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Methodological note

All data used in this publication are from banks with valid banking licences as of 31 December 1998 (except for Universal banka, whose licence was revoked at the beginning of 1999 and which as of 31 December 1998 no longer submitted the necessary statements and reports on its activities), unless stated otherwise in the chapter heading or relevant passage. Data are always taken for the bank as whole, ie including its foreign branches, with the exception of the structure of credits and deposits by sector and industry, which include only bank transactions in the Czech Republic.

The data for 1998 partly reflect the results of external audits, so the data given here may differ from data previously published by the CNB. There may be additional partial changes to data given in this publication; however, they should not significantly affect the trends indicated.

A.

BANKING SUPERVISION IN 1998

Banking supervision activities proceeded in 1998 in harmony with the medium-term "Conception for the further development of banking supervision" approved by the CNB Bank Board in January 1998. This comprehensive document expresses the basic objectives of banking supervision and the measures required for their accomplishment. It is based on four main pillars:

- the achievement of a high degree of harmonisation of the regulatory framework, methods and procedures with EU prudential principles and best international practices,
- the establishment of a comprehensive, standardised and well-balanced system for the regulation and supervision of banks,
- effective communication between CNB banking supervisors and the banking sector,
- the development of co-operation in the regulation and supervision of the financial market both within the Czech Republic and at international level.

The "Conception" was based on the organisational changes that took place at the end of 1997. Its primary aim was to create the preconditions for intensive development in on-site supervisory activity – one of the principal methods of banking supervision in the Czech Republic – by establishing separate supervisory teams. Of the four teams planned, only two have been set up so far. These two teams immediately started on-site examinations and informative visits as planned. To improve the supervision of banks, work was started on building an integrated information system. This will provide the database needed for the analysis of a bank's financial condition and its adherence to the prudential rules. The system will be used both for acquiring information on a bank's track record and for determining possible risk areas in the short and long run.

In the methodological area, activity was focused in 1998 on improving the present regulations in the interests of limiting the range of risks to which banks are exposed. Two important amendments to the Act on Banks entered into force. These amendments, in whose preparation the CNB's banking supervisors played an active part, have brought Czech banking regulations and supervisory procedures several steps closer towards those in force in the European Union. The changes involve areas where the supervisory authority had seen loopholes and unaddressed risks. The rules concerning acquisitions of holdings in banks by new investors were adjusted in compliance with EU Directive 89/646, and a Decree was subsequently prepared specifying the terms for assessing new investors' acquisitions in existing banks. Provisions based on the government measures in April 1997 have been incorporated into the Act on Banks. These restrict the links between banks and businesses both in terms of ownership (a ban on banks' controlling non-bank, non-financial companies, and limitations on ownership interests in individual businesses and in businesses in general) and in terms of personnel (a ban on senior bank officers acting in business bodies). Major changes were made to the deposit insurance system. The maximum amount for compensation was increased from the original CZK 200,000 to CZK 400,000; the coverage of insured deposits was raised from 80% to 90%; and the insurance was widened to include legal entities. Particularly important as regards the powers of the supervisor are provisions relating to the sanctions imposed on banks failing to meet the minimum capital adequacy requirement. In connection with the amendment to the Act on Banks, the CNB issued a new Provision on disclosure of information by banks and prepared an amendment to the conditions for the establishment of a bank.

In drawing up the new regulations, amending the existing ones and supervising banks, the CNB's banking supervisors worked closely with professional organisations, particularly the Banking Association and the Chamber of Auditors. This co-operation primarily concerned the preparation of two new provisions – the Provision on capital adequacy incorporating market risk and the Provision on consolidated supervision (which should enter into force in 2000 and mid-1999 respectively) – and the addressing of the Year 2000 issue in the banking sector.

The establishment of the Securities Commission in April 1998 and the rapid development of its supervisory activities, together with the development of financial banking groups, resulted in the signing of a tripartite

Agreement on Co-operation between the Czech National Bank, the Securities Commission and the Ministry of Finance. This agreement has created a platform for closer co-operation between the regulators on the Czech financial market.

International organisations involved in banking supervision have intensified their activities in the methodological area with the aim of harmonising the procedures of regulators at international level and improving the current methods of measuring and managing banking risks. The revision of the concept of capital adequacy and the drafting of a number of consultative documents on various risk areas necessitated the active participation of CNB banking supervisory staff in the comments process and in the activities of several working groups (eg the Liaison Group at the Basle Committee on Banking Supervision). The "Core Principles for Effective Banking Supervision" – in whose preparation the CNB was invited to take part – were announced at the International Conference of Banking Supervisors in Sydney. The CNB has signed up to these principles, which represent best international practices.

The Czech Republic's preparations for EU membership affected the banking area. Laws and regulations under preparation were thoroughly reviewed by experts with regard to their compliance with EU directives. Preparations were in progress last year for the "screening" which took place in February 1999.

In its efforts to achieve full harmonisation with international standards in co-operation with foreign banking supervisors, the CNB Banking Supervision Department intensified its contacts with regulators in countries where banks with branches or subsidiaries in the Czech Republic have their headquarters and in countries where branches and subsidiaries of Czech banks operate. Among others, these include the Slovak Republic, Germany, the Netherlands, Great Britain and France.

The contents of an agreement between the CNB and the German Ministry of Finance were discussed. Under this agreement, which is to be signed in 1999, German banking experts will provide assistance to the CNB within the framework of a "twinning" programme financed from Phare funds. The programme is intended to promote the processes of harmonisation of Czech banking supervisory regulations and procedures with EU laws.

Within the framework of the regional group of banking supervisors from Central and Eastern Europe, the CNB held a workshop in Prague in March 1998 on asset classification and provisioning. For 1999, it is planning a seminar on capital adequacy incorporating market risk.

1. CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

The Core Principles for Effective Banking Supervision were announced at the International Conference of Banking Supervisors held in Sydney in 1998. The principles were defined by a working group consisting of banking supervisory experts from selected countries under the auspices of the Basle Committee on Banking Supervision. The Core Principles represent the best practices of banking supervisors in regulating banking operations, and their fulfilment should be the primary objective for ensuring banking sector integrity on an international scale.

The Czech Republic was one of the countries that participated in the drafting of these principles. All the CNB's supervisory activities in 1998 were directed at improving the regulatory framework and performing banking supervision so as to further increase harmonisation with these principles.

The next part of this report describes the current status of banking regulation in the Czech Republic in relation to the Core Principles. Attention has been devoted mainly to the news and events of 1998. The description does not attempt to give a full and detailed assessment of the implementation of the principles; such an assessment is performed separately by the CNB supervisory authority on a half-yearly basis.

Principle 1

An effective system of banking supervision must have clear responsibilities and objectives for each agency involved in the supervision of banking organisations. Each such agency should have operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking organisations and their ongoing supervision; power to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Banks are supervised by the Czech National Bank in accordance with Act No. 6/1993 Coll. on the Czech National Bank. The independence of the Czech National Bank, and therefore also the CNB banking supervisory authority, is laid down in the Constitution of the Czech Republic. Banking supervisory activities are governed by the medium-term "Conception for the further development of banking supervision" adopted by the CNB Board in 1998. This document defines the basic targets of banking supervision in the areas of methodology, practice and international co-operation. Within the framework of this medium-term strategy, annual plans of action have been prepared. Adherence to these plans is checked regularly.

The basic functional framework for banking supervision is laid down by Act No. 6/1993 Coll. (which stipulates the general duties of the banking supervisor, viz. to take care of the safety and soundness of the banking system) and Act No. 21/1992 Coll., on Banks, as amended (hereinafter the "Act on Banks"), which specifies the powers of the CNB banking supervisor.

In 1998, steps were taken to create a legal framework for co-operation with the other regulators on the financial market, namely the Securities Commission, which is responsible for supervising the capital market, and the Ministry of Finance, responsible for oversight of insurance companies and pension funds. On 1 July 1998, an Agreement on Co-operation between these three entities was signed. This should help improve and integrate the supervision of entities providing financial services. The agreement focuses on information sharing (including in the licensing area), co-operation in control activities and consultations on methodological and other issues.

There is very close co-operation with the regulatory bodies of other countries, although no concrete agreements are in place. An agreement on co-operation with the Slovak National Bank was drafted in 1998 and signed in 1999, and agreements with other foreign banking supervisors will gradually be prepared.

The requirement to ensure legal protection for supervisors has yet to be met in full. This issue is being discussed and its incorporation into the amendment to the Act on Banks currently under preparation is being considered.

Principle 2

The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.

The permissible activities of banks are defined in the Act on Banks. The possibility of specifying permissible activities in banking licences is being considered within the preparation of the amendment to the Act on Banks. Also, the use of the word "bank" is protected by the relevant provision of the Act on Banks. Except for entities that have acquired a banking licence from the Czech National Bank, no one is permitted to use the name "bank" or the name "savings bank" (which in the Czech Republic corresponds to a specific type of bank). The only exceptions are names of entities from which it is clear at first glance that such entities are not involved in activities entrusted by law only to banks (eg blood banks, etc.).

Principle 3

The licensing authority must have the right to set criteria and reject applications for establishments that do not meet standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

In accordance with the Act on Banks, banking licences are granted by the Czech National Bank. The Act gives the CNB the authority to stipulate the essentials for banking licence applications. Such applications must contain sufficient information to allow an objective and good decision to be made. The CNB Provision stipulating the essentials for a banking licence application has been in force since 1993 and was amended in 1998 following the changes made to the Act on Banks. Banking licence applications must contain information enabling an assessment of the future shareholders of the bank, its senior officers, its business plan for the subsequent three years, the involvement of its shareholders in other economic entities, their past and present activities and the activities of senior officers proposed by the bank in other banks and financial institutions, documents on the origin of the funds invested in the bank's initial capital, etc. If the applicant for a banking licence is a foreign bank, the prior consent of its home country supervisor is also required.

Following assessment of the application, a proposal for granting or rejecting the licence is submitted to the CNB Bank Board.

Principle 4

Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

The Czech National Bank used to assess transfers of ownership interests in existing banks if they exceeded 15% of the bank's capital. However, this limit was not in full compliance with international practices. Therefore, in 1998, the Act on Banks was amended, bringing this issue fully into line with European directives. Under the amendment, the prior consent of the Czech National Bank is required for the acquisition of a direct or indirect holding of a bank's voting shares if it exceeds 10%, 20%, 33% or 50%. Also, the duty has been imposed to inform the CNB about any reduction in such a holding should it fall below these limits. The consent procedure for such a change is similar to that for the assessment of shareholders in the establishment of a new bank. To ensure sufficient basic documents for making such a decision, the CNB banking supervisory authority prepared a new Decree in 1998 stipulating the essentials for an application for prior consent to acquire voting shares and the essentials of notification about decreasing a holding of voting shares. This entered into force on 23 February 1999. The essentials of such an application correspond to those of a banking licence application, as far as shareholders' relations to the bank are concerned. The amendment to the Act on Banks simultaneously cancelled the different treatment of foreign investors, who under the previous version of the Act had to ask for prior consent to acquire a holding or to make any change to such a holding.

Principle 5

Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

The issue of acquisitions of other entities was not dealt with comprehensively in the previous Act on Banks. The amendment to the Act adopted in 1998 regulates this area in compliance with European directives. The relevant provisions of the Act forbid banks from exercising control over non-bank entities and limit a bank's qualifying holding in a legal entity that is not a bank, financial institution or business providing auxiliary banking services to 15% of its capital in a single legal entity and to 60% of its capital in the sum of all legal entities. In addition, the Act restricts relations with other legal entities at the personnel level by stipulating that a member of the bank's statutory body may not at the same time be a statutory body or a member of a statutory body or a supervisory board of another legal entity which is an entrepreneur. Similarly, a bank employee may not at the same time be a statutory body or a member of a statutory body of such a legal entity. This provision does not apply in the case of financial institutions under the bank's control or in the case of businesses providing auxiliary banking services. In line with international practices, a qualifying holding is defined as the sum of direct and indirect holdings of the bank exceeding 10% of the initial capital or voting rights of the other entity.

The amendment to the Act on Banks has contributed significantly to curbing the risks arising from close links with businesses. Nevertheless, even this amendment is not yet sufficient. An essential precondition for effective monitoring of these risks is the introduction of supervision on a consolidated basis, something which has yet to be applied in the Czech Republic (see Principle 20 for details).

Principle 6

Banking supervisors must set prudent and appropriate minimum capital adequacy requirements for all banks. Such requirements should reflect the risks that the banks undertake, and must define the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the Basle Capital Accord and its amendments.

The capital requirements for banks are set by means of a single obligatory capital adequacy threshold for all banks. The capital adequacy ratio, which currently incorporates credit risk only, has been set at 8%. The CNB Provision on the capital adequacy of banks defines in detail the rules for determining a bank's total capital and its volume of risk-weighted assets for the calculation of capital adequacy. The minimum level of initial capital has been set at CZK 500 million.

The "risk-based" approach, which sets capital adequacy individually for different banks depending on their risk exposure, risk management systems, etc., has yet to be applied in the Czech Republic. The CNB considers this approach very valuable for assessing individual banks and this issue has therefore been included in the twinning programme.

Principle 7

An essential part of any supervisory system is the evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.

