*" (committee of inquiry) to examine the banking issues and develop recommendations to remedy the problems.[18] In the following year, the commission faced nine issues and considered at least four or five solutions. It had to come up with responses to, for instance,

"3. Can this type of a monetary crisis be overcome at all, and if so, how can it be done?

9. What general measures are needed to assure regular monetary flows in Hungary, and to set domestic credit onto an independent and firm foundation?"

In this debate *Ede Horn,* who also regularly published in French professional journals, said the legislature was to blame and raised the general issue of the "responsibility" of state supervision in a manner that remains valid to this day. He blamed a portion of the failures on the way permits were granted. Charters have to be submitted to the government, and sometimes these are sent back five or six times for correction before issuing the final permit. That being the case, should not the public believe that "the government, which it finances with extraordinary high sums of money to protect its interests, has certainly found every security hole one can think of before finally issuing a permit .... The process of granting the permit simply supports the laziness in thinking that many people just born with."[19]

He believed that the solution was in the second phase of supervision development, in a *shift to a normative system*:[20] "The legislature should enact general regulations for corporations based on the two main principles of complete openness and absolute responsibility ... these normative rules are not a violation of freedom. Corporations exist only because the government permits them and they do not have the same freedom as individuals who born with them. Therefore, the state has the right to monitor these corporations and to regulate general areas related to them."

By this time, *Gyula Kautz agreed*:

"*a)* The state should neither hinder nor deliberately promote the establishment of banking corporations.

b) The establishment of a normative law that carefully regulates the establishment, organization etc. of banks can be a quite good replacement for the concession system...

f) The idea of establishing a separate bank monitoring committee or office that could investigate whether accounts were correct or incorrect, and could audit the books of banks with government authorization etc. A similar organization as the one established in England with the Peel Act is commendable and even desirable.

g) It is not necessary to design bank statutes if the state desires to exert a direct influence. The general bank act was adopted to include the most general regulations in this regard...

i) The state bank must not be granted exceptional position, authorities, prerogatives, and financial advantages. As far as material supervision is concerned, the state should refrain from excessive intervention and should only exert supervision and control to the extent that it is necessary for the long term higher-level interests of society and business life.

In summary, the advice to be offered to the state is to establish a measure of careful supervision vis-á-vis the banks that rests on a principle that allows them freedom of movement and operations. The state should undertake a passive rather than an active role, and when it deviates from these rules the deviation should be thoroughly justified and based on reason and strong evidence."[21]

There was perhaps an even more important sign that a measure of state control was under consideration. *Menyhért Lónyay*, as a wise politician, no longer objected completely to *the idea* of continuous *state monitoring*. [22] Lónyay was a man who had enjoyed enormous prestige since the War of Independence, known as "the closest follower of Széchenyi's economic views," and who often cited the German *Adolf Wagner* who had undisputed prestige among banking professionals. According to him, "the safeguards should be as follows: strict definitions of the limits to bank authorities, broad-scale publicity for business outcomes, expedient organization of state supervision, and strict sanctions for violations of the rules. Experience tends to prove this need as in America, the land of daring speculation, managers who deliberately and consciously break the law may be punished with up to 15-years of imprisonment."

However, it required a great deal of time before "the expedient organization of state supervision" was established. Banking was almost completely dominated by centrists who avowed laissez faire principles. Thus, despite of the stock market crash in 1873, – which resulted in losses of about fifty-five million forints – neither the participants of the 1874 national congress that met to design a trade act, nor the 1882 and 1883 national assemblies of lawyers considered it necessary to enact a separate legislation. Even at that time, some people argued that "there are those who just do not foresee the hazards and prefer to bury their heads in the sand like an ostrich and do nothing when it is clear that a monetary crisis can cost hundreds of millions. Therefore, it is absolutely necessary to remedy this situation and urgently call for enactment of a law to this effect.[23]

At this time, however, the majority was opposed to state supervision. The professional elite of the time – Gyula Kautz, *Ede Horn, János Hantos, Hugó Beck, and Menyhért Lónyay* - essentially agreed that "*normative*" application of Act XXXVII of *1875*, with general specifications for business ventures that is included in the trade act (sections 453-462) was sufficient. In addition, they thought that voluntary *audits* in accordance with the English, or the even more popular Scottish practices, might also be satisfactory.[24] Ede Horn sarcastically called the people supporting the need for state supervision "*agents of micro-management*." He raised a question that even today is perhaps the most difficult question of supervision: "Do you really think you can protect the people from making any mistake, from any financially faulty move, and from all resulting losses?" Later, he formulated the liberal "credo" of supervision: "Study of the basic principles dominating this issue have shown us that the nature of matters and the play of free competition, which the Civil Code holds under continuous observation, are as sufficient here as elsewhere to prevent excesses, abuses, and their hazards."[25]

After the Compromise Agreement was concluded, a "*second phase*" of regulation evolved, which was still quite liberal and lead to a *three-tiered*, "*divided system of supervision.*" Its insufficiencies and unsatisfactory nature became apparent quite soon, around the 1880's to 1890's. It became clear that

- neither "formal" nor "financial control" could be expected from the "overextended courts of registration, other courts, or business record archives" charged with supervising the *legality* of operations,
- the supervisory committee members – who were not required to have or obtain technical skills – were unable to offer *professional* supervision, and
- the "little people" and participants in general meetings who were responsible for *ownership* supervision somehow managed not to learn about even the most serious abuses early enough to counter them.[26]

As a result of "laissez faire" regulation and "divided supervision," – despite a credit crisis in 1899 that "decimated" them – at the turn of the century there were more banks and credit institutions (2,026) operating in Hungary than in Austria and Germany together. Given the low level of capitalization in Hungary, the only way this number of businesses managed to survive was by introducing income-generating *non-financial activities* to such an extent that their banking operations appeared to be supplementary or secondary ... A series of failures occurred, – which particularly infuriated public opinion – since good portion of the new institutions that sprouted to replace the ones that went under were connected to the same "bad bank managers" who had already "failed" at least once, generating major losses among their customers.

Towards the end of the century, professionals sought resolution in two directions. One measure was tightening up the "*norms*." Under the trade act of 1875, the members of the supervisory committee were required to have the necessary skills prior to their appointment, and rules of their responsibilities were introduced (Sections 195 and 196). However, it was much more significant that from this time on efforts of smaller financial institutes to jointly run *autonomous multiple audits* received significant support. *The Central Mortgage Bank of Hungarian Savings Banks*, which also handled the voluntary auditing of 29 rural banks, was established in *1892*. It is considered the first independent Hungarian – though not yet state – (voluntary) supervisor of private financial institutions. (Approximately 391 institutes belonged to this group before 1913. This is about one-fifth of all financial institutions).

However, the *National Central Credit Cooperative* (OKH), established on *December 23, 1893,* became even more significant with Act XXXIII of 1898, that passed thanks to the efforts of "the agrarian count," *Sándor Károlyi.* Along with its many other tasks, this cooperative was authorized to and charged with a large amount of supervision. Based on Section 21, "it could suspend the board of directors or any board member of member-cooperatives until the next general meeting, if it learned of behavior that seriously jeopardized the successful operation of the cooperative."[27] In addition, it had the right to supervise the business records and administration of its members at any time. In fact, the credit cooperative was really a type of *professional interest advocacy chamber*, acting as a *primary filter* (corporative) toward the non-member credit cooperatives:

"It had supervisory and organizational authorities in that it was authorized to establish new cooperatives and reorganize cooperatives established on the basis of the trade act in conformity with the cooperative act, and to approve amendments to the charters of all cooperatives. Without this approval the charters can not be registered in the business records of the commercial court."[28]

(Act XXX of 1920 made it mandatory for all credit cooperatives to join the OKH. With this action, it established the possibility and the obligation for OKH to conduct continuous supervision and monitoring functions over them). This is why we rightly consider this institution to be the direct *predecessor to (one branch of) state and mandatory bank supervision*. The facts to support this statement are that the main founder of OKH was the treasury, that the king appointed the chairman of the institute, and that the Finance Minister, the Minister of Agriculture, and the Trade Minister each delegated two members to its board.