Lending continues to be the most important and, at the same time, most risky activity of banks in the Czech Republic. The assessment of the policies, practices and procedures applied by banks in their lending activities is one of the basic objectives of on-site examinations. Adherence to the prudential rules in this area has been incorporated into several Czech National Bank provisions (eg those on credit exposure, claim classification and capital adequacy). Banks' activities on the capital market are monitored in a similar fashion.

Principle 8

Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.

The unified principles set forth in the "CNB Provision stipulating the principles of classification of claims on credits and creation of provisions for such claims" and the "CNB Provision stipulating the principles of creating securities portfolios and ownership interests by banks and covering the risks of depreciating securities and ownership interests through provisions" are used to define the quality of assets, especially loan and securities portfolios, in a precise and unified fashion.

Loan portfolio classification is based on an individual evaluation of the financial condition of each debtor from the point of view of its ability to repay the borrowed money. On the basis of this evaluation, and taking into account other aspects such as delays in repaying individual loan instalments, the availability of financial information on the client and so on, all claims are placed into one of five categories: standard, watch, substandard, doubtful and loss. Provisioning of 5% is required for watch claims, 20% for substandard claims, 50% for doubtful claims and 100% for loss claims. When provisioning, the bank may take into account the collateralisation of these claims.

Collateralisation of loans is one of the most problematic aspects of evaluating the adequacy of loss loan provisions. The present legal environment does not allow flexible seizure of collateral, especially collateral in the form of real estate. This significantly reduces its significance in relation to provisioning. After thoroughly assessing the situation, the Czech National Bank decided to adopt an amendment to the aforementioned Provision introducing the obligation to create provisions for loss claims secured by real estate if such claims are more than one year past due. This provisioning obligation has been spread over a three-year period, ie full coverage of all loss loans collateralised by real estate which are more than one year past due will be achieved by the end of 2000.

For securities portfolios, banks must cover the difference between the market value, defined for individual types of securities in the aforementioned Provision, and the purchase price with provisions. For securities in the trading portfolio, the banks create provisions for individual securities on a daily basis, whereas for securities in the investment portfolio provisioning always takes place at the end of the year for the overall volume of securities.

Adherence to these rules is verified by CNB supervisors during on-site examinations at banks and by external auditors as part of the mandatory audit. It is also evaluated within off-site surveillance using the regular information that the banks submit through the CNB's information system.

Principle 9

Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.

Credit exposure is governed by the CNB Provision specifying the principles for calculating individual exposures to borrowers or groups of related borrowers and stipulating appropriate limits. Individual credit exposures must not exceed 25% of the bank's capital, or in the case of related parties 20% of its capital, or in the case of banks 125% of its capital.

The correct setting of the credit exposure volume, in particular as regards the completeness of the determination of groups of related borrowers, is checked during on-site examinations. Banks are obliged to submit regularly a list of all credit exposures exceeding 10% of their capital for evaluation of the concentration of loan activities and for monitoring of adherence to the credit exposure limits.

Principle 10

In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.

The Act on Banks requires banks to treat related parties in the same way as other clients. In terms of credit risk exposure, stricter limits (20%) are applied against such entities. In addition, the CNB has set stricter requirements for transactions with related parties in order to prevent any close ownership and credit links which would weaken the bank's capital. These requirements are contained in the CNB Provision stipulating limits for banks and the terms for some types of credits and investments in ownership interests. This Provision, for example, prohibits a bank from granting credits collateralised by equity securities issued by legal entities related to the bank or controlled by its major shareholders; from granting credits for the purchase of such equity securities; or from acquiring the equity securities of legal entities which are its major shareholders or are controlled by these shareholders.

Principle 11

Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risk.

Under the CNB Provision on credit risk exposure, banks are obliged to evaluate country risk and set limits vis-à-vis other countries if such exposure is of significance in the bank's business activities. Also, banks have to take country risk into account when assessing credit quality. The CNB supervisor assesses such exposure and the adoption of adequate measures only through on-site examinations. For 2000, regular monitoring of banks' activities abroad by means of separate reporting by banks through the CNB's information system is under preparation. The poor elaboration of country risk monitoring in the prudential rules results from the fact that Czech banks have negligible involvement in foreign transactions, particularly as regards countries with a higher risk level.

Principle 12

Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.

The CNB requires banks to have an integrated system for managing all the risks to which a bank is exposed. Compliance with this requirement is controlled mainly during on-site examinations. In addition, the external auditor is required to give its opinion in the regular annual Bank Performance Report on the effectiveness and adequacy of this system as regards the scope of the bank's activities. The Bank Performance Report, whose content is stipulated in a CNB Provision, is drawn up by the bank and verified by the external auditor. The prudential rules for banks govern only currency risk (setting limits on open foreign exchange positions in relation to the bank's capital) and securities depreciation risk (through provisioning for differences between market value and purchase price).

The relationship between market risk and the bank's capital remains unresolved, since in the Czech Republic capital adequacy incorporates only credit risk. Capital adequacy incorporating also market risks is likely to be applied from 2000. In 1998, a new CNB Provision was prepared on capital adequacy incorporating credit and market risks. This specifies capital requirements for individual types of risk, ie credit, interest rate, share, currency and commodity risks and options risks. As previously, the new Provision has a single capital adequacy limit for all banks, ie the introduction of individual limits for individual banks is not expected (see principle 6).

Principle 13

Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.

The completeness of the identification, measuring, monitoring and control of all the risks to which a bank is exposed during its operations is checked only during on-site examinations and within the framework of the Bank Performance Report verified by the external auditor. The coverage of all risks through capital requirements has yet to be fully ensured. Even after market risk has been incorporated, operational, legal, tax and other risks will still remain unaddressed.

Principle 14

Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

The establishment of independent internal controls corresponding to the nature and scale of bank activities is a fundamental requirement for banks. When applying for a banking licence, a bank has to submit its Articles of Association, which must contain the basic authorities and responsibilities of specific persons at the bank. During its activities, the adequacy and consistency of its internal regulations concerning all banking activities are monitored, as is the independent control of adherence to these regulations and other laws and provisions.

In accordance with the Act on Banks, each bank must be externally audited. The Czech National Bank not only requires an audit of the annual accounts, but also has set a whole range of other requirements for the auditor's opinion. In particular, these involve the assessment of risk monitoring and risk management systems and the effectiveness of internal controls. This information is an important supplement to the assessment and evaluation of banks by CNB banking supervisors.

Principle 15

Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

This principle is partially incorporated into individual CNB provisions, which generally stipulate the duty to establish internal regulations containing practices and procedures for specific activities. These regulations are available to CNB banking supervisors, who can assess their adequacy and compliance with the general prudential principles for such activities. Pursuant to Act No. 61/1996, on some measures against the legalisation of proceeds from criminal activity and on amendments to related laws, a bank is obliged to identify each client if any transaction between that client and the bank exceeds CZK 500,000.

Principle 16

An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Banks are supervised through both off-site surveillance and on-site examinations. Off-site surveillance is based on a system of reports and returns containing information from all the bank's areas of activity. These create the basis for comprehensive analyses of its activities and adherence to prudential rules. When conducting these analyses, inspectors use automated outputs from the banking supervision information system, which provides them with basic information on the key indicators characterising the bank's financial condition and enables them to assess past developments and certain indications of future development.

On-site examinations are an integral part of banking supervision in the Czech Republic. As part of the restructuring of the CNB Banking Supervision Department in 1997, conditions were created for the establishment of four separate supervisory teams. Nevertheless, for personnel reasons only two complete supervisory teams were set up during 1998. This limited to a certain extent the possibility of conducting examinations more frequently.

Both parts of the CNB banking supervisory authority co-operate closely and share information. To ensure a standard approach towards both on-site surveillance and off-site examinations, manuals are gradually being written for both these basic activities. The original versions are being continuously updated and improved as greater knowledge is acquired and the database is expanded.

Principle 17

Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.

Apart from on-site supervision where at least one comprehensive on-site examination is expected at each bank every two years, informative visits form an integral part of the supervision of banks. These visits involve discussions with the bank's management regarding its strategy, the identification of possible problems, and basic familiarisation with the bank's functioning, risk management system, internal controls, etc. CNB banking supervisors have gradually established a system of relations with the management of individual banks which enables them to gain a fairly deep knowledge of the bank's operations and to discuss possible solutions to any problems arising.

Principle 18

Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis.

Through the CNB's information system, banking supervisors acquire information on a regular basis regarding banks' individual business activities as well as on adherence to the prudential rules. Within this system, data transferred from individual banks are processed according to a standardised methodology, allowing full comparability between individual banks.

At present, an integrated Banking Supervision Information System, which uses the above-mentioned database, is being created. This system transforms the database into a form which allows flexible analysis of banks and the banking sector (from a time, structural, qualitative, etc. viewpoint). The basic outputs of this system are standardised analytical tables assessing all areas of business and prudence, and a system for evaluating monthly changes in selected indicators, bank ratings, etc. This system also contains information regarding the shareholder structure of the banks, members of statutory bodies and supervisory boards, senior bank officers, measures taken against banks, etc.

At present, information is acquired only on a solo basis; supervision on a consolidated basis has yet to be introduced (see Principle 20).

Principle 19

Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.

The truthfulness and fairness of information acquired is verified by both the aforementioned methods in the Czech Republic. Since, for reasons of capacity, it is not possible to perform on-site examinations at each bank every year, banking supervisors require the external auditor to give its opinion on each report with respect to the prudential regulations at the year-end. The auditors must verify that reports have been correctly filled in and assess the reporting system from the point of view of completeness.

Principle 20

An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.

Banking supervision in the Czech Republic is performed on a solo basis only. In 1998, a CNB Provision was prepared stipulating the terms for banking supervision on a consolidated basis. This sets forth the duty to monitor on a consolidated basis activities concerning the entire banking group, ie the structure of financial entities, including insurance companies, headed by the bank. This Provision is expected to enter into force in mid-1999, which means the first information will be available at the close of 1999. In particular, it sets the procedure for establishing a consolidated entity, stipulates consolidation methods dependent on the extent of the bank's interests in the other companies, and sets limits for capital adequacy and credit risk exposure on a consolidated basis.

The expansion of consolidation to include financial and mixed holdings that are not headed by banks, in compliance with EU directives, is not possible without a change to the Act on Banks and other laws regulating surveillance of other financial institutions. This change would involve the appointment of a "lead supervisor", the sharing of information on individual financial institutions and a unification of the conditions for their activities. Such changes will be incorporated into the amendment to the Act on Banks, which is expected to enter into force in 2001.

Principle 21

Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.

Banks' record-keeping is governed by the Act on Accounting, which stipulates unified principles for accounting, maintenance of records, valuation, etc. Banks in the Czech Republic use a unified chart of accounts up to the level of synthetic accounts. The correctness of the accounting is verified during on-site examinations, and the annual accounts are verified by the external auditor. The Ministry of Finance is the director and co-ordinator of the accounting system in the Czech Republic. The Czech National Bank co-operates closely with the Ministry of Finance in the area of harmonising accounting procedures with EU directives and international accounting standards. The amendment to the Act on Accounting, which is expected to be prepared and approved during 1999, represents a substantial step forward in this area.

To keep clients better informed of banks' financial soundness, the requirements for information disclosure were expanded under the amendment to the Act on Banks adopted in 1998. These were specified in a CNB Provision stipulating the minimum requirements for disclosure of information by banks and foreign bank branches. Since September 1998, banks have been obliged to disclose the following information on a quarterly basis:

- information on the members of the board of directors, the supervisory board and other persons in managerial posts,
- information on shareholders having stakes of larger than 10%,
- the organisational chart of the bank,
- selected data from the balance sheet and profit-and-loss account,
- information on capital adequacy, credit portfolio classification and the bank's efficiency, etc.

This new Provision does not change the original obligation to disclose annual audited results in accordance with the Act on Accounting and to draw up an annual report.

Principle 22

Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking licence or recommend its revocation.

The measures that banking supervisors may impose when banks fail to meet their legal obligations are stipulated in the Act on Banks. These have been conceived so as to allow a tailored approach depending on the significance and gravity of the bank's shortcomings. If banking supervisors detect shortcomings in the activities of a bank or foreign bank branch, they are authorised to demand that the bank remedy these shortcomings within an agreed period, to restrict some of its permitted activities, to demand the replacement of its senior managers, to require the creation of an appropriate level of provisions and reserves to cover the losses, and to require the bank to replace members of the supervisory board, use its profit after tax for supplementing its reserve funds or for increasing its initial capital, etc. In addition, banking supervisors may order an extraordinary audit at the bank's expense, impose a fine of up to CZK 50 million and reduce the initial capital of the bank by an amount equalling the loss, provided that this loss exceeds 20% of the bank's equity.

If these measures do not lead to an improvement in the bank's situation, or if the bank's shareholders do not co-operate sufficiently with banking supervisors in rectifying the shortcomings and putting the bank's activities back on a prudential footing, conservatorship may be imposed or the banking licence revoked directly. The revocation of a banking licence is the most severe measure available. The Czech National Bank decides upon such action on the basis of a comprehensive assessment of the situation in the bank and of the possibilities of rectifying the situation. The revocation of a banking licence does not have to be preceded by the imposition of conservatorship; this step may be taken directly.

The amendment to the Act on Banks revised the duties of the Czech National Bank in cases where a bank's capital adequacy falls below the set limit. If capital adequacy falls below two thirds of the set limit, the CNB must adopt some of the measures laid down in the Act on Banks (eg by ordering the bank to increase its initial capital so as to achieve the required capital adequacy limit, to acquire assets only with a risk weight of less than 100%, not to acquire any ownership interests in other companies, not to provide credits to related parties, etc.). These obligatory measures do not restrict the possibility of other measures laid down in the Act on Banks being adopted. If a bank's capital adequacy falls below one third of the set limit, the CNB must revoke its banking licence.

Principle 23

Banking supervisors must practise global consolidated supervision over their internationally-active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by banking organisations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.

This principle has not yet been implemented in the Czech Republic. The CNB Provision under preparation for banking supervision on a consolidated basis (see principle 20) does not differentiate between companies operating in the Czech Republic and those operating in other countries. The only deciding factors for inclusion in the consolidated unit are the level of the bank's ownership interest and the type of the organisation.

Principle 24

A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

The Czech Republic is just starting work on fulfilling this principle. In 1998, an agreement was prepared on mutual co-operation with the Slovak National Bank. This agreement, which was signed in 1999, regulates exchange of information on the problems of banks with subsidiaries or branches in the other state, on the results of controls (if they contain information relevant to the parent bank's soundness), and on regulatory changes, as well as co-operation in controls, etc. At present, work is starting on agreements with other countries in which banks operating in the Czech Republic are based. Initial contacts have been established with the Financial Services Authority in Great Britain, the banking supervisory authority in Austria, and others.

Although co-operation with foreign banking supervisors has yet to be addressed in the law, a whole range of informal contacts do exist, both in the area of practical banking supervision, and, in particular, in the methodological area. In the latter case, experience gained in other countries with establishing and applying new regulatory principles has been of significant help in creating the regulatory base in the Czech Republic.

The present Act on Banks allows for information exchange between CNB banking supervisors and foreign banking supervisory authorities and similar institutions in the case of entities that operate or intend to operate in the relevant country. However, the Act does not permit the supervisory authority of the home country to perform on-site examinations in the relevant foreign bank branch. This shortcoming will be removed in the amendment to the Act on Banks currently under preparation.

Principle 25

Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

In regulating the banking sector, supervisors ensure a "level playing field" for all entities, which means there is no differentiation between foreign and domestic institutions; the CNB's prudential provisions apply equally to all entities. Certain exceptions do exist for foreign bank branches, but these do not ensue from a different approach to such entities, but from their different organisational form.

The Act on Banks also allows for disclosure of data for the purposes of ensuring banking supervision on a consolidated basis, except for individual data on clients, which are subject to banking confidentiality.

2. THE YEAR 2000 RISK

All entities that use automated systems, including banks, are confronted with the Year 2000 problem, ie the necessity to adjust their systems for the change in year from 1999 to 2000. Systems exposed to this risk are those into which a "fatal error" has been programmed, consisting in the numerical representation of the date using only a six-digit date field.

The primary responsibility for resolving the Year 2000 issue remains exclusively in hands of banks and their management. The CNB banking supervisory authority, being aware of the importance of securing against the Year 2000 risk, is actively participating in resolving this issue. Its role consists particularly in defining and monitoring the individual steps for handling the risk. The CNB is co-operating closely with the Banking Association, particularly in the area of information sharing, testing, etc., and with external auditors, whose task it is to verify Year 2000 compliance.

On the recommendation of the Basle Committee for Banking Supervision at the BIS, a Year 2000 team has been set up. This consists of representatives of selected divisions of the CNB and the Banking Association. At regular monthly meetings the team analyses the situation, monitors activities at individual banks and adopts measures to ensure other necessary steps.

In mid-1998, official information was drafted for banks specifying the basic areas on which banks should focus when addressing the Year 2000 issue. The defining of "resistance to the year change from 1999 to 2000", which means that systems are adjusted to the change in the date from 31.12.1999 to 1.1.2000, was an important part of this document. Banks have been recommended:

- to carry out a stock-taking of all automated systems facing the problem, not only with regard to banking services, but also with regard to infrastructure,
- to ask all suppliers of automated systems used at the bank and its branches and subsidiaries for their opinion on the Year 2000 risk,
- to discuss with important customers and business partners the problems which might arise during the year change from 1999 to 2000,
- to verify and possibly supplement the bank's emergency plans ("business continuity plans"),
- based on the results of the automated systems' verification, to ensure Year 2000 compliance of these systems and perform testing of this compliance.

Furthermore, an amendment to the CNB Provision stipulating the requirements for the Bank Performance Report entered into force in September 1998. This amendment requires each bank to carry out by a specified date an external audit of its automated systems, focusing on critical areas for the bank's safety and soundness and for deposit protection, and to send by a specified date the external auditor's 2000 Year report to the Czech National Bank, together with the bank's own standpoint regarding its Year 2000 compliance.

In December 1998, a CNB Provision was issued stipulating the requirements for safeguarding the operations of banks and foreign bank branches with respect to the Year 2000 risk. This Provision imposes the duty on banks and foreign bank branches to minimise the Year 2000 risk by ensuring resistance of their automated systems to the year change from 1999 to 2000, to prepare a strategy to minimise the Year 2000 risk and ensure the necessary human, technological and financial resources for its implementation, to draw up emergency plans, etc. The banks' year 2000 preparations, including testing, should be completed by 31 March 1999. By the end of June 1999, each bank must have informed the public in an appropriate way of its Year 2000 compliance.

In addition to these methodological aspects, the CNB supervisory authority has taken a number of steps to verify the progress of activities in this area. In July 1998, it sent a letter to all supervisory boards calling on them to devote greater attention to the Year 2000 issue. In autumn 1998, the first round of on-site examinations took place, the purpose of which was to ascertain whether the banks were devoting sufficient attention to this issue and how far they had progressed in carrying out the individual steps to ensure Year 2000 compliance. Prior to these on-site examinations, the banks had to fill in a questionnaire which formed the basis for the on-site verification. This questionnaire was based on the recommendations of the Basle Committee for Banking Supervision. A further round of on-site examinations is due to take place in the first half of 1999. During both rounds, all banks will gradually be visited. Should any shortcomings be detected, banks will be inspected more frequently.

In addressing the Year 2000 issue, the CNB's banking supervisors are working also with other domestic and foreign institutions. The main line of co-operation exists with the Banking Association, which has held a seminar on this issue, has started releasing Year 2000 information on the Internet, and has made contact with the associations of various financial institutions to co-ordinate individual activities. The CNB's supervisors have also contacted banking supervisors in the home countries of the banks operating in the Czech Republic and in the host countries of Czech banks with the aim of acquiring information on their approach to resolving this issue and stipulating the role of "lead supervisor" in cases of foreign bank branches in the Czech Republic or branches of Czech banks abroad. Active co-operation exists with the Bank of England/FSA, with which a system for off-site examination of Živnostenská banka in London and Midland Bank's branch in Prague is under preparation.

B.

BASIC TRENDS IN THE BANKING SECTOR

1. THE ECONOMIC ENVIRONMENT IN 1998

In 1998, the world economy was characterised by a gradual decline in economic growth, disinflationary tendencies in most countries, a fall in prices of raw materials, energy and commodities on all world markets, and considerable volatility in global financial markets. These factors had a significant effect on macroeconomic and price developments in the Czech economy.

The main macroeconomic feature of the Czech economy was the continuing decline in GDP and domestic demand. The GDP decline was generated in particular by the services and construction sectors. Industrial production saw a gradual slowdown throughout 1998 caused by lower external demand, the structure of realised investment and the incomplete restructuring of the business sector. From the monetary point of view, a disinflationary trend emerged in 1998 Q2. The slowdown in net and regulated price inflation fed through into a slowdown in overall inflation.

The favourable inflation outturns opened up room for a gradual lowering of basic interest rates, particularly in the second half of 1998. The 2W repo rate was lowered from 14.75% to 9.5%, the discount rate from 13% to 7.5% and the Lombard rate from 23% to 12.5%. The minimum reserve requirement was meanwhile decreased from 9.5% to 7.5% as of August 1998.

The koruna's exchange rate against the Deutsche Mark strengthened significantly in the first half of 1998, and then stabilised in the second half. On the one hand, the daily movements in the exchange rate testified to its sensitivity to the external environment. On the other hand, the rapid fading of these fluctuations indicated a certain change in foreign investors' attitude towards the koruna and their evaluation of it as a relatively stable currency.

The unfavourable economic conditions in the business sector had a significant impact on the banking sector. The biggest risk in banking remains credit risk. The worsening financial situation of a significant section of businesses placed credit risk at a level which banks could no longer accept. The high credit burden of businesses, their inability to obtain funds from the capital market or other cheaper financial sources, and the declining investment activity mean that no room was created for improvement in the performance of businesses and their ability to repay funds.

The legal environment is another factor affecting the banking sector. In 1998, there were no major changes in the legal framework, nor was there any significant improvement in law enforcement, particularly in business relations. The law still gives better protection to debtors than to creditors, bankruptcy proceedings are inflexible, right of pledge suffers from considerable loopholes, legal actions are long and drawn-out, etc. A rapid completion of the necessary laws and measures to enhance law enforcement would contribute considerably to the stability of the banking sector.

2. STRUCTURE OF THE CZECH BANKING SECTOR

2.1 Number of banks in the banking sector

As of 31 December 1998, there were 45 banks and foreign bank branches operating in the banking sector, a fall of five from the same time a year earlier. COOP banka, Velkomoravská banka, Agrobanka Praha and Pragobanka had their licences revoked after failing to meet the prudential regulations. In 1998, several foreign bank subsidiaries operating in the Czech Republic were merged following amalgamations of their parent banks. Bank Austria and Creditanstalt merged to form Bank Austria Creditanstalt Czech Republic, and HYPO-BANK and Vereinsbank became HypoVereinsbank CZ. In 1998, one new banking licence was granted: to GE Capital Bank, which took over part of Agrobanka's activities. No banks are operating under conservatorship at present.

Another significant change in the banking sector structure in 1998 was the termination of conservatorship at Podnikatelská banka and the sale of the bank to a new foreign investor, who relaunched the bank under the name of J&T Banka. The subsidiary Société Générale Banka was transformed into a foreign bank branch.

Table 1 Number of banks by group
(banks that have started client operations)

	1 Jan. 1990	31 Dec. 1990	31 Dec. 1991	31 Dec. 1992	31 Dec. 1993	31 Dec. 1994	31 Dec. 1995	31 Dec. 1996	31 Dec. 1997	31 Dec. 1998
Total banks	5	9	24	37	52	55	55	53	50	45
of which:										
large banks	5	5	6	6	6	6	6	5	5	5
small banks	x	4	14	19	22	21	18	12	9	8
foreign banks	x	x	4	8	11	12	12	13	14	13
foreign bank branches	x	x	x	3	7	8	10	9	9	10
specialised banks	x	x	x	1	5	7	9	9	9	9
banks under conservatorship	x	x	x	x	1	1	0	5	4	0
Additionally, banks without licences	x	x	x	x	x	1	4	6	10	18

Since 1989, the banking sector structure has undergone very dynamic development. A large number of the newly established banks were unable to cope with the strong competition and risky conditions associated with the economic transformation and were forced to terminate their operations. The tightening of the conditions for setting up new banks has restricted the entry of new entities into the sector, particularly since 1996. Recently, the structure of the banking sector has been affected by mergers of individual banks, leading to a concentration of the sector. Between 1989 and the end of 1998, a total of 63 banking licences were granted and 18 revoked. Of these, 14 were revoked because of the relevant bank's poor financial situation and failure to meet the prudential rules, 3 as a result of mergers, and 1 because the bank did not start its operations within the allotted legal period.

2.2 Breakdown of banks into groups

The breakdown of banks into individual groups is based on the amount of total assets managed, the origin of capital and any specialisation a bank may have (a detailed overview of groups by individual banks is given in the appendix).

Owing to the amount of total assets they manage, the **group of large banks** has the biggest influence on the banking sector as a whole. However, the group is very inhomogeneous, as it includes banks with various orientations, despite their gradual convergence. Česká spořitelna's core activity is providing services to households and small businesses; Komerční banka and Investiční a Poštovní banka both focus on a large and medium-sized business clientele; and ČSOB's activities are still oriented mainly abroad. As regards providing services to households, Investiční a Poštovní banka is starting to compete significantly with Česká spořitelna through its Poštovní spořitelna division, which focuses on collection of deposits from households using the post office counters. Konsolidační banka – the only state-owned financial institution – was established for the administration of bad credits provided prior to 1989. The large banks manage 66% of all the assets of the banking sector.

In addition to Konsolidační banka, which is wholly state-owned, the state has controlling stakes in three other large banks. At the beginning of 1998, the privatisation of state stakes had been completed only at Investiční a Poštovní banka, which now has considerable foreign capital. The privatisation of the state stake in ČSOB will be finished this year, and the privatisation of the two remaining banks is under preparation.

The **small bank group** has experienced the stormiest development over the past few years. Banks with predominantly Czech capital which started functioning in the banking sector during the 1990–1993 period formed part of this group. These banks were granted their licences in a period when capital requirements were low and when it was very hard to find high-quality staff, particularly for senior posts. In a number of cases, shareholders founded these banks to support their own business activities in the short-term, and were not interested in the safe and sound development of the bank on a long-term basis. At the same time, these banks to a large extent underpinned the development of the economy at the beginning of the transformation; however, the considerable riskiness of this environment led to a large number of poor transactions. These risk aspects gradually resulted in such heavy losses that the small banks were unable to cope because of their low level of capital. As a result, the operations of 14 small banks have been terminated since 1994. As of 31 December 1998, the group comprised eight banks managing only 3.5% of the banking sector's total assets.