However, it was typical of the peculiar type of coexistence within the Monarchy that the "*Solidaritatea* Asociatone de Institute Financiare ca Insotire" established in *1898*, which conducted mandatory auditing of 129 Romanian financial institutes by 1901, and a similar organization established *in 1903* to supervise Saxon savings banks, called "*Revisionsverband* von Provinz-Kreditanstalten als Genossenschaft," had far greater affects on the development of Hungary's financial institutions than any domestic move.[29] Therefore, it was expected and by the turn of the century it had become clear to many that it is was necessary to move forward towards a given direction: "The Saxons with their Revisionsgenossenschaft and the Romanians with their Solidaritate managed a situation in which not one of the nearly 40 Saxon and about 150 Romanian financial institutions were lost in the most recent crisis ... While these national institutions operate with excellent homogenous planning, Hungarian credit circles work in opposite with their spontaneity and absence of uniform management."[30] The favorable "ethnic" experience – and the less-than-convincing experience in 1898 and 1903 with the "voluntary auditing groups" within the Hungarian financial institutes – led to the reorganization of the voluntary system of supervision. This is why the *National Cooperative of Financial Institutions in Hungary* was established in early *1904*. One task of the similarly named "*Corporation*" became the supervision and control of rural financial institutions through "local governments, to determine their conformity to the rules and the reliability of the administrations of institutions that are members of the association."[31]

By the early 20th century, the earlier state of "bare-bone regulation" and the "*norms + self-auditing*" called for in the 1875 trade act were no longer sufficient as the country rapidly became more capitalized. "None of the significant institutions of economic life have been as untouched by legislation as the domestic financial institutions ... We will be unable to find any law governing the establishment, organization, operation, or termination of the financial institutions, no matter how hard we may look ... Except for a few rules on taxes and fees that mention them, the concept of the finance institute and what it consists of has been left just as ambiguous in legislation as it is in practice. We have no information on what the essential distinguishing features of financial institutions are, how they are granted rights and assigned responsibilities as financial institutions," wrote Elemér Hantos in 1906.[32] One year earlier in a more general overview, he wrote, "This unlimited operation of the principle of laissez faire in the life of financial institutions is even more amazing as nowhere else in Europe, or even in the United States, the operation of financial institutions is as unregulated as it is in Hungary. With the exception of Hungary, there is no civilized state that has not established some measure of government or other public scrutiny of the founding and operation of savings banks."[33]

However, the bankers of the time had no intentions of looking beyond the walls that protected the sector. They even failed to notice that, for instance, the so-called *sickness assistance funds* had undergone "revolutionary monitoring" changes. These predecessors of today's *mandatory* and voluntary private *pension and healthcare funds* saw the evolvement of a *many color and mixed* supervisory system based on Act XIV of 1891.

- The *district's,* so called, sickness assistance funds, which operated on a regional principle, were monitored by an industrial authority appointed by the Trade Minister.
- The Trade Minister monitored the *company* (factory) funds that companies employing more than 100 persons were permitted to establish.
- The *construction-entrepreneurial* sickness assistance funds established for long-term, but non-permanent construction workers were under the simplified supervision of the responsible industrial authority.
- The *industrial* facilities that employed over 200 assistants were allowed to establish industrial facility sickness assistance funds, but these required only self-audits.
- The sickness assistance funds for *miners* remained from the Mid-Ages. They were now permitted to expand their activities to areas other than mining and metallurgy. However, they were required to adhere to the stringent and high-level service requirements set forth in the mining act and to accept the supervision of the mining authority.
- The sickness funds established for the *private (free)* associations were the predecessors of today's voluntary health insurance funds. They had the right to operate a fund if they had over 200 members. The professional supervision was subordinate to the Trade Minister.
- Any employee between the ages of 14 and 35 was permitted to join the *family assistance funds* established by Act XVI of 1900, while "non-live-in domestics" could join only with the permission of their employers. These organization operated using fees paid by members, employer contributions, state support, and donations. Local bodies of public administration including the chief clerk supervised the local committees of the organization and the Minister of Agriculture exercised the right of supervision over the central administration.[34]

The Hungarian pension and health fund monitoring system of the recent past has a predecessor that was established at the turn of the 20th century. Within this, there is a wide variety of monitoring configurations, ranging from norms to self-auditing, and to mandatory state (centralized) and local or industrial body (decentralized) solutions. Acceptance of the idea of state supervision in this portion of the financial sector rested on a psychological foundation similar to the idea behind the *insurance system*, that "The state cannot allow unskilled laymen to be at the mercy of private enterprise so it has an ethical obligation to pay attention to insurance issues."[35] Following the Compromise Agreement of 1867 the Hungarian market was inundated by foreign investors, many of whom had the best of intentions. The Hungarian insurance companies and other non-professional (laymen) investors established and offered the entire range of modern insurance products. They took these products to every outpost of the country. There was, however, a high price to pay for this exceptional professional development. The insurance companies that were unable to survive on the comparatively small market either chose bankruptcy or *transferred* their clients, or simply merged with stronger companies. During times like this, there was no one to investigate or monitor accountability of what happened to the premiums that had been collected, the adequacy of reserve funds, the justification for a possible reduction in services, and the arguments behind demands for supplementary payments. *Kálmán Huszár*, who believed that not everything was the fault of the "selfish Austrians," described the confusing and dishonest situation that evolved as, "before we shifted from the pre-1848 system to the current one – in which there is neither control, nor permit granting, nor publicity – we had a system that preceded the Trade Act in which a company, be it a corporation, insurance firm or other, could begin operation on the basis of the charter submitted to the ministry. Well before the Trade Act was adopted it was recognized that the system was sustainable as many institutes abused it, so we shifted to a system of laissez faire in which there was neither control, nor permission, nor even clear publicity."[36]

The (first Hungarian) *Insurance Bill of 1890* was written at the request of the Justice Minister, and linked to the name of Finance Minister *Hugó Beck*, and focused on putting an end to this nebulous situation. Responding to publicity, this bill was an attempt to introduce government supervision – essentially skipping the development phase of *normative controls + autonomous (voluntary and/or mandatory) audits* that dominated the banking system at the time. It also deserves mentioning that this was the *first attempt* to regulate the financial conditions of insurance *contracts derived from private law* (civil code, and liability law) as well as the *public law aspects* (supervision) *of* the *insurance* market in Hungary. Recognizing the dual edge of government intervention,[37] it takes a firm position in principle in favor of material supervision, "for the security of the institution, it is necessary that under all circumstances we demand companies to offer undisputable guarantees that they will be able to meet their obligations to insured parties."