Table 2 Share of individual bank groups in total assets (in %) for banks with valid licences as of 31 Dec. 1998

	31 Dec. 1996	31 Dec. 1997	31 Dec. 1998
Banking sector, total	100.00	100.00	100.00
of which:			
large banks	72.41	68.20	65.99
small banks	4.34	3.99	3.54
foreign banks	11.67	13.70	15.55
foreign bank branches	8.33	9.63	9.47
specialised banks	3.25	4.48	5.45

The significance of **foreign banks** in the banking sector is continuing to rise, not only with respect to the total assets they manage, but also with regard to their beneficial effects on competition in banking. In particular, they are positively influencing the quality of services provided to clients. In order to compete, other banks operating in the Czech market are having to broaden their range of banking products, improve their services, etc. On the other hand, foreign banks have certain competitive advantages. These consist particularly in the good reputation of their parent banks (most of them belong to internationally well-regarded banks), easier and cheaper access to expertise, cheaper funds from the parent bank or other banks, etc. Foreign banks, along with foreign bank branches and building societies, have seen steady growth. Since 1996, the share of foreign banks in total banking sector assets has increased by 3.9 points to 15.6%. Foreign banks operating on the Czech banking market focus mainly on wholesale banking.

Foreign bank branches, like foreign banks, concentrate on wholesale banking and finance their growing credit activities mainly from interbank sources. They have developed particularly rapidly in the past three years. At the close of 1998, they accounted for 9.5% of total banking sector assets, up 1.2 points from 1996. The group of foreign bank branches is very heterogeneous, encompassing dynamically developing branches – which, with regard to total managed assets, are becoming medium-sized entities (Commerzbank AG, ING

Bank N.V., Société Générale, Deutsche Bank, etc.) – as well as a number of small border-area branches of German and Austrian banks with limited operations.

Specialised banks include building societies in particular, whose activities are limited by law to support for housing. Českomoravská hypotéční banka has a similar nature to the building societies; Českomoravská záruční a rozvojová banka focuses on providing guarantees to small and medium-sized enterprises; and Česká exportní banka provides support for exports. Specialised banks are subject, in addition to the Act on Banks, to special regulations limiting their current banking risk exposure. The development of building savings and other activities of specialised banks has led to a gradual strengthening of their importance in the banking sector. As of 31 December 1998, they accounted for 5.5% of total assets, a rise of 2.2 percentage points compared with the close of 1996.

2.3 Banking sector structure by total assets and initial capital

(for banks with valid licences as of the given date)

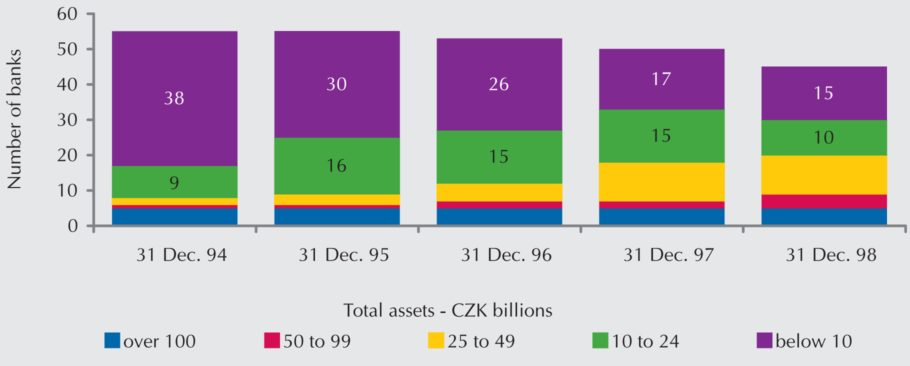
The structure of banks by total managed assets reflects the reduction in the number of banks operating in the Czech banking sector. This is a result of involuntary termination of their operations and ongoing acquisitions, as well as the varying intensity of growth in individual bank groups.

The decline in the number of banks and the ever-increasing level of total managed assets has brought about an increase in the average bank size. As of 31 December 1994, the average bank was managing total assets of CZK 27.7 billion, whereas by the end of 1998 the figure had almost doubled to CZK 55.5 billion.

Most banking licences have been revoked for banks with Czech capital, which from the point of view of total managed assets were among the smallest financial institutions in the banking sector. Consequently, the number of banks with total assets of less than CZK 10 billion has gradually declined, from 38 as of 31 December 1994 to 15 at the close of 1998.

Chart 1 Banks by total assets

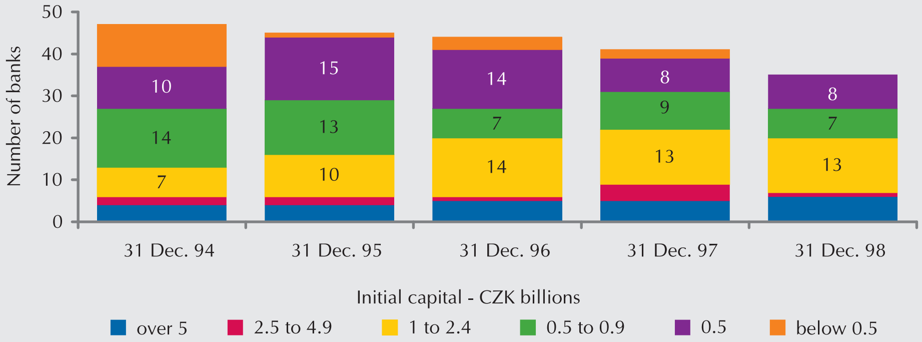
for banks with valid licences as of the given date



On the other hand, the growth of foreign banks and foreign bank branches, along with the ongoing mergers, has led to an increase in the number of medium-sized entities. Only three banks with total assets in the range of CZK 25 billion to CZK 100 billion were operating in the Czech banking sector at the end of 1994, compared with 15 banks and foreign bank branches in the same range as of 31 December 1998. The number of banks with total assets above CZK 100 billion has remained unchanged at five since the beginning of the establishment of the banking sector in the Czech Republic. However, the ongoing concentration of the sector may change this long-term trend in the near future. Whereas in 1994, the sixth bank in the order stood roughly CZK 38 billion below the CZK 100 billion level in terms of managed assets, and the seventh bank CZK 72 billion below, at the end of 1998 they were only CZK 19 billion and CZK 39 billion below respectively.

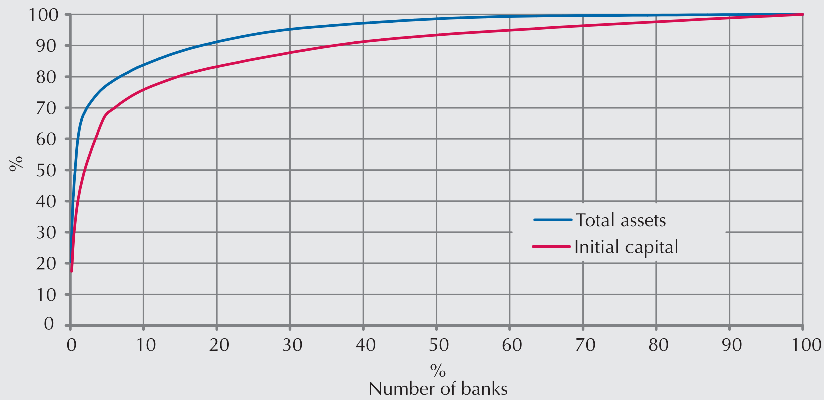
The initial capital of the banking sector has seen similar tendencies. The average amount of initial capital per bank rose by CZK 900 million against the end of 1994 to stand at CZK 2.2 billion as of 31 December 1998. The number of banks with initial capital exceeding CZK 1 billion was up by 7 to 20. Meanwhile, the number of banks with initial capital at the minimum permissible level of CZK 500 million declined. This threshold level was set in 1995, which explains the large number of banks with initial capital of less than CZK 500 million in 1994. In subsequent years, conservatorship was imposed on a number of banks with initial capital below the required minimum.

Chart 2 Banks by initial capital
for banks with valid licences as of the given date



The share of total assets managed by the largest banks in the sector also testifies to the continuing concentration of the banking sector, especially as regards the gradual formation of medium-sized banks. As of 31 December 1994, the five largest banks managed 73.4% of the total assets and the ten largest 83.4%, whereas at the end of 1998 they managed only 66.0% and 77.4% respectively.

Chart 3 Total assets and initial capital as of 31 Dec. 1998
for banks with valid licences as of 31 Dec. 1998



2.4 Banking sector structure by ownership

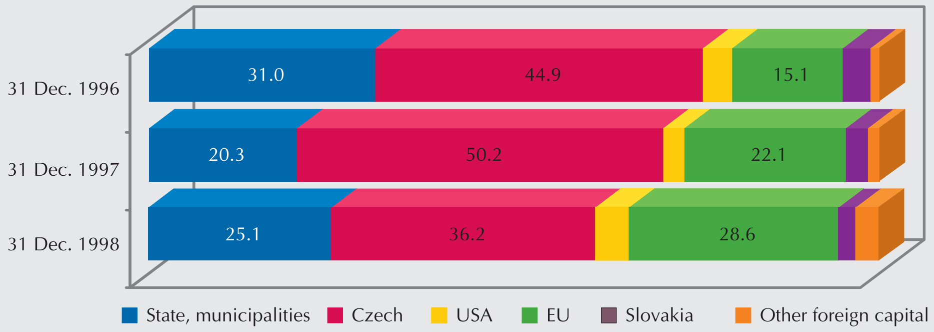
(for banks with valid licences as of the given date)

In the Czech Republic, both legal and natural entities are permitted to be bank shareholders, regardless of their country of residence. However, if their share exceeds 10% of the initial capital of the bank in question, they must meet the tight prudential criteria set by the Czech National Bank. Changes in ownership structure over time thus reflect the varying intensity of initial capital increases with respect to domestic and foreign investors, as well as changes in the number of banks.

The decline in the proportion of Czech capital (to 36.2% as of 31 December 1998, from 50.2% a year earlier) is largely due to the revocation of banking licences from more banks with predominantly Czech private capital. The fall in Czech capital in the banking sector led to a relative increase in the shares of other groups of bank owners, including the state and municipalities, where initial capital as of 31 December 1998 was up by 4.8 points to 25.1% against a year earlier. However, this does not represent an absolute increase in the share of the state and municipalities. The continuing relatively high share of state ownership is connected with the unfinished privatisation of the large banks. Once this is completed (one bank is to be privatised by the end of 1999 and the remaining two in 2000), the ownership structure will change significantly in favour of foreign entities, as the new investors in all cases are likely to be major foreign banks.

Chart 4 Bank ownership structure

for banks with valid licences as of the given date



Note: data in the chart represent proportion of initial capital in %

The increase in the share of foreign entities in the banking sector's total initial capital was due to the completion of Investiční a Poštovní banka's privatisation and the granting of a banking licence to GE Capital Bank. This led to an increase in the shares of the USA and countries of the EU.

2.5 Employees and banking units

(for banks with valid licences as of the given date)

A total of 52,760 people were working in the banking sector as of 31 December 1998, ie 7.6% less than a year earlier. The number of banking units dropped by 10% during 1998 to 2,220. The reduction was even more marked in comparison with 1994: 10.5% for employees and 36% for banking units. This was due in part to several banks terminating their operations (although not to any large extent as their branch networks were usually sold to some other bank). The cuts in workforce and banking units were generated primarily by an effort to rationalise operations and increase efficiency. This is confirmed by the fact that substantial declines in workforce and banking units occurred in the group of large banks (falls of 10% and 38% respectively against the end of 1994), ie in a group which has remained unchanged in composition throughout the period.

Table 3 Number of employees and banking units in the banking sector for banks with valid licences as of the given date

	31 Dec. 1994	31 Dec. 1995	31 Dec. 1996	31 Dec. 1997	31 Dec. 1998
Number of employees	58 920	61 073	60 137	57 082	52 760
Number of banking units	3 467	3 411	3 172	2 467	2 220
Number of employees per bank	1 071	1 131	1 135	1 165	1 172
Number of employees per banking unit	17	18	19	23	24
Number of population per banking unit	2 981	3 029	3 252	4 177	4 639
Number of population per employee	175	169	172	181	195

The situation is rather different in foreign banks and foreign bank branches, where the number of employees and banking units has been on the increase owing to the expansion in their activity since 1995. In foreign banks the number of employees was up by 54% against 1994 to 3,224 and in foreign bank branches by 88% to 912. For foreign banks the number of banking units more than doubled. Foreign bank branches usually provide services from one location only.

Despite the contrary trends in the groups of large and foreign banks, there still exists a large difference in the personnel and organisational structure of these groups. This is primarily due to different orientation. Foreign banks concentrate mainly on wholesale banking, which is less demanding in terms of both personnel and organisation. The amount of total assets per employee in foreign banks is roughly double that in the large banks. The difference is even more striking in the size of banking units, with a mere CZK 1 billion per banking unit for large banks and almost CZK 3.5 billion for foreign banks.