However, the motley and obscure conditions that evolved in insurance proved to be insufficient as an incentive and did not have the coercive power to move forward, so Beck's bill was defeated. Not even the major insurance bankruptcies of the 1890's, which caused a great deal of anger, were enough to move forward with supervision. One particularly shocking case was that of the General Children's and People's Insurance Institute, which in three years of "operation" spent not only its base capital (its reserve fund), but also the insurance premiums paid by its customers. After a 250 percent "subsequent payment" – or to use today's terminology, a capital increase attained through additional contributors – failed to help, the company was liquidated (without a successor).[38]

No matter how disappointing it may appear, but the real incentive guiding the more sober-minded at the end of the 19th century was the desire *to access* the unified *markets* of the Monarchy that became possible by the Compromise Agreement of 1867, and not the interests of the insured parties. "We must have regulations, rules similar to those of the Austrians because that is the requirement of affiliation," said *János Horváth*, amidst general agreement at a professional meeting in 1897. At this same meeting, Kálmán Huszár, who has already been mentioned, using a style reminiscent of Széchenyi, pointed to a series of international interactions that are valid to this day, but are still often overlooked, "there is a proposal before the public that ... is aimed at regulating the public administration portion of insurance law ... a state insurance office can hardly be considered an objectionable idea, particularly at this time when such offices are to be found in essentially all nations. This proposal is a fortunate combination of government supervision and freedom of movement.... But to argue over what demands we plan to make vis-á-vis Austria when we are not even taking the most essential measures at home is like throwing our words away in the desert ... for ... how can we expect a country like Austria – in which the insurance institution is already so strong – to consider us its equal? So, before we have fair demands from Austria, it will be necessary for us to create the prerequisites ... because we cannot demand that a country with fully regulated conditions allow Hungarian institutions with their wholly unregulated conditions to settle there. At the same time, I believe that what other speakers have said about the principles behind the new Austrian regulations is exaggerated, because the main point is ... that every nation wants to apply its own laws on its own territory."[39]

Therefore, at the turn of the century they shook off the dust from the Beck insurance bill, which the author modestly called "the best in the World."[40] An important advance came in 1900 though, when the goal was to have a separate "insurance bureau" to deal with operative interactions. This would involve differentiating the various sectors of insurance, maintaining the management of premium reserves in a state fund, planning for profit sharing, somewhat restricting the scope of re-insurance, and dealing with inappropriate advertisement and (client) misinformation. Sadly, nothing came of this (second) Hungarian insurance bill either, which was connected to the name of *Sándor Hegedüs*, who was the Trade Minister. Therefore, everything remained as it was before, within the ill-defined Austrian-Hungarian relationship. The market conditions established by the 54 insurance companies made even more complex by the appearance of two cooperative insurance firms in 1900 and 1901. The Farmers' Insurance Cooperative and the Hungarian Life and Annuity Insurance Institute were established with *state* shares and an admitted intention of gaining a competitive advantage, and both became quick successes despite expectations to the contrary. Finally, the rest of the insurance companies combined forces against "the common enemy moving along with a strong tailwind" of government assistance. Thus, they managed to attain a separate finance ministry decree extending the specifications of the trade act to cooperative insurers. They even managed to successfully lobby that good and tight self-auditing be required of the cooperative insurers…

Hungarian banking and insurance issues had to go through World War I and the complete upheaval that ensued for the *idea* of state supervision, already *adopted in principle* – and included in textbooks – to become a demand upon all banks and insurance companies.[41] Most likely a major reason why earlier plans for reform through increasing supervision failed was that under the proposals to supervise insurance, the investigations – in contrast to the banking sector – were supposed to have extended to all insurance firms including the largest ones which strongly opposed this…[42]

We also find similar resistance in the banking area. The bank monitoring experts of the early 20th century – and first of all the men already mentioned, including *Elemér Hantos, Lajos Katona, Gusztáv Wandke,* and *Sándor Halász* as well as *János Bun, Imre Fenyvessy, Imre Grötschel, László Hegedüs, Károly Herich, Sándor Neumann, Gyula Schnierer, József Schmidt, Miksa Pásztor,* and *Lajos Várnai*, moreover the finance ministers of the time*: László Lukács, János Teleszky, and Sándor Popovics* had recognized that the "supervision formula" of normative control plus voluntary auditing was certainly not a satisfactory solution.[43] At this point, they did not see a way out in state supervision, but in *mandatory self-audit* supplementing the norms and reinforcing the professional and organizational factors. "Our financial institutes are still uneasy about central supervision and generally only take advantage of the Union after the trouble has already occurred … Although the task of a real, ideal audit is not to find the causes of abuses after they have occurred, but to prevent them and nip them in the bud. The most valuable component is the education received when an expert who has heard and seen a great deal comes from headquarters. That person speaks to the less experienced officials, management, and supervisory board at the institution and teaches them a great deal," stated the secretary of the Hungarian National Association of Finance Institutes in a textbook written for bank auditor trainees in a program that started in *1904*.[44] "*Permanent internal auditor*" training began accordingly. The basic principle that became generally accepted was "supervision should be continuous and all-inclusive."[45] Lajos Katona, who had fifteen years of experience as an auditor, proposed a central banking institution "with the task of employing auditors on a business basis and essentially at full time. That way, the supervision is conducted by the management and the supervisory committee under the leadership of an expert who, for all practical purposes, is an outsider.... This type of professional supervision should be different from what has been done to date in a sense that it must be *preventive in nature*, focused on preventing trouble and not operating *like detective action* to expose trouble that already exists.[46] In essence, this is the time when the *financial institution and insurance segments of Hungarian accounting as a profession* went from being – using the wording of the time – "amateur auditing to professional auditing," evolving into a separate profession. The unbeatable advantage in qualifications, which government officials were declared to have but which did not require evidence of existence, later became an argument to oppose all Hungarian state supervision that went on for decades and has been extremely difficult to overcome. "The advantage of autonomous audits over state ones is that the interested parties will see that the auditors they use have excellent abilities…"[47]

WORLD WAR I AND ITS CONSEQUENCES

It took the terrible conditions of *World War I* for the Hungarian banking sector to come to terms – (at least) *temporarily* – with the idea of *a mandatory audit valid for all financial institutions* and conducted by *a government body*. "…Hungarian credit organizations will soon have to accept regular audits, for otherwise the economy of the country will suffer dearly."[48] The desirable and most strongly supported solution was in line with the German law of 1899 and the Austrian law of 1903 that required mandatory auditing, and with earlier Hungarian attempts for supervision within the insurance sector. One part of the goal was limited to having financial institutions that operated as cooperatives and smaller competitors (where the equity was less than 10 million crowns) accept mandatory supervision. However, the larger credit institutions operating as corporations – including the five major financial institution groups (actually they were typical finance capital holding companies) that held the majority of Hungary's credit and industrial property[49] – continued to see voluntary auditing as the solution.

Finance Minister *János Teleszky* – fully and demonstratively supported by Prime Minister *István Tisza* – planned to cut through the "Gordian knot" of diverse interests, aspirations, and ideas with an elegant move. On *April 19, 1915* he submitted a proposal to the lower house calling for establishment of the *Financial Institute Center*. A retrospective by the minister explaining and evaluating the move offered a good summary of the shortcomings that made up the essence of the Hungarian "supervisory" system. "Professionals were not surprised when a greater shake-up on the financial market triggered crises for a significant portion of the smaller financial institutions. On the contrary, well before the outbreak of war they knew that the country's financial institution structure was unhealthy and required reform. The liberal measures in the Hungarian trade law and the absence of any preventive monitoring measures triggered the establishment of a comparatively large number of finance institutions. Some of them were not economically viable and some managed outside monies that were disproportionate when compared to their own capital. In addition, they did not always handle these outside monies, most of which were savings bank deposits, the way that savings bank deposits, the way such instruments supposed to be handled…There were no real demarcation lines between savings banks, deposit banks and even credit institutions, these concepts all flowed into one. In fact, it often happened that smaller financial institutions that called themselves savings banks and truly collected comparatively large amounts of savings deposits from small depositors, used this money to finance real estate plot purchases and to support manufacturers.[50]

At the same time, the minister making the proposal also saw that it would be tactically incorrect to call for a comprehensive reform of the structure of financial institutions. "This did not appear to be the time or the place to regulate the whole of financial institutions affairs through legislation. Wartime conditions were not conducive to comprehensive organic reforms. Regulation through legislation would only have exerted an affect over a longer term. In the given situation, the result of many long years of inappropriate practices, laws passed with even the greatest circumspection would still have been sufficiently rigid to cause problems severe enough to consider that it might have been less damaging to do nothing. First, the foundation needed to be laid and a situation established in which, if needed, regulation through legislation will not trigger even greater hazards."[51]