The more substantial fall in the number of banking units compared with the number of staff indicates that small banking units are being abolished and banking services are being concentrated into larger organisational units. This is also documented by the gradual increase in the size of banking units expressed as the number of staff per banking unit. This number grew from 17 in 1994 to reach 24 at the end of 1998. The rationalisation of the branch network has also been fostered by the development of automated banking services, particularly ATMs and the gradual replacement of traditional counter banking in some financial institutions with home banking. Automation will be an important factor in the further rationalisation of banking services.

With the population of the Czech Republic currently flat, the falling number of staff and banking units is of course being reflected in a rising number of citizens per employee and per banking unit. Thanks to the development of automated forms of banking, however, this does not necessarily mean a sizeable decline in the level of services. Czech banks first started offering payment cards ten years ago. As of the end of 1998, there were 1,373 ATMs in the Czech Republic and two million payment cards. The number of cash withdrawals per ATM per month was about 4,500 in 1998.

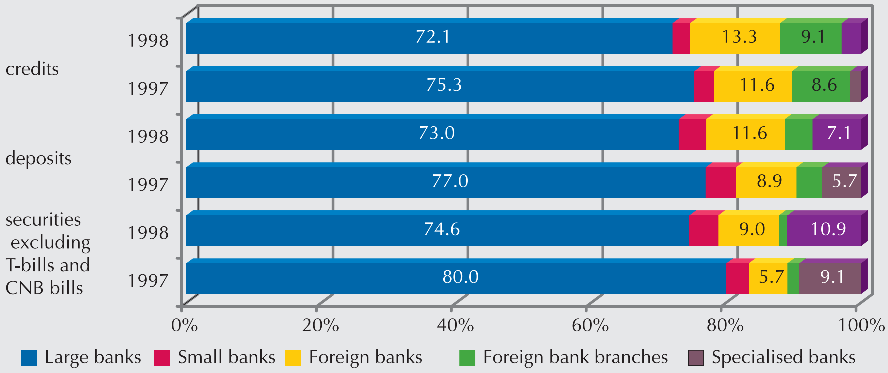
Banks operating on the Czech banking market are not active in other countries to any great extent. As of 31 December 1998 only two banks had branches abroad. Of the overall number of 887 staff in banking units abroad, more than 95% worked in the Slovak Republic. The weight of the foreign network expressed as the share of the number of staff registered at units abroad in the overall number of staff remained at the 1997 level, ie about 2%, with large banks accounting for the major part.

2.6 Market shares of individual groups of banks

(for banks with valid licences as of 31 December 1998)

The developments in the market shares of individual groups of banks in the main bank products are primarily the result of the different growth rates in these groups. The size of these shares is then dependent on the orientation of these groups towards the various products.

Chart 5 Market shares of groups of banks in selected products in %
for banks with valid licences as of 31 Dec. 1998



Large banks still have the dominant share in all the main products. However, the high pace of growth in foreign banks and foreign bank branches seen since about 1995 has led to a constant decline in this ratio. At the end of 1998, the share of the large banks in total credits granted was down by 3.2 points against a year earlier, while that of foreign banks and foreign bank branches was up by 2.2 points. The deposit structure saw a similar trend, with the large banks' share falling by 4 points and that of foreign banks and foreign bank branches increasing by 3 points. The expansion in building savings also resulted in a strengthening of the share of specialised banks, which rose by 1.4 points for total deposits to 7.1% and by 1.3 points for total credits to 2.9%. The group of small banks currently has the lowest shares for all monitored products.

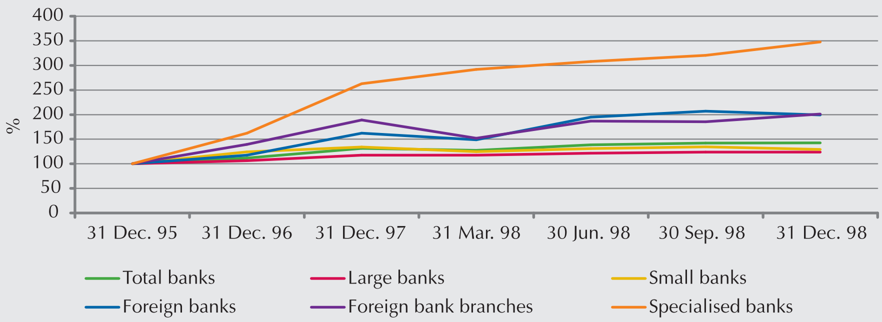
3. BANK ASSETS

(for banks with valid licences as of 31 December 1998)

As of 31 December 1998, the total assets of the banking sector amounted to CZK 2,440.7 billion, up 8.6% against a year earlier. The rate of growth was down by 9 points against 1997.

The individual bank groups made different contributions to the growth in total assets. Small banks registered an absolute fall owing to the downturn in their activity. The lowest growth was recorded by the large banks as a result of their more prudent lending policies. On the other hand, foreign banks, foreign bank branches and specialised banks continued to develop their activities in line with the trend visible since 1995. Foreign banks and foreign bank branches, despite a certain slowdown in 1998, almost doubled their total assets compared with 1995. Building societies, which make up the major part of the specialised bank group, almost quadrupled their total assets.

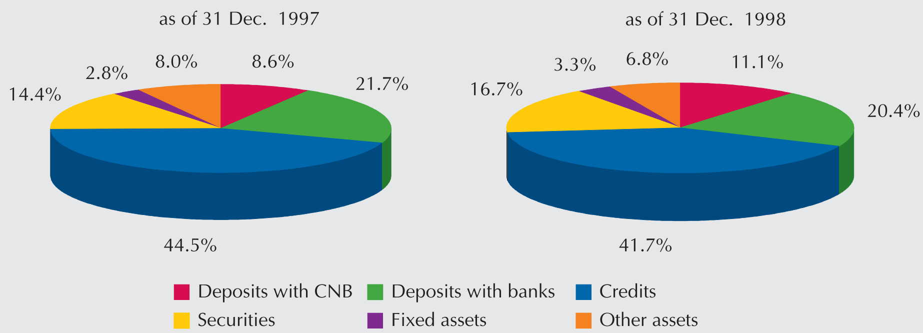
Chart 6 Growth of total assets
for banks with valid licences as of 31 Dec. 1998



Note: 31 Dec. 1995 = 100 %

The lower rise in total assets compared with 1997 reflected the overall stagnation of the economy and increased bank prudence. This fed through also to changes in the structure of the assets side of the banking sector's balance sheet.

Chart 7 Asset structure
for banks with valid licences as of 31 Dec. 1998



Banks reacted to the higher riskiness of the economic environment primarily by curtailing their lending activity. This led to the share of credits in total assets falling a further 2.8 points to 41.7%. Other important factors in this fall included higher provisioning, write-offs of loss loans and transfers of some credit claims outside the banking sector within the framework of the stabilisation programme. Banks located their free funds mostly in quick assets, especially T-bills and CNB bills, which led to the share of securities in bank portfolios rising 2.3 points to 16.7%. The 1.3 point drop in the share of bank deposits to 20.4% is connected with the lower need of banks to boost their funds.

3.1 Credit transactions

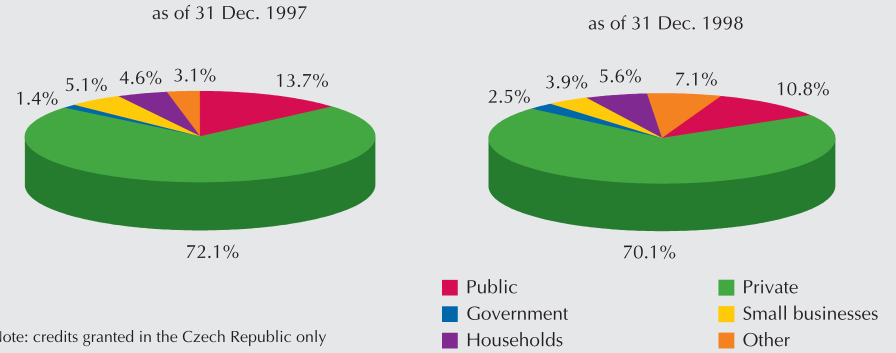
A substantial part of the present loan portfolio of the Czech banking sector was formed to support business entities lacking sufficient capital under the conditions of the transition economy. In this way the banking sector created conditions for economic growth, but simultaneously took on the real risk of poor-quality credits. The unfavourable economic developments in 1998 caused banks to curtail new lending in an effort to reduce the risk of new losses. At the same time, they attempted to deal with their existing losses.

As of 31 December 1998, the overall volume of gross credits was CZK 1,135.4 billion, 3.4% higher than a year earlier. Credits represent about 91% of GDP in constant prices.

The stagnation in lending was seen predominantly in the group of large banks, where the volume of credits granted remained at the 1997 level. Small banks registered an absolute decline. In foreign banks and foreign bank branches, the volume rose by 16.7% and 7.7% respectively against the end of 1997. However, this was still well below the level of growth seen in 1997 (41.2% and 35.7% respectively). There was an enormous rise in lending activity in building societies (2.5 times more than at the end of 1997). This, however, was because building societies started to provide the first credits to their clients after the two-year savings period required by law, ie gradually from about 1997.

Chart 8 Credit structure by sector

for banks with valid licences as of 31 Dec. 1998

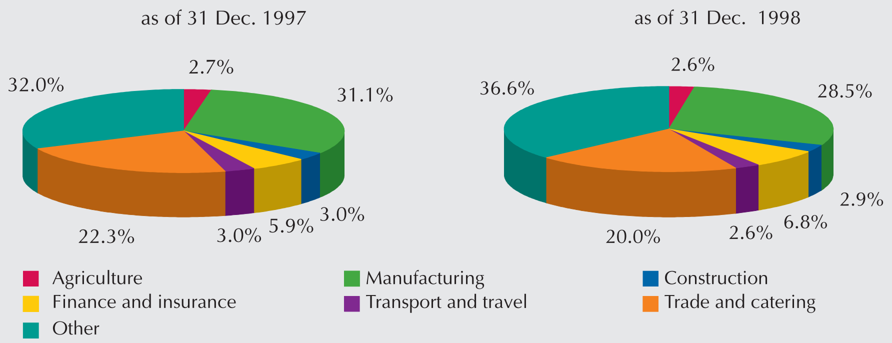


Note: credits granted in the Czech Republic only

The most frequent credit recipients are private sector entities. However, their share in the overall volume of credits dropped by 2 points against the end of 1997 to 70.1%. The share of credits granted to households rose more substantially, by 1 point to 5.6%. This confirms the increasing orientation of some banks towards small clients and wider possibilities for consumer credits, although specific building society loans account for the lion's share of these credits. Loans to the government sector and to other entities expanded as well, rising by 1.1 points (to 2.5%) and by 4 points (to 7.1%) respectively. In contrast, the share of credits provided to the public sector continued to decline, reflecting the ongoing predominance of private entities in the economy. The lower proportion of credits granted to small businesses in comparison with the end of 1997 was caused by the high risks existing in this sector.

Chart 9 Credit structure by industry

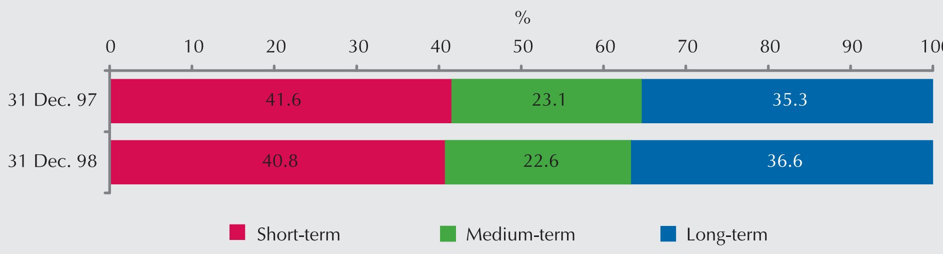
for banks with valid licences as of 31 Dec. 1998



Note: credits granted in the Czech Republic only

The credit flows into individual industries are fully in proportion to the sector structure of the Czech economy, where manufacturing has a dominant position. As of 31 December 1998, a total of 28.5% of all credits provided by the banking sector were channelled into manufacturing, 2.6 points lower than in 1997. A similar trend was seen in the trade and catering sector, which is the second-largest credit recipient. The share of loans provided to this industry in total credits as of the end of 1998 was 20%, 2.3 points less than a year earlier. Finance and insurance followed with a mere 6.8%. The shares of credits in construction, agriculture and transport and travel were all below 3%, approximately at the end-1997 level.