This position, which was unusually objective for a finance official and which recognized its own limits, was evolved around an expressly practical (pragmatic) position that proved very necessary. Even the appearance of the first proposals for a monitoring law triggered a nationwide political scandal.[52] In the name of the opposition *Albert Apponyi* had already argued against debate of the proposal and had sharply protested its appearance on the agenda. He said "…if an institution was created that made all financial institutions in the country dependent on a single center that was wholly in government power, then even the remnants of opportunity to take free political positions would be lost." The Prime Minister took strong exception to this insinuation. "…at which point *Gyula Andrássy* said it was an incredible illusion to think that this center would not be used for partisan politics."[53]

The situation was exacerbated by the fact that this was the first acute conflict between the political parties in a Hungary since the start of the World War, and occurred at a time when the country was in a very difficult position. For that reason, professional public opinion sharply objected to granting credit assistance to financial institutions in difficulty, or to any related mandatory auditing of them. However, the group making the proposal was correct in both theory and practice in wanting to see this new type of "*financial institution reorganization"* since there was not an independent Hungarian central bank or other establishment that could serve as an institute of *last resort.*[54] The members of the Hungarian bureaucracy were similarly ahead of their time when they dared to propose (preventive) "democratic" state monitoring that would be mandatory for all financial institutions. The professional and parliamentary majority, however, refused to do more than selectively adopt the idea of post investigations. They only wanted to allow them for the smaller institutes that wanted credit from the Center, meaning that they too were ready to recognize the difficult or critical situations that had evolved in the past.[55]

The government (with exemplary wisdom) did not want to push things too far. Therefore, citing formal issues – that the charter for the Financial Institute Center (to be established to give it independent authority) had not yet been submitted – it withdrew the bill and immediately began serious and real coordination (consultations) with the opposition and professional organizations.[56] Even though every player in this series of negotiations and compromises was playing with a hidden agenda, the talks were a success, and on November 30, 1915, during the autumn session, the government was able to resubmit the "voluntarily" amended bill. The proposal was debated by Parliament in a lengthy thorough and exemplary professional discussion[57] that involved additional compromises and amendments. It was finally adopted and promulgated as law as *Act XIV of 1916.*

The draft for the Financial Institute Center (PK) became an appendix to the framework law, which contained only ten sections. The entire material was twenty-eight pages long and showed that the submitters really had been forced into making major compromises.

- The Financial Institute Center (PK) was set into operation as a cooperative "for a five-year trial period" and the state treasury was allowed to buy a share valued at 100 million crowns (§ 1);
- The chairman operating the PK was to be appointed by the King, following a proposal by the Prime Minister, for a five-year term of office (§ 2);
- PK documents were declared authorized public documents that carried the evidentiary power of same (§ 4);
- PK was to be allowed only to "initiate supervision" of members "that request credit or a loan from it, or that expressly ask to be audited" (§ 5);
- When a finance institute "initiates" bankruptcy proceedings, PK was authorized to play the primary role (§ 7);
- Officials appointed by the King or the government may not be chosen to become part of management, the board of directors, or the supervisory committee" (§ 8);
- No permit for a new financial institution was to be allowed until January 1, 1919 (§ 9).

The Appendix (to the law), which included 64 sections and two additional appendices, also showed that

- The "goal of PK is to support and promote the interests, and thus the economic interests, of the financial institutions operating in the countries of the Hungarian Holy Crown. To do this, the Financial Institute Center:

1. shall offer credit to its member financial institutions during extraordinary times and under special circumstances when they have difficulty satisfying their credit needs through regular sources;
2. shall participate in re-establishing a healthy foundation for financial institutes or possibly in merging them into others or liquidating them (sic!) when monitoring finds this to be necessary…
3. without violating specifications in supervision law, shall continuously monitor the business and administration of the financial institutions and process the obtained data in appropriate categories;
4. shall participate in establishing, and operating under clear and unambiguous principles for the management of financial institution business and administration, in order to support the healthy development of the money market, and to evaluate whether the administration and nature of the institution under review, as determined under § 7, operate under principles that meet economic requirements." (§ 5)

- PK was permitted "to conduct supervision from time to time" only for members with comparatively low levels of capitalization amounting to less than 20 million crowns – or to less than 10 million in Croatia-Slavonia – while for financial institutions established under separate law (§ 10, Subsection 4) it may do so only when instructed by the Finance Minister. It may not investigate cooperatives that are within the National Central Credit Cooperative. (§ 7)

- "The audit is restricted to fact based conclusions, and the auditor does not have the right to give instructions to the supervised institution… however, modifications regarding audit instructions can be performed by the leading body, in other words, the general meeting." (§ 7)

- Only the chairman of PK, the director-general, and the highest-level officials authorized may learn of the results of the investigation," which the director-general shall duly report to the board of the institute under supervision, and "only shall submit a report to the PK board if the initiated dialogues do not produce a satisfactory result." (§ 7)

- If the dialogues do not produce a satisfactory result … the PK board may submit the decision sent to the institution to its general meeting." (§ 7)
- The institution's board may appeal the decision to the PK steering committee within fifteen days of receipt and – operating as an appellate organization – which may amend the decision. (§ 7)
- The members of PK are the financial institutions and savings banks that operate as corporations, the Hungary-based branches of foreign financial institutions, the cooperatives that conduct bank-type operations, the financial institutions established under separate statute, and the "Royal Hungarian State Treasury" which shall have B series shares (§ 10). However,
- members may choose to terminate their membership or they may be expelled (§ 17-18) on actions of
- the leading bodies of PK – the general meeting, the 21-member board, the director-general, the 61-member steering committee, the 9-member supervisory committee – which are required and permitted to act in keeping with a strict order of procedure (§ 22-53) in which
- the form and content of the investigation has been regulated by law and specified in detail as set forth in the investigation instructions found in Appendix 1. (§ 54-64) etc.

Evidence of the success of the legislators who designed and adopted the many compromises is that most of the institutes that were operating as corporations – 1,261 institutes out of a total of 1,871 – including all the major banks *joined the Financial Institute Center "voluntarily,"* meaning that it accepted the option of government supervision. Relying on an outline of the law, on *June 1, 1916* Finance Minister *János Teleszky* presided over the ceremonious general meeting that established the Financial Institute Center – a ceremony that was qualified as the peak of his career in public administration. The meeting was held in the auditorium of the Finance Ministry and attended by representatives of 1,136 financial institutions. The *first independent and responsible state financial institution began its supervisory operations* under the expert and diplomatic leadership of retired state secretary *József Schmidt*, appointed as chairman by the King, and considered a high-ranking "veritable internal secret counselor," who worked together with director-general *Béla Schóber*.[58]

The institution really has withstood the test of time. By the proposal of Finance Minister *Sándor Popovics*, Act XV of 1918 established its permanence and then Act XXXVII of 1920 introduced the requirement to monitor all smaller members. (Nevertheless, the non-PK-member larger banks successfully avoided monitoring by the Center until 1939). János Teleszky's forward-looking idea for gradual and, as he termed it, organic development was eventually fulfilled in *Act XIII of 1926.* At this time, following a proposal submitted by Finance Minister *János Bud*, the authorities of PK were reinforced and its organizational framework was extended. Of course, a major factor making this possible was that the Hungarian Royal State Bank Note Institute, established in 1921-1922 to temporarily serve as bank of issue, was finally replaced by the *National Bank of Hungary,* established with *Act IV of 1924* as a bastion that reinforced the lines of "ultimate defense" for system of financial institution.