Chart 10 Time structure of credits
for banks with valid licences as of 31 Dec. 1998



Notes: data in the chart represent proportion in %
credits granted in the Czech Republic only

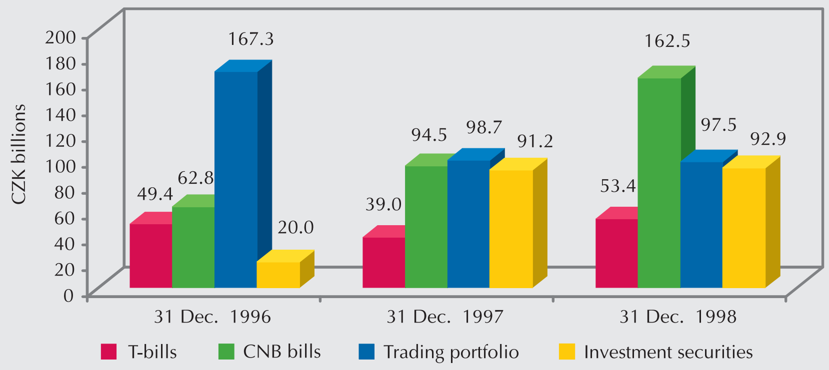
The time structure of credits as of 31 December 1998 saw a slight shift towards long-term credits, whose share in the total was the only one to rise (up 1.3 points to 36.6%). Short-term credits, ie those with maturities of up to one year, still account for the largest part of all granted credits, with a 40.8% share. The credit time structure reflects the structure of the banking sector's disposable funds, where shorter maturities also predominate.

3.2 Securities

The net value of the total volume of securities – ie Treasury and other bills, marketable securities and long-term financial investments – totalled CZK 406.3 billion as of 31 December 1998, up 25.6% from a year earlier. Securities accounted for 16.6% of total assets, 2.2 points more than at the end of 1997.

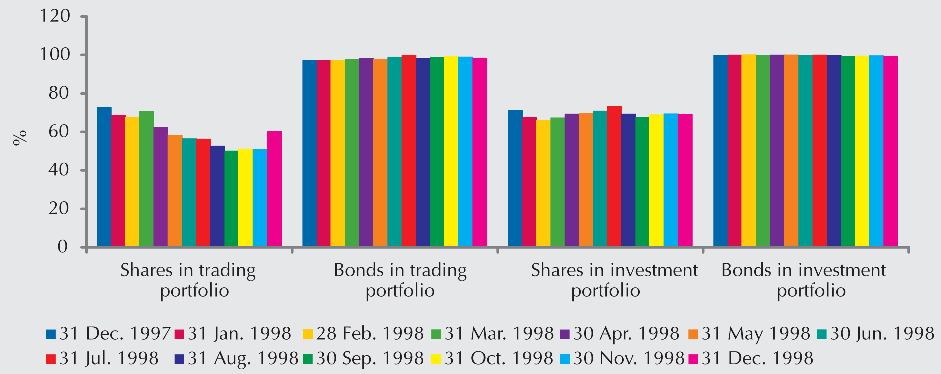
The expansion of the volume of securities in bank portfolios is due to the rise in the volume of T-bills and CNB bills, which is outpacing the minimal growth in more risky securities in the banks' investment and trading portfolios. The downward trend in the banks' involvement as capital market participants is thus continuing. Treasury and other bills are an advantageous form of bank investment thanks to their minimal risk and their liquidity.

Chart 11 Structure of securities in bank portfolios
for banks with valid licences as of 31 Dec. 1998



As of 31 December 1998, the distribution of securities between the trading and investment portfolios remained approximately the same as a year earlier. At that time, portfolios had already been adjusted to the new terms set by the CNB for provisioning against the risks arising from holding securities with respect to their placement in individual types of portfolios. The net volume of securities partly reflects their market value, owing to the mandatory coverage of negative differences between the market value and the purchase price on a daily basis in the case of the trading portfolio and on an annual basis for the investment portfolio.

Chart 12 Securities - ratio of market value to purchase price
for banks with valid licences as of 31 Dec. 1998



As of 31 December 1998, the ratio of the market value of securities (excluding Treasury and other bills) to their purchase price was 92.3%, which is 0.1 points lower than a year earlier. On the same date, the ratio for the trading portfolio was 97.2% (up 3 points) and that for the investment portfolio was 87.9% (down 2.9 points).

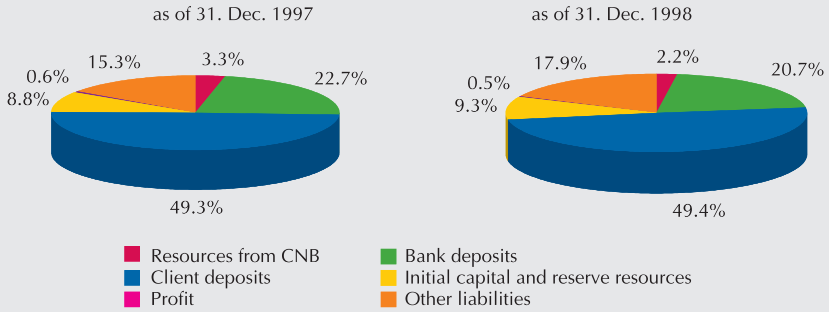
An important aspect for evaluating the risk profile of the securities portfolio is its breakdown by type of security. The main reason for the low level and volatility of market values, particularly for equity securities, are the developments on the Czech capital market; for debt securities the situation is much more favourable. The market value/purchase price ratio for equity securities has for a long time been moving at about 60% in the trading portfolio and at 70% in the investment portfolio; for debt securities the ratio has usually been only slightly below 100%. Banks are therefore investing more in bonds, which accounted for almost three quarters of their securities portfolio (excluding Treasury and other bills) as of 31 December 1998.

4. BANK LIABILITIES

(for banks with valid licences as of 31 December 1998)

The Czech banking sector's liabilities structure reflects the banks' possibilities in obtaining external funds, their need for asset transactions and the development of their own funds. Client deposits, which have been fluctuating in the long run at about 50% of total assets, are the most significant part of liabilities. The reasons for the persisting significance of traditional depositing of free funds with banks are the underdevelopment of the capital market and other forms of allocation of disposable funds, mainly those of households, together with a certain distrust in new forms of fund valuation.

Chart 13 Liabilities structure
for banks with valid licences as of 31 Dec. 1998

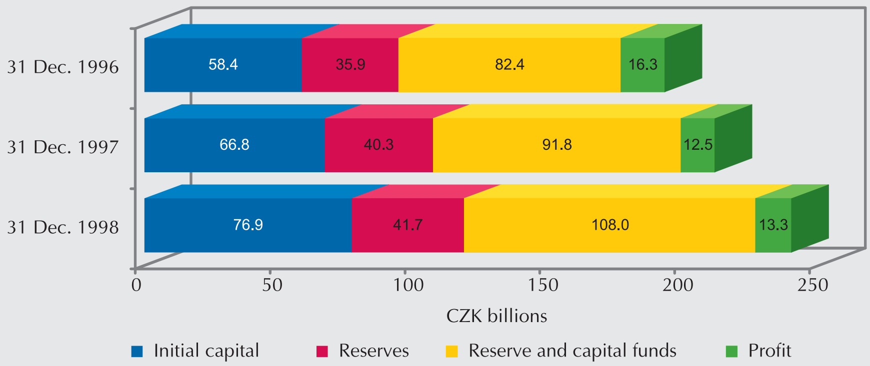


The second most important component of banks' external funds is deposits from other banks, which account for more than one fifth of overall liabilities. Compared with a year earlier, this ratio was down by 2 points to 20.7%, mainly because of lower bank demand for additional funds in connection with the subdued lending activity in 1998. Initial capital and reserve resources account for about 9% of overall assets over the long term.

4.1 Own funds in the banking sector

The banking sector's own funds consist primarily of initial capital, reserve and capital funds, general reserves and current and retained profits. As of 31 December 1998, own funds amounted to CZK 239.9 billion, ie 13.4% more than a year earlier. The biggest contributors to the year-on-year increase were growth in initial capital (up 15.0%) and in reserve and capital funds (up 17.6%).

Chart 14 Development and structure of banks' own funds
for banks with valid licences as of 31 Dec. 1998



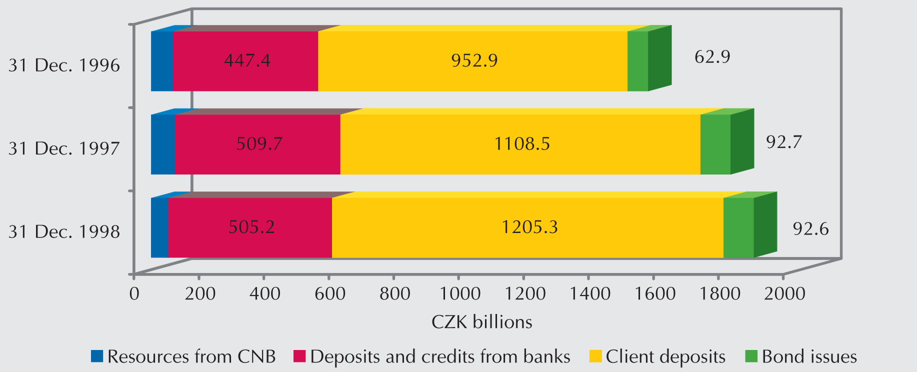
The banking sector's initial capital as of 31 December 1998 totalled CZK 76.9 billion, which represents an annual increase of CZK 10.1 billion. The main contributions came from Investiční a Poštovní banka (owing to the increase in initial capital following its privatisation) and from the establishment of the new GE Capital Bank. The group of small banks also saw a substantial rise in initial capital; here, however, this was a necessary prerequisite for covering realised losses and maintaining the required level of capital adequacy.

Reserve and capital funds rose by CZK 16.2 billion during 1998 to CZK 108.0 billion, accounting for 45% of overall own funds. The creation of reserve funds depends on the level of profits achieved, which are their main source. At present, banks in the Czech banking sector are opting to set aside reserve funds rather than pay out dividends in the interests of maximum strengthening of their capital base.

4.2 External funds in the banking sector

The overall volume of external funds as of 31 December 1998 was CZK 1,855.9 billion, up 4.0% year-on-year. Client deposits accounted for the greatest share (64.9%). Deposits and credits from banks made up less than one third of the total. The significance of the volume of bonds issued as of 31 December 1998 was down in relative terms from a year earlier, with the total volume of CZK 92.6 billion remaining unchanged while total external resources increased.

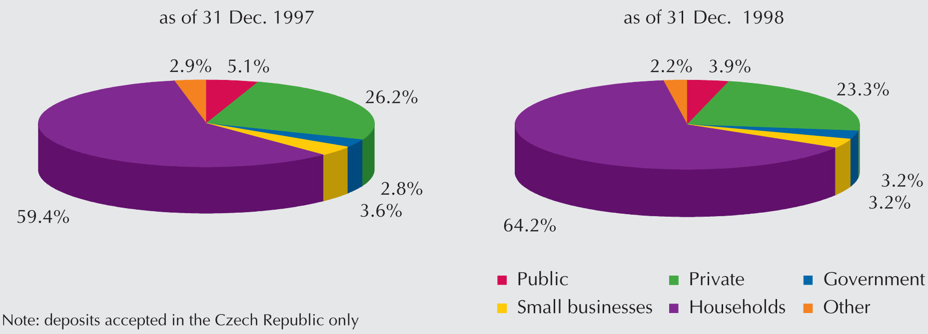
Chart 15 Development and structure of banks' external funds
for banks with valid licences as of 31 Dec. 1998



4.2.1 Primary funds

The overall volume of client deposits was CZK 1,205.3 billion as of 31 December 1998, ie 8.7% higher than a year earlier. The increase was attributable mainly to household deposits, with corporate sector deposits seeing a significant fall. This confirms the strained financial situation in the corporate sector, which caused a reduction in free funds. In contrast, households still gave preference to saving over consumption.

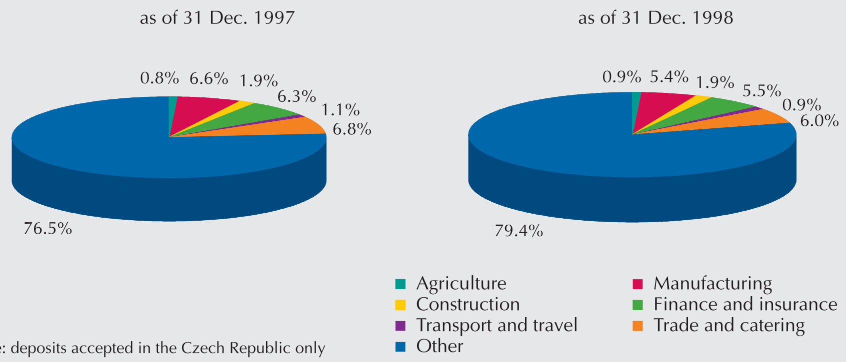
Chart 16 Deposit structure by sector
for banks with valid licences as of 31 Dec. 1998



Note: deposits accepted in the Czech Republic only

The proportion of household deposits in total primary deposits increased by a further 4.8 points in 1998 to 64.2%. At the same time, the share of the business sector (ie the private and public sectors) dropped by 4.1 points to 27.2% in the same period. An absolute decline was seen also for small businesses' deposits, leading to a further 0.4 point drop in their share in total client deposits to 3.2%. In addition to households, the absolute volume of primary deposits increased also in the government sector.