At roughly this time, conditions became ripe for establishing the other pillar of the Hungarian state financial institution monitoring system, the independent state insurance supervisory authority. Following the short-lived intermezzo during the Republic of Councils, Hungary's insurance issues returned to the earlier state of chaos. In fact, the insurance issue situation became even more complex, and at times even critical because of the war, followed by the fact that multiple regions of the country were ceded to neighbors under the Treaty of Trianon (one of the Paris peace treaties ending World War I) signed in June of 1920. The need for order created the rationale for an increase in state supervision. This made *Act VIII of 1923*, "on the (mandatory) state supervision of private insurers," which was designed by the Finance Ministry and the professional interest organization (BIOSZ) and based primarily on more palatable Swiss, German, and Austrian examples. Under this law, the Finance Ministry "was authorized to issue regulations on the monitoring of private insurance companies until such time as the legislature passes additional laws. In particular, it was to issue decrees establishing the organization and jurisdiction of the authority supervising insurance companies, the manner in which the companies were to contribute to the costs of this authority, its operation conditions, and in particular, the insurance fund, the premium reserve fund, and the insurance companies that were to be maintained by the public authority…" (§ 2)[59]

FINALLY, A "TECHNICAL" DETAIL

An attentive reader cannot, of course, be misled by the simple "trick" of avoiding what appears to be a technical issue. If supervision of the Hungarian financial institutions truly took centuries of moving forward one step at a time, tripping and slipping and sliding "over hill and dale" in its advance, *when can we really consider* Hungarian state financial supervision to have come about? To get a really accurate answer, we have to approach this question by asking another series of questions. Let us begin with the "proud past" of supervision history that we have not even mentioned yet, the bygone era of the monarch *Charles Robert* (r: 1301-1342) and his famous treasurer *Demeter Nekcsei*, or the era of the Queen *Beatrix* (wife of King Matthias, r: 1458-1490) and her generous court "numbers master" *Fülöp of Brixia(?)*. Should we consider the institutions of Austria and Hungary and the changes which evolved over the centuries that matured by the 1840's as predecessors to Hungary's organizations, or the only "real Hungarian" point of departure is the 1848 organization established by the Finance Ministry under Lajos Kossuth? How should we judge the modernization and creative measures by Josef II and the chancellery of the Bach era that were focused on putting an end to our independence and centralizing the empire?[60] Can we accept the "voluntary financial institutions' self-audits" that evolved after the Compromise Agreement of 1867 as the predecessor to the state institution, and if so, what about the exemplary professional performance of the Saxon and Romanian financial institutions? Does the start of our supervisory system date from the bill on the Financial Institute Center submitted in the spring of 1915 that initially covered only the smaller institutions, or does it date from the autumn submission, or perhaps only from adoption of the law in 1916, or from the actual establishment of the Center? Would it be more correct to date it from 1920 and the bank supervision law that made it possible to monitor all credit institutions, or perhaps from 1923 and the establishment of an insurance supervisory office that "democratically" covered all insurers and marked the start of modern supervision?

The many questions lead to the emergence of still other questions that become Gordian knots of their own. Let us try to cut through them with the elegance of our colleagues from an earlier age of financing. While paying homage to all people in the profession for their roles in the ideas and practices leading up to it, I propose that the *birthday* of independent, responsible, state, and modern supervision of Hungarian financial institutions be *June 1, 1916* and the *establishment of the Financial Institute Center*. By that time all the principles and practical measures that continue to set examples and define the nature of Hungarian professional supervisory operations had developed.[61] An international financial supervisory conference could be organized in *May or June of 2006* or perhaps a ceremony could be held at the gathering of the entire world's financial supervisory organizations in Budapest next year. That would be a truly appropriate occasion to pay our respects to the Hungarian pioneers of the audit profession as well as to reinforce the international prestige of the 90-year-old Hungarian financial supervisory authorities and their legal successor HFSA.[62]

NOTES

1 For early history of Hungarian authority, see László György Asztalos, "The History of the Hungarian Financial Authority Prior to 1848." [in Hungarian] (in print, 2005). For the global history of financial supervision, see László György Asztalos, "Supervisory Authorities of World" or "The World of Supervision." [in Hungarian] (in print, 2005). As well as the reference materials used by the author to write these studies.

2 Sándor Halász, "The Security of Deposits in Financial Institutions, with Particular Respect to Savings Banks." [in Hungarian] (Budapest: Pesti Printers, 1904): pp. 24-26, 53-54. Elemér Hantos, "Supervising Financial Institutes in Hungary." [in Hungarian] (Budapest: National Association of Hungarian Financial Institutes, 1905): p. 31.

3 Elemér Hantos, "Supervising Financial Institutes in Hungary." [in Hungarian] (Budapest: National Association of Hungarian Financial Institutes, 1905): pp. 31-32. The issue of granting permits to operate financial institutions was also connected to the centralization and modernization efforts of *György Apponyi,* who had been appointed Vice-Chancellor in 1844 at the young age of 35, and who was involved with the tasks of the royal administrators. The latter were against the initiatives for allowing the independence of counties and modernization of rural regions, therefore, they were despised. See Henrik Marczali, "The History of Hungary." [in Hungarian] (Budapest: Atheneum printers, 2000 reprint) and (Budapest: Laude Publishers): p. II/642.

4 József Földi, Judit Gondos, István Hetényi, "The Finance Ministry, 1848-1998." [in Hungarian] (Budapest: Finance Ministry Publication, 1998): pp. 9-14, 70-73. Domokos Kosáry, "Kossuth's Finance Ministry in 1848," in *The Hazards of History* [in Hungarian] (Budapest: Magvető Publishers, 1987): pp. 279-320. Földi, József, "Hungary's First Finance Minister, Lajos Kossuth." [in Hungarian] (Budapest: Finance Ministry publication, 2002).

5 István Sinkovics, "Kossuth, the Man Who Established an Independent Financial Regime." [in Hungarian] (Budapest: Akadémia Publishers, 1952): p. 142. Note: This was a memorial volume to mark Lajos Kossuth's 150th birthday. National Bank of Hungary, (1993) "The History of the National Bank of Hungary." [in Hungarian] (Budapest: Közgazdasági és Jogi Publishers): p. I/142.

6 Sebestyén Szőcs, "The Evolvement of the Institute of Government Commissioner in 1848." [in Hungarian] (Budapest: Akadémia Publishers, 1972): p. 192. Further research is needed to determine the role played by *Lajos Duschek*, who succeeded Kossuth as Finance Minister, as well as by the staff of the time regarding disclosure of the "disappearance" of a number of diamonds confiscated from Ödön Zichy, which caused the downfall of Police Minister László Madarász. (The diamonds later turned up abroad where intentions had been to use them for "diplomatic purposes.")

7 An open demonstration occurred in 1849 when the bank notes issued by Kossuth were publicly burned at a central location in Pest. For an engraving of the event, see Pest Hungarian Trade Bank, "The Pest Hungarian Trade Bank 1841-1941: Memoirs of 100 Years." [in Hungarian] (Budapest: Pest-Buda Youth Cultural Institute, 1941 reprint).

8 Henrik Marczali, "History of Hungary." [in Hungarian] (Budapest: Atheneum Printers, 2000 Reprint), and (Budapest: Anno Printers): p. II/688.

9 Gyula Kautz, "The History of the Development of National Economic Ideals and Their Influence on Public Relations in Hungary." [in Hungarian] (Pest: Gyula Heckenast's Printing House, 1868): p. 485. See also p. 511, where later he said, "... while in the past, attempts to introduce reforms were initiated by national public life and evolved in a more of less organic way, this time everything came from above. Everything bore the stamp of the government and the police and often appeared in mechanical and coerced form."

10 The various county offices have to submit 232 periodic reports a year to headquarters in Buda ... Szekfű, "The Biography of the Hungarian State." [in Hungarian] (Budapest: Manó Dick, 1917 Reprint), and (Budapest: Maecenas, 1988): pp. 210-213. In the public administration that took over after the revolution, measures of "Hungarianism" began appearing in 1853, the period of greatest oppression, for instance with "The Rules on Wearing Uniforms." In the financial administration, officials were mandated to wear uniforms, the items of which included traditional Hungarian capes, caps, and a curved sword with a mother-of-pearl hilt on weekdays, and uniforms reminiscent of the medieval Hungarian nobility on holidays, but bearing the two-headed eagle on lapels, buttons, and sword hilts, to portray the unity of the empire. Full beards were prohibited for they brought forth memories of the "rebellion" as opposed to beards covering cheeks only, which were the symbol of loyalty. MT, "The History of Hungary." [in Hungarian] (Budapest: Gondolat Publishers, 1867): p. II/14.