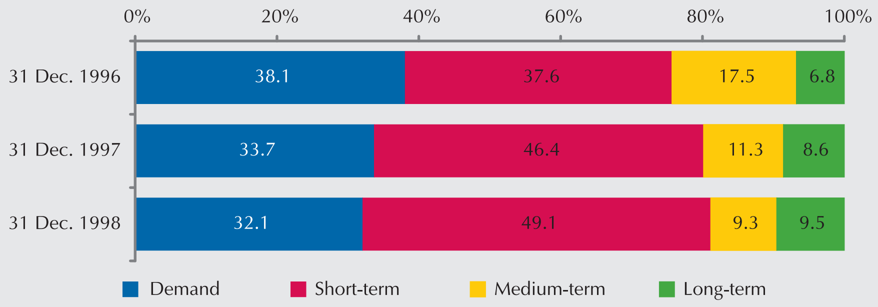
Chart 17 Deposit structure by industry
for banks with valid licences as of 31 Dec. 1998



Note: deposits accepted in the Czech Republic only

The structure of primary deposits by industry reflects the large share of household deposits, which are in this context included in other industries. Among industries, first place was again occupied by trade and catering, with a 6.0% share in total client deposits, followed by finance and insurance with 5.5% and manufacturing with 5.4%. The deposits of these three industries accounted for a smaller share of the total than they did a year earlier.

Chart 18 Time structure of deposits
for banks with valid licences as of 31 Dec. 1998



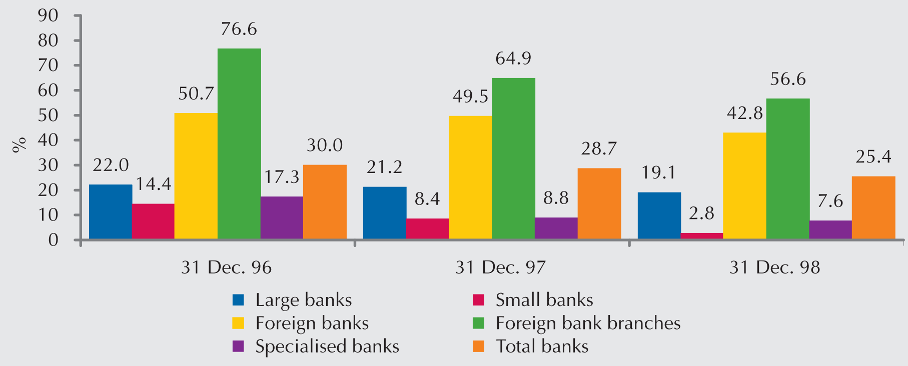
Note: deposits accepted in the Czech Republic only

Short-term time deposits, representing 49.1% of overall primary deposits as of 31 December 1998, are the most frequent type of deposit by maturity. Changes in time structure are not very significant over time. The moderate increase in the share of long-term time deposits (up by 2.7 points to 9.5% since 1996) is a positive trend. This shift, however, was mainly due to a drop in the proportion of medium-term time deposits.

4.2.2 Secondary funds

At the end of 1998, the total volume of deposits from banks was CZK 505.2 billion, 0.9% less than a year earlier. With respect to the type of deposits, time deposits predominate (68.1%) followed by credits accepted (29.5%).

Chart 19 Share of secondary funds in external funds
for banks with valid licences as of 31 Dec. 1998

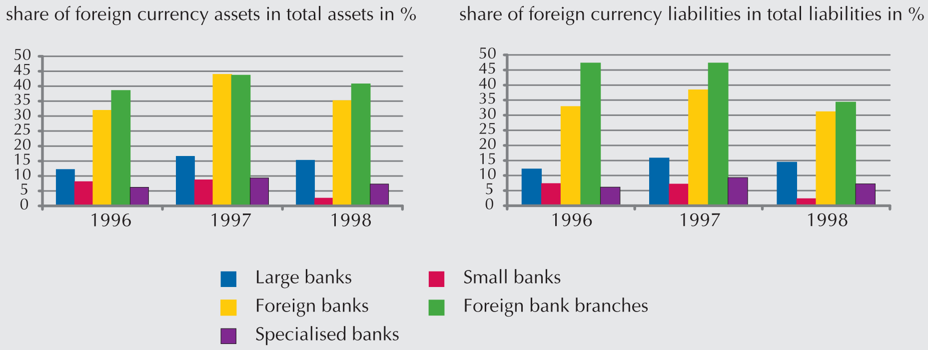


Financing through the interbank market is used most by foreign banks and foreign bank branches. This trend is still strongest in the group of foreign bank branches, although the share of secondary funds in total external resources slid from 64.9% at the end of 1997 to 56.6% a year later. Foreign banks have also been curtailing their heavy use of interbank market financing. The share of their secondary funds in external funds dropped by 6.7% during 1998 to 42.8%. This high but slowly decreasing share of interbank activities at foreign banks and foreign bank branches stems from the fact that some are beginning to orient themselves toward a wider clientele and are thus gaining access to primary sources of financing. In contrast, interbank market financing in the group of small banks stands at only 2.8%; as a consequence, they are almost fully dependent on client deposits. The large banks are maintaining a stable level of financing from secondary resources at 20%.

5. FOREIGN EXCHANGE ACTIVITIES OF THE BANKING SECTOR

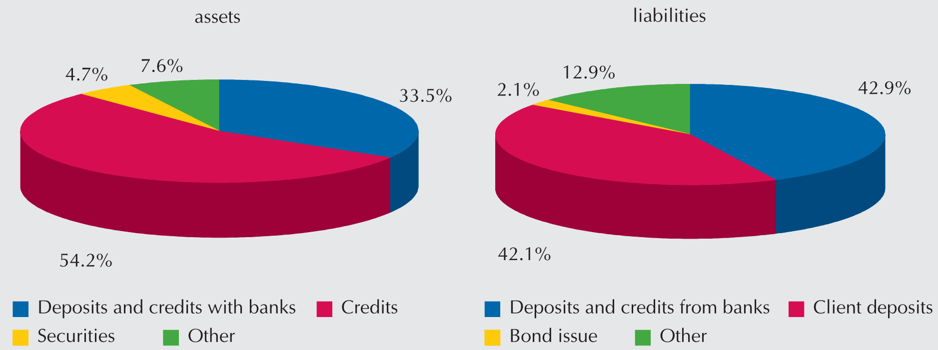
As of 31 December 1998, foreign exchange assets totalled CZK 486.0 billion and foreign exchange liabilities CZK 442.4 billion, down 2.8% and 7.7% respectively compared with a year earlier. Foreign exchange activities represented about one fifth of the overall volume of total assets. After the sizeable expansion of foreign exchange activities in 1997, visible in all groups of banks except for small banks, it has again become interesting for banks and their clients to effect their asset and liability transactions in korunas, mainly because of exchange rate and interest rate developments. The drop in the share of foreign exchange assets and liabilities in total assets in 1998, resulted in this indicator, except in the case of the assets and liabilities of large and specialised banks, falling below its end-1996 levels.

Chart 20 Banking sector foreign exchange activities
for banks with valid licences as of 31 Dec. 1998



The extent of foreign currency transactions differs considerably in individual types of banks. Foreign banks and foreign bank branches have the highest proportion of foreign exchange activities, accounting for 30%–40% over the last three years. In contrast, small and specialised banks, especially building societies, conduct virtually no foreign currency transactions.

Chart 21 Structure of foreign exchange assets and liabilities as of 31 Dec. 1998
for banks with valid licences as of 31 Dec. 1998



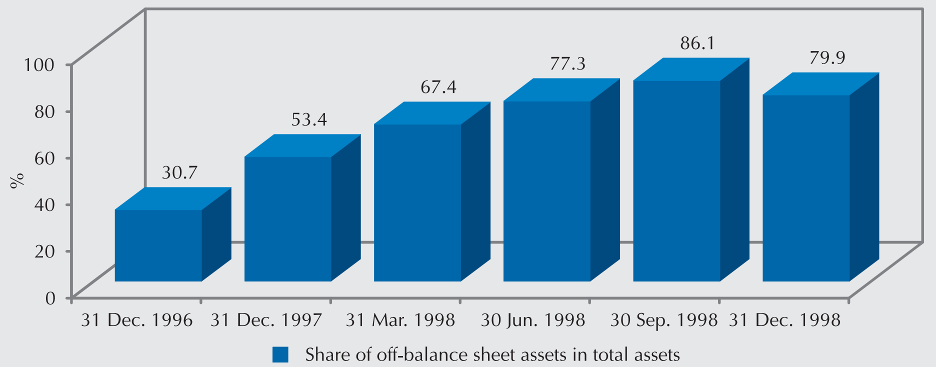
With respect to banking products, credits predominate in foreign exchange assets, accounting for more than 50% of the total. Against the end of 1997, their share rose by another 5.1 points owing to a fall in deposits and credits with banks, which represent the second key item in the structure of foreign exchange assets. As for foreign exchange liabilities, the shares of interbank deposits and deposits from non-bank clients remained broadly unchanged at slightly above 40% of the total. These figures converged during 1998, when banks accepted less funds from foreign banks. This resulted in a 3.8-point rise in the proportion of client deposits and a 6.4-point decrease in the proportion of interbank deposits.

6. OFF-BALANCE SHEET ACTIVITIES OF THE BANKING SECTOR

The rapid expansion of off-balance sheet activities is one of the new trends in the Czech banking sector in the last two years. As of 31 December 1998, off-balance sheet activities had reached CZK 1,947.5 billion, which represented about 80% of the total assets of the banking sector. Compared with a year earlier, the volume of off-balance sheet activities had increased by 62.2% and their share in total assets was up by 26.4 points.

Chart 22 Share of off-balance sheet assets in total assets

for banks with valid licences as of 31 Dec. 1998

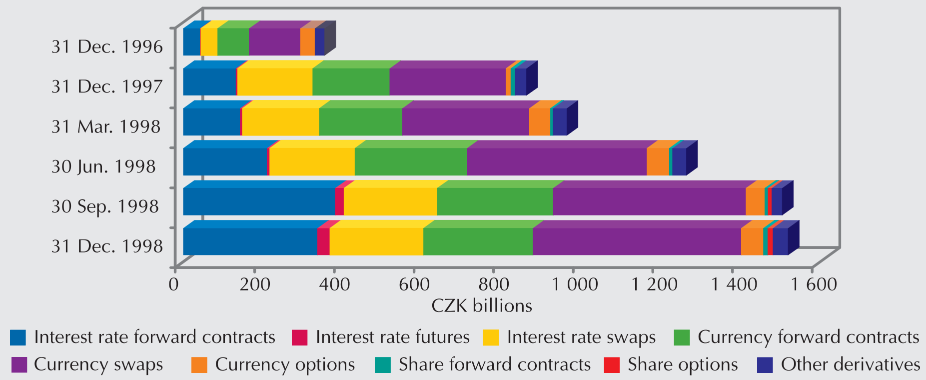


Futures, forwards and swaps are the main component of off-balance sheet activities, accounting for 73.7% as of 31 December 1998. Options are much less frequently used, with their share in total off-balance sheet activities fluctuating around 4% in the long run. Traditional banking activities, ie loan commitments, guarantees and letters of credit, are also diminishing in significance; their share was down 4.4 points against a year earlier to 14.9%.

The Czech derivatives market has seen a substantial expansion in the last two years. At present, this involves the interbank market and the market intermediated by foreign organisers. It is necessary to obtain a licence for derivatives trading from the Securities Commission. At present, there is much less trading in share options and forwards than in currency and interest rate derivatives. The commencement and subsequent development of derivatives trading on organised markets in the Czech Republic also depends on the granting of appropriate licences to securities traders, on investors' interest and on the range of instruments and specific items available.

Chart 23 Development and structure of derivatives

for banks with valid licences as of 31 Dec. 1998



Currency swaps, whose volume grew by almost 80% during 1998 to CZK 523.8 billion, account for the largest part of derivatives trading. Second are interest rate forward contracts, which saw even more radical growth during 1998, rising by 155% to CZK 337.1 billion as of 31 December 1998. A very high level and rapid expansion is also visible for currency forwards and interest rate swaps. This trend is set to continue, with the volumes of trading in the various products of the derivatives market expected to converge gradually towards those common in other countries.

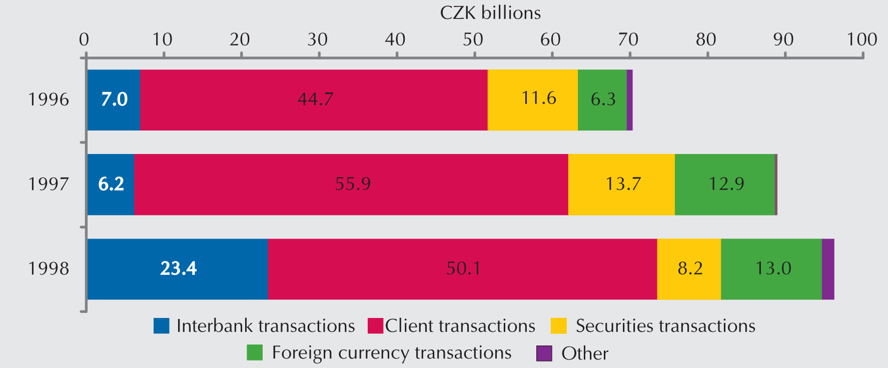
7. BANKING SECTOR PERFORMANCE

(for banks with valid licences as of 31 December 1998, excluding Konsolidační banka)

7.1 Profit from banking activities

Profit from banking activities amounted to CZK 96.3 billion, 8.3% higher than in 1997, with the major part coming from client operations, ie traditional deposit and credit transactions. However, the share of client operations in the overall profit structure has been gradually decreasing. In 1998, its share fell by 10.8 points to 52.1%, and for the first time this component also experienced an absolute decline (of CZK 5.8 billion to CZK 50.1 billion).