11 Menyhért Lónyay, the man who eventually became Finance Minister and Prime Minister remembers these times like this: "I made a last attempt to found one. I initiated establishment of a savings bank in Nyíregyháza, which ran into so many obstacles that I was not able to extract a permit until the early 1860's. "On Banking." [in Hungarian] (Budapest: Atheneum Publishers, 1875): p. 539. Sándor Milhoffer, "Hungary's Economics."[in Hungarian] (Budapest: Franklin Society, 1904): pp. 533-535.

12 Compare Jenő Csury & Imre Marosi, "The History of Hungarian Insurance Affairs." [in Hungarian] (Budapest: Gyarmati Ferenc Publishers, 1931): pp. 35-40.

13 Imre Sándor, "The Financial World of Transylvania." [in Hungarian] (Újhelyi and Boros Press, 1910): pp. 3-4. Gergely Sándor Lukács, "The History and Modernization of Hungarian Savings Cooperatives." [in Hungarian] (Budapest: National Association of Savings Cooperatives, 1994): p. 35. ET, "History of Transylvania." [in Hungarian] Ed. László Makkai and Zoltán Szász of the second edition. (Budapest: Akadémia Publishers, 1987): p. III/1509.

14 Sándor Halász, (1904) op. cit. pp. 166-175.

15 János Tallós, "State Supervisory Tasks Regarding Private Insurance Companies." [in Hungarian] (Budapest: Published by the author, 1932): pp. 2-3. Imre Csécsy, "State Supervision of Insurance," [in Hungarian] in the *Encyclopedia of Economics* [in Hungarian] (Budapest: Atheneum Publishers, 1929): pp. I/542-545. Ede Horn, "Banking Freedom with Particular Respect to the Hungarian Banking Movement." [in Hungarian] (Pest: Atheneum, 1870): pp. 12-32.

16 Gyula Kautz, "National Economy, and Financial Studies with Respect to Practical Industrial Life, the Need for a High-level Study, and the Tasks of State Government and the Legislature." [in Hungarian] (Pest: Gusztáv Heckenast, 1863): pp. 490. In the next edition, that is the second revised and improved edition of the book: Gyula Kautz, "The System of National Economic Studies." [in Hungarian] (Pest: Gusztáv Heckenast, 1870): pp. 482-483. Perhaps "*Hungary's greatest financial expert"* – the person who played a key role in preparing the practical economic foundation for the Compromise Agreement, who chaired the joint bank of issue after 1892, and who even won the praise of the elderly Lajos Kossuth had advanced his theories and supplemented his ideas in this volume. Béla Földes, "Remembering Gyula Kautz." [in Hungarian] The Hungarian Academy of Sciences' held ceremonious meeting marking Gyula Kautz's 100th birthday, and this remembrance was published by the Hungarian Academy of Sciences in 1929. The essence of the change in his position was deliberate and open to "material supervision." "From the point of view of the future, he concluded that "a separate *banking supervisory committee* or medium within an authority should have the right to learn of bank procedures, accounting, and business operations at any time." Gyula Kautz published a book the following year that again marked a turning point. Gyula Kautz, "Institutions in Partnership in the National Economy." [in Hungarian] (Pest: Mór Ráth, 1871). When dealing with insurance issues, he stated "that Parliament have the time and the power to adopt legislation covering regular supervision in conformity with the standards of our times." op. cit. p. 254.

17 Our colleagues from that period gradually evolved the courage to voice their criticism. "The parity established in 1867 exists as an air bubble but not in reality," wrote *János Horváth* in a debate of the period. "We, too, need regulation and to establish a set of rules similar to those of the Austrians, because that is the requirement of reciprocity agreement. According to Vilmos Gaár, "the parity guaranteed in tariff and trade contracts by § 8 of Act XXII of 1878 was not employed for financial institutions as it was for other corporations and cooperatives." Pál Róth, "The Legal Situation of Hungarian Insurance Companies in Face of New Austrian Regulations," [in Hungarian] in *Papers from the Association of Hungarian Lawyers 126, 14, Book 3* [in Hungarian] (Budapest: Book publishers of the Franklin Society, 1897): pp. 19-21, 25.

18 For information on this less well-know activity by this great Hungarian author, it is worth quoting Ede Horn (1870) op. cit. p. 3, and the (slightly exaggerated) dedication of his book. "A goodly portion of the Hungarian banking movement is the result of your work, my friend. You were the one whose arguments in Parliament led to official recognition of the issue, and you were the one who won the right to send the committee of inquiry which is keeping the issue on the agenda." For more information on Jókai's role and on assumptions of the committee that are thought provoking to this day, see Menyhért Lónyai, "On Banking." [in Hungarian] (Budapest: Atheneum Publishers, 1875): pp. 243-268. Also, see Andor Táray, "On Banking." [in Hungarian] (Budapest: Property of the author, 1874): pp. 118-201.

19 Ede Horn (1870) op. cit. pp. 10 and 15. The debates on gradually terminating permit requirements for insurance products that took place among the Hungarian supervisory authorities of the 1990's and the lessons thereof literally supported the conclusions of this colleague of ours 120 years ago. Ede Horn, who was thoroughly grounded in financial theory, wrote the first professional work that, on the one hand offered proof of the need *to evaluate credit risk* and on the other, to evaluate the possibility and need for *credit insurance* in Hungary (pp. 104-107).

20 Jenő Gaál, "The National Economic System in Two Parts." [in Hungarian] (Budapest: Atheneum Publishers, 1899): p. II/349; and János Tallós (1932) op. cit. pp. 2-4, distinguish among three phases or types in the advance of supervisory systems as follows:

I. *Publicity*, when only business results need to be published, perhaps with come commentary,

II. *Normative*, when responsibilities mandated by law must be adhered to on a continuous basis and must be monitored through "self-supervision."

III. *Government supervision,* linked with financial supervision.

21 Gyula Kautz, (1871) "Corporate Institutions in the National Economy." [in Hungarian] (Pest: Mór Ráth, 1871): pp. 115-117. This competitive effort was

rewarded with the Hungarian Academy of Sciences Fáy Award.

22 Menyhért Lónyay (1875) op. cit. pp. 547 and 560 respectively. This was more or less typical of the conditions at the time and was a warning of problem. "The most important part of the Prime Minister's brief but momentous statement is in the following words:" "the banking issue is not political – it is merely a matter of economics and expediency." The other Finance Minister of the era, *Kálmán Széll*, voiced a similar "pro-regulation" position following 1876.

23 Elemér Hantos (1905) op. cit. p. 34. For specifics of the supervision model called "autonomous audits," see Elemér Hantos (1905) op. cit. pp. 15-25. For financial supervision, see János Tallós (1932) pp. 36-352. For a comparison of the two models, see László György Asztalos, "Monitoring Insurance Issues." [in Hungarian] (Monitoring Review No. 4, 1998), op. cit. pp. 35-38.

24 When debating the Trade Act, there had already been a proposal to tighten supervision of financial institutes more than for other corporations, but it was rejected. See Financial Institute Center (PK), "The First Twenty-five Years of Financial Institute Center Operations, 1916-1941." (Budapest: PK, 1941): p. 30: "State supervision has neither goal nor authority. This system failed in all other countries where it was introduced. In Hungary, it does not even have the advocacy of anyone within the profession." The publication printed this in 1905, exaggerating slightly and a bit prejudiced on the issue, because Elemér Hantos (1905) op. cit. p. 45, as secretary of the National Alliance of Hungarian Financial Institutions had written similarly on the matter. However, he recognized that he contradicted himself in his introduction on page 9: "at this point in time there are differing opinions in Hungary on whether economic laissez faire will tolerate intervention in institutional management. However, the variety of views only yields a clear position when ..."

25 Ede Horn (1870) op. cit. pp. 274 and 288.

26 *Frigyes Korányi,* Director of OKH (the national bureau of small stockholders), stated a long-known truth in 1914: "The little people are the last to know if there is trouble." Elemér Hantos quoted it in his second enlarged edition of "Reforming Financial Institutions." [in Hungarian] (Budapest: National Association of Financial Institutions, 1916): p. 66. Also, see Elemér Hantos (1905) op. cit. pp. 26-29.

27 Gusztáv Wanke, "Credit Cooperatives in Hungary and Abroad." [in Hungarian] (Budapest: Pátria Printers, 1935): pp. 15-43.

28 Gusztáv Wanke (1935) op. cit. p. 17. Also, see Lajos Katona, "Reconstruction, and Revision of Financial Institutions in Practice." [in Hungarian] (Budapest: Pallas Corp Printers, 1916): pp. 22-24 and 75-85.

29 For details, see Lajos Katona (1916) op. cit. pp. 73-86, and Sándor Halász (1904) pp. 339-348.

30 Elemér Hantos (1916) op. cit. pp. 68 and 89. Also, see Imre Sándor (1910) op. cit. pp. 8-12. His (just) criticism of Hungarian financial institutions in Transylvania is so harsh that their publication would result in scandal even today.

31 Sándor Halász (1904) op. cit. pp. 337-338. MPOSZ Corporation changed its name to "Central Credit Bank of the Hungarian Financial Institutes." Financial Institute Center – PK (1941) op. cit. p.31.

32 Elemér Hantos (1916) op. cit. p. 29. His views are supported by, for example, Kornél Exner, "Hungarian Financial Law." [in Hungarian] (Budapest, Atheneum Publishers, 1910). This is a very thorough textbook used in law schools, which was first published in 1901, and later revised and reissued in 1910, however, we will not find a single word in it on finance institutions. On the contrary, we will find evidence in the material of Károly Kmety (1902). His nearly one thousand page textbook is about public administration law that was reissued three times in five years. This textbook excluded the material on public administration finance law, for by then it "was a mandatory core subject in the faculties of law and state science, as a section of public administration law of exceptional practical importance." Károly Kmety, "Manual of Hungarian Public Administration Law." [in Hungarian] (Budapest, Zsigmond Politzer, 1902). See third, revised edition, "Introduction to the Third Edition," and footnote 167 on pages 679-684.

33 Elemér Hantos (1905) op. cit. p. 53. Compare with Milhoffer (1904) op. cit. pp. II/431-433.

34 Károly Kmety (1902) op. cit. pp. 459-469.

35 János Tallós (1932) op. cit. p. 1.

36 The dispute is cited by Pál Róth, "The Status of Hungarian Insurance Companies in Contrast with the New Austrian Regulations," [in Hungarian] *Papers from the Hungarian Bar Association, 126. XIV. Book 3* [in Hungarian] (Budapest: Franklin Association Book Printers, 1897): pp. 22-23.

37 "Where this system has been introduced, the state has a deep-reaching influence on the evolvement, organization, management, and operations of a company. The conclusion from these actions is that these states undertake moral responsibility for the operations and business of the companies in question." Hugó Beck (1890). "Legislative Reforms in the Insurance Field," [in Hungarian] *Records of the Hungarian Bar Association 27. V. Book 6* [in Hungarian] (Budapest: Franklin Society, 1890): p. 4.

38 Marosi-Csury (1931) op. cit. pp. 77-78.

39 Quote taken from Pál Róth (1897) op. cit. pp. 23-24. Also, see Sándor Milhoffer (1904) op. cit. pp. II/467.

40 "... No better insurance law exists than the Hungarian insurance bill we have designed. Our insurance bill is progressive compared to the past," was the conclusion drawn by this eternal representative of the ethos of the

Hungarian Finance Ministry during a professional debate in 1896 Quoted by the Hungarian Bar Association (MJE) "The Bill on Private Insurance Companies," [in Hungarian] *Hungarian Bar Association, debate May 1895 MJE, "The Reports 112. XII. Book 5* [in Hungarian] (Budapest: Franklin Society, 1896): pp. 48-49.

41 No matter how little known and unusual it sounds after the regime change, for the sake of historical accuracy, we do need to mention that *the first independent insurance supervisory body* was established following Austrian law by People's Law No. 29 *during the 1919 Republic of Councils.* However, it took until February 1919 before the National Association of Insurance Institutes (BIOSZ), following difficult and heated debates, was able to convince the members of the *insurance directorate* (more or less), that private insurance did have a place. Compare with Marosi-Csury (1931) op. cit. pp. 193-194. László György Asztalos, "Basic Issues of State Insurance Supervision," [in Hungarian] (Monitoring Review No 2-3, 1986): pp. 47-49. MTPR "The Financial System of the Hungarian Republic of Councils." [in Hungarian] (Budapest: KJK, 1959): pp. 175-206.

42 "…where insurance has been larger in scale and where numerous private companies are involved, a separate national supervisory bureau shall be established to prevent insurance firms from spreading and undertaking general activity, and to prevent abuses" – writes Jenő Gaál (1899) in a textbook. He adds: "This type of intervention by the state is completely justified, because professional knowledge and experience are necessary to judge the operations of large companies, which the public in general cannot be expected to have." op. cit. p. II/346.

43 For detailed information on the finance institute debates taking place simultaneously in at least 10-12 professional interest groups, which suggests an enviable level of diverse and thorough professional knowledge, see Sándor Halász (1904) op. cit. pp. 231-321.

44 Elemér Hantos (1905) op.cit. p. 46. He wrote this, although he already knew that state (central) supervision in Prussia required monthly self-audits of funds, which were monitored by state officials, similarly to what was done in Austria after 1844. As of 1880, the Interior Minister in Denmark was charged with supervising the savings bank sector. In Italy, as of 1888, these authorities and responsibilities went to the ministers of agriculture and trade. As of 1891, England established a standing savings bank committee whose costs were paid by the government. In France, starting in 1895, every credit institution was audited at least once a year under the supervision of the Trade Minister. For example, see Sándor Halász (1904) op. cit. pp. 3-180. However, general opinion on these international developments was negative. "Experience in the other countries has certified that government agents only exercise their right to supervise if some disorder, negligence or shortcoming arises. No one conducts regular, repeated audits that include all institutes, mainly because there is a shortage of professional state officials. The rare state audits also tend to be formal." Elemér Hantos (1905) op. cit. pp. 9-14.

45 For details, see Alfréd Kormos, "Continuous Monitoring of Financial Institutions for the Management of Financial Institutions and Corporations, Members of Supervisory Committees, Officials, Legal Counselors, and Shareholders." [in Hungarian] (Budapest: Apolló literary and printing corporation, 1908): p. 13. For a similar view, see Elemér Hantos (1905) "Everything and Everyone should be Monitored; that is the Motto of Thorough Supervision." Op. cit. p. 59.

46 Lajos Katona (1916) op. cit. pp. 94-95. The essence of the issue raised by the author and the portion still worthy of consideration today is that the "audited" parties (by themselves) should not be the ones to pay their accountants. Instead, an institution that they jointly finance should send each of them a truly independent auditor.

47 Elemér Hantos (1916) op. cit. p. 15. Béla Vadnai & Sándor Fenyvesvölgyi, introduce their book "The Auditing of Private Insurance Companies" [in Hungarian] (Budapest: Madách Press, 1932): p. 14. by saying that "the institution of auditing the Hungarian insurance profession is in its adolescence." For information on the role of the National Association of Auditors in financial institutions, see Financial Institute Center (PK) (1942) op. cit. p. 5.

48 "Extensive operation of state government and government power in the various centers is in accordance with the exceptional economic policies required by wartimes." Elemér Hantos (1916) op. cit. pp. 5 and 8.

49 By the early 20[th] century, the Hungarian General Credit Bank (connected to the Rothschild and the Creditanstalt groups), the Pest Hungarian Commercial Bank (in the Deutsche Bank and the Wiener Bankverein groups), the Hungarian Accounting and Money Changing Bank (a member of the Union Laender group), the Pest Domestic Savings Bank, and the Hungarian Bank became the controllers of the financial and industrial holding companies (conglomerates) that evolved. MT, "History of Hungary." [in Hungarian] (Budapest: Gondolat Publishers, 1967): pp. II/107 and II/163-164.

50 János Teleszky, "Financial Issues of the Hungarian State During the War." [in Hungarian] (Budapest: Hungarian Academy of Sciences, 1927): pp. 355-356.

51 János Teleszky (1927) op. cit. p. 357.

52 Most likely, they were aware of the advice issued by Jenő Gaál (1899). He said that "There is no bank able to resist the state if it really exerts its willpower. For that reason any protests against unjustifiable obstacles within the bank organization that also recognizes their comparative validity will have to find the real evidence of such obstacles in the government and not the banking framework." Op. cit. p. 324. As far as insurance

supervision was concerned: "…state intervention must be transitional only, for excessive protection of the public would simply lead to a drop in attention and a decline in the institutions' own sense of responsibility. Excessive paternalistic behavior involves a great moral responsibility even though it may be unintended, for the public will tend to consider the insurance firms given operation permits and monitored to be unquestionably reliable, and will not pay attention to protecting their own interest." Op. cit. p. 349.

53 Financial Institute Center (PK) (1941) op. cit. p. 6. János Teleszky (1927) also mentioned other thought-provoking arguments. "The opposition was strongly against the proposal. They believed it contained hidden political goals and an attempt to extend government power. In fact, some people charged that the government wanted to establish a reserve fund to cover losses so that it could use the money for its own partisan purposes or to pay off its own debts." Op. cit. p. 358.

54 Ferenc Eckhart was one of the few, and perhaps the first, in Hungarian professional literature to recognize the relationship between a central bank (of issue) and the monitoring of finance institutions. Ferenc Eckhart, "The Hungarian Economy over one Hundred Years, 1841-1941." [in Hungarian] (Budapest: Posner Graphics Institute, 1941): pp. 218-219.

55 We can be proud of the professionalism of these early colleagues of ours. "An institution that – as János Teleszky said – connects the role of the critics, the managers, and that of the supportive credit provider, not only defining the problems but immediately offering to help, can be found nowhere else even though state supervision or mandatory auditing of financial institutions has been operating for a long time in other countries. However, there can be no doubt that some new foreign legislation did influence the organization and operation of the Financial Institute Center." PK (1941) op. cit. p. 6, and National Bank of Hungary (1993) op. cit. p. 78. In connection with the German and Austrian foreign exchange centers established in early 1916, see pp. 373-374. After the regime change, considering the principles, organization, methods, and results of bank consolidation, it is particularly worthwhile to think about the professionalism of our predecessors. Compare: Government Audit Office Institute of Development and Methodology, (2004) "Privatization in Hungary" [in Hungarian] (Budapest: State Audit Office Institute of Development and Methodology, June 2004): pp. I/35-59, and pp. 217-221, and pp. II/188-200. Éva Várhegyi, "Banking World in Hungary." [in Hungarian] (Budapest: Helikon, 2002): pp. 22-68.

56 For this reason, Elemér Hantos (1916), who supported the bill during negotiations, proudly noted that "some of his proposals had been accepted." p. 6. The author, who was considered a supporter of the "banking lobby," had some expectations that continue to be thought provoking to this day. For ten years he had argued that the "issue of auditing had to be treated separately from that of a central bank, and auditing should be left to an autonomous financial institute." Nevertheless, now he adopted the proposal … "because we believe that the universality of financial institutions, with target-oriented efforts, will manage to develop the Finance Institute Center into a fully autonomous organization whose auditing activity will be free of all state power and government influence." p. 78. For this reason, he said the following in a contribution to parliament in January 1916, "The entire fate of this institution depends on whether we find the appropriate professionals to implement the institutional ideals …" (Acceptance): p. 82. There is very little for us to add to this statement…

57 For more detailed minutes on parliamentary debate, see Elemér Hantos (1916): pp. 95-112.

58 The PK began operations in a building located at 3 Szentkirályi Street. In November 1916, it moved to a building at 1 Deák Ferenc Street, in what was then District 4. (This was the same building where Deák himself had spent the final decades of his life in what used to be the "Queen of England" hotel).

59 The tasks were defined in Prime Minister Decrees 196/1923 and 4730/1923, and in Finance Minister's decrees 48718/1923, 48692/1923, 48718/1923 and 130623/1923. For details, see Finance Ministry (1924), "Collection of Legal Regulations in State Supervision of Private Insurance Companies." [in Hungarian]. (Budapest: Hungarian Royal Printers, 1929). For interpretations, see Marosi-Csury (1931) op. cit. pp. 200-204; László György Asztalos (1986) op. cit. pp. 48-49; Béla Schack, "The Révai Encyclopedia of Trade, Finance, and Industry." [in Hungarian] (Budapest: Révai Literary Institute, 1929): p. I/276; KE, "Encyclopedia of Economics." (Budapest: Atheneum Publishers, 1929): p. I/544.

60 Our historical consciousness has a particularly difficult time swallowing the duality of the Bach era that followed the defeat of the 1848 War of Independence. "Summing up all these factors, we might say that the measures of this period were aimed at freeing up agriculture, attaining less restricted use of rural estates, preventing obstacles to purchases and sales, allowing the sale of only parts of an estate, and making it easier to obtain credit. In other words, it was attempting to put an end to institutions rooted in the medieval and feudal era and to replace a cumbersome crop-based economy with a new *monetary economic system*. These were definitely laudable moves. The only problem was that their point of departure was not that of our national interests and they contained standards that *governed us but without asking us*, and that had a decisive influence on our entire economic life." Gyula Kautz (1868) op. cit. p. 514.

61 To cite an example of the advanced level of the PK, one of the three divisions of the subsequently estab-

lished "Royal Hungarian State Supervisory Authority for Private Insurance Companies," the insurance technology department, was transitionally housed within the Finance Institute Center until the 1930's. See Béla Schack (1929) op. cit. p. 279. Another sign of its professionalism was that even in 1936, Center staff – working in cooperation with the insurance supervisory authority – was assigned to design and implement resolutions used to this very day when the Phoenix Life Insurance Corporation declared bankruptcy. This triggered repercussion that was felt throughout Europe and was subsequently liquidated. Not too many people realize that in 1939, the Financial Institute Center helped to establish the "Institute for the Regulation of the Hungarian Money and Capital Markets," *the institute that was charged with monitoring the Hungarian capital market.* See Financial Institute Center (1941) op. cit. p. 106. For a concise description of the institutions responsible for the security of the Hungarian financial system between the two World Wars, see Gusztáv Ladik "Basics of our Itemized Public Administration Laws." [in Hungarian] (Budapest: Attila Printers, 1941): pp. 91-103.

62 It might also be possible, a quarter century after 1980 and the "re-creation" of the Hungarian supervisory system, to have a conference at last. This, – as we have learned has been expected for over a century now – includes an open and professional debate in which the specifics, lessons learned, development trends, etc. of the Hungarian and international supervisory systems are compared and evaluated. We already know that the Austrian insurance supervisory authority has taken advantage of a meeting like this to do exactly that the same. The meeting of the International Alliance of Insurance Supervisors (IAIS) in the autumn of 2005 in Vienna was an exemplary demonstration of cleverness and achievement, celebrating "the 150th anniversary of the foundation of the oldest Austrian state financial supervisory organization." Perhaps they were also celebrating the foundation of the "oldest Hungarian financial supervisory authority...?"