Chart 24 Structure of profit from banking activities
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka

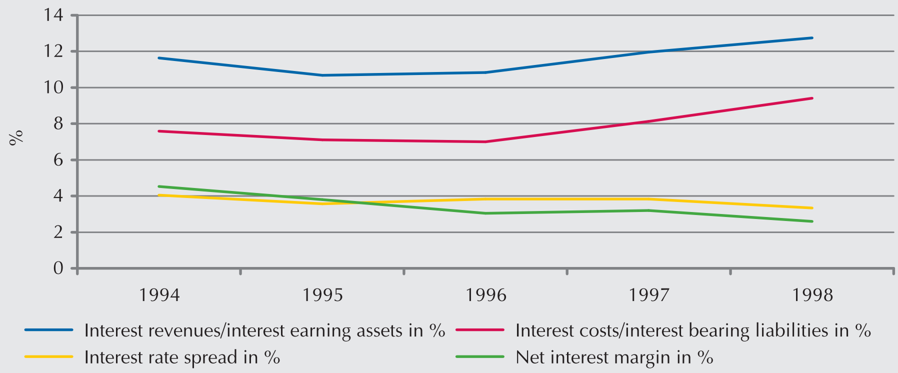


The share of client transactions dropped primarily in favour of interbank transactions, which almost quadrupled to CZK 23.4 billion. This is largely due to the subdued lending activity of the banking sector in 1998, coupled with a preference for interbank activities, particularly repo operations. Profit from foreign currency transactions remained roughly at the level seen in 1997, when, however, it was very high owing to the exchange rate turbulence in the middle of the year. Securities transactions showed both an absolute and a relative contraction in 1998, falling by CZK 5.5 billion to CZK 8.2 billion as of 31 December 1998 and showing an even more marked percentage decline of 6.9 points to 8.5%.

With respect to the type of profit, interest revenues have the greatest influence on profit from banking activities. These totalled CZK 58.5 billion in 1998, up 18.6% from 1997. Profits from fees and commissions, associated with interbank and cash transactions and client operations excluding securities and foreign currency transactions, increased by 12.3% to CZK 13.2 billion. Their weight in the total profit from banking activities was 13.7%, up 0.5 points against 1997.

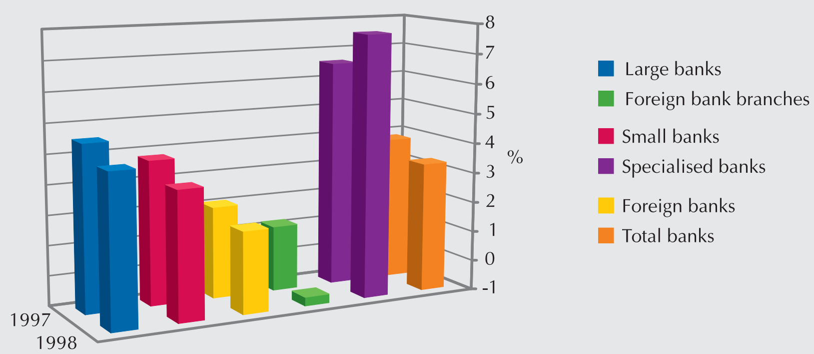
The faster growth in interest costs than that in interest revenues was reflected in another partial fall in the interest rate spread and net interest margin. The average profitability of credits rose by 0.8 points against 1997 to 12.76%, while average deposit costs were up 1.3 points to 9.44%. The rise in interest rates was felt mainly in the first three quarters of 1998. In Q4, because of the CNB’s intensive lowering of basic interest rates, client rates were also on the decrease. This, however, could not offset the rise from the major part of the year. Overall, the interest rate spread narrowed by 0.5 points to 3.32% and the net interest margin by 0.6 points to 2.59%.

Chart 25 Main indicators of profitability
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



In individual groups of banks, the interest rate spread differs substantially. Specialised banks are achieving the highest levels, thanks largely to building societies. Relatively high levels can also be seen in the large and small banks, which are having to maintain such levels because of a pressing need to create provisions and reserves. Nonetheless, the large banks experienced a slight drop against 1997 of 0.5 points to 4.01%. In contrast, in foreign banks and foreign bank branches the interest rate spread is moving at lower levels.

Chart 26 Comparison of interest rate spread by bank group
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



The overall return on assets (the ratio of revenues from banking activities to average assets) fell by just 0.1 points to 4.42% in 1998 for the banking sector as a whole and can be characterised as stable. Specialised banks achieved the highest level (7.96%), followed by the large banks (4.82%). The lowest figure was registered in small banks, with a mere 1.31% as of 31 December 1998.

7.2 Net profit

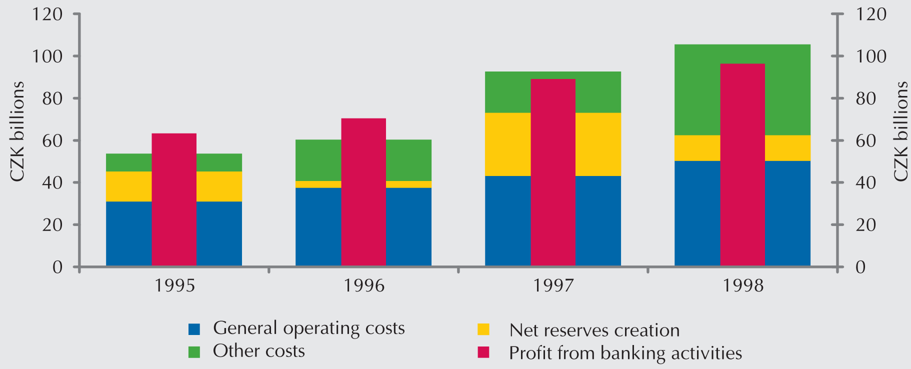
In recent years, net profit after tax has been affected above all by extensive provisioning to cover potential losses from the loan and securities portfolios. The second most important factor has been the operating costs of banking institutions.

The banking sector ended 1998 with a loss of CZK 9.0 billion. Three groups of banks ended 1998 in the black: foreign banks (CZK 1.1 billion), specialised banks including building societies (CZK 3.3 billion) and foreign bank branches (CZK 0.1 billion). On the other hand, the large banks and small banks lost CZK 11.3 billion and CZK 2.2 billion respectively.

The banking sector's loss was mainly due to high loan loss provisioning. This was reflected not only in the net volume of reserves and provisions created, which is transferred to the following year, but also in other operating costs, which include the direct use of provisions to write off receivables. In 1998, banks wrote off classified loans worth CZK 29.6 billion, ie roughly speaking they created provisions and reserves amounting to CZK 41.8 billion.

Chart 27 Net profit

for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



General operating costs – the second most important factor affecting net profit – generally account for about 50% of the profit from banking activities. The rise of 3.8 points to 52.4% in 1998 was mostly due to profit from banking activities rising less than operating costs. The rate of growth of profit from banking activities was around two thirds lower than in 1997; general operating costs grew two points faster than in 1997.

7.3 Efficiency and productivity

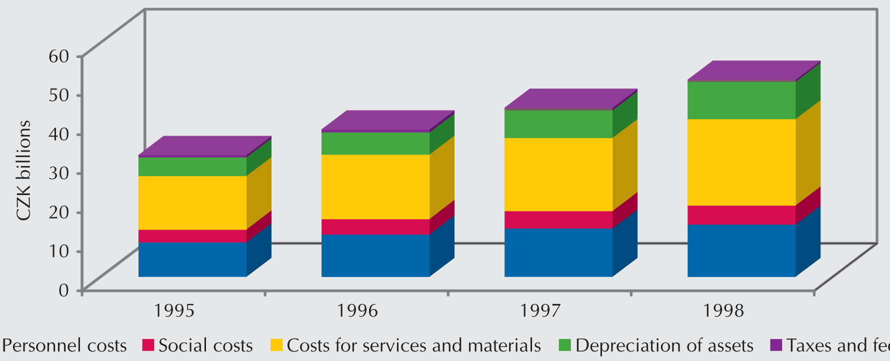
Banks operating in the Czech banking sector are continuing to focus on increasing the efficiency of their banking transactions. The optimisation of workforces and branch networks, in an attempt to boost productivity while maintaining the quality of services, continued into 1998.

The favourable trend in productivity and efficiency is confirmed by data on total assets per employee, which were up 8.2% against 1997 to CZK 43.6 billion as of 31 December 1998. Profit from banking activities per employee also rose, by CZK 136,000 to CZK 1.8 million as of 31 December 1998.

General operating costs were the key efficiency factor, reaching CZK 50.4 billion as of 31 December 1998, up 16.7% on a year earlier. The most important component is costs for services and materials. Their share in overall general costs has been constantly rising and totalled 43.9% as of 31 December 1998. A similar growth trend can also be seen for depreciation, which reflected extensive reconstructions of buildings leading in turn to their revaluation. In contrast, the share of personnel costs, though still the second most important item in general operating costs, is diminishing, falling by 2.1 points against 1997 to 26.5%. This indicates not only the reduction in the number of employees, but also lower wage increases compared with previous years. Wage and other personnel costs rose by 8.0% to CZK 13.4 billion in 1998, against 14.2% in 1997 and 23.3% in 1996.

Chart 28 General operating costs

for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



The contrasting trends in personnel costs and other operating costs, together with the falling workforce, fed through into different developments of these costs per employee. While operating costs per employee are still growing at virtually the same pace (annual increases of about 20% since 1996), the growth of wage and other personnel costs has gradually dropped from 20% in 1996 and 1997 to 7.7% in 1998.

Chart 29 Costs per employee

for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka

The rise in the productivity and efficiency of the banking sector is also confirmed by the trend in the ratio of profit from banking activities per employee to costs per employee. This ratio was 6.5 in 1996, 7.2 in 1997 and increased again slightly in 1998.

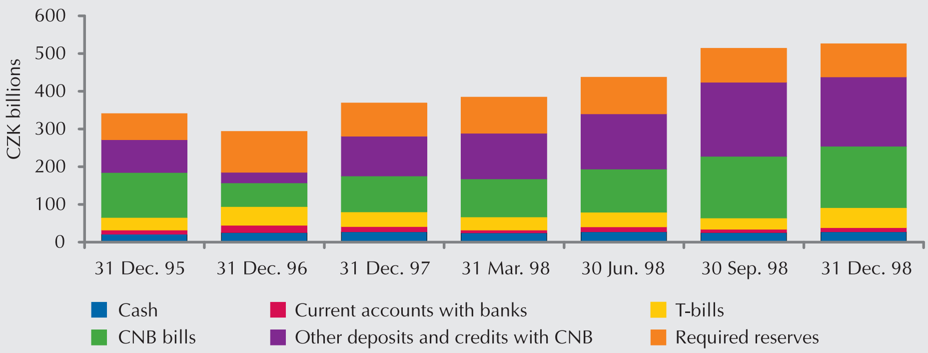
8. THE BANKING SECTOR WITH RESPECT TO PRUDENTIAL RULES

The main precondition for a stable banking sector is compliance with the prudential rules stipulated in individual CNB provisions. The environment in which the Czech banks are operating is still characterised by a high degree of risk. Czech banks are most exposed to credit and liquidity risks, but recently, with the development of off-balance sheet activities, market risk has also been on the increase.

8.1 Liquidity

The overall volume of quick assets – cash, current accounts with other banks, deposits and credits with the CNB (including required reserves), and Treasury and other bills – amounted to CZK 525.8 billion as of 31 December 1998, ie 21.5% of total assets. This share was 4.9 points higher than a year earlier. If the securities included in banks' trading portfolios are also considered liquid, the volume of liquid assets as of the end of 1998 was CZK 623.4 billion, which is 25.5% of the overall volume of assets.

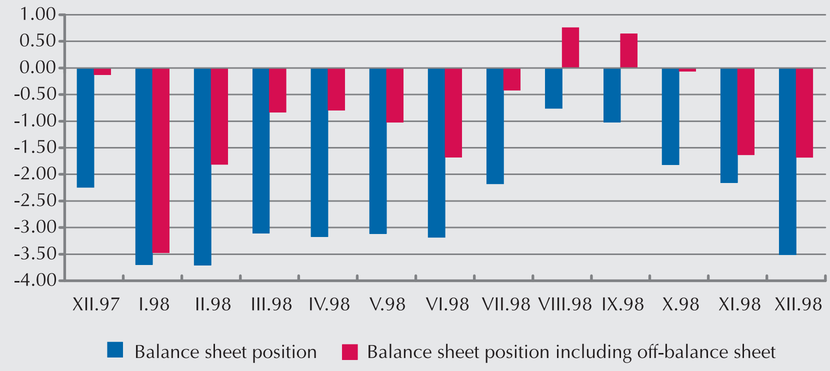
Chart 30 Quick assets
for banks with valid licences as of 31 Dec. 1998



Compared with the end of 1997, the overall volume of quick assets was up by 40.8%. This was mostly due to a preference for locating free funds in quick assets, which are less risky than credit transactions. The most sizeable increase in quick assets occurred in the first three quarters of 1998; at the end of the year the rise slowed as a consequence of progressive cuts in the CNB's key interest rates.

Deposits and credits lodged at the central bank, including required reserves, accounted for the highest share of quick assets. These totalled CZK 271.5 billion as of 31 December 1998, or more than half the overall volume of quick assets. The second largest item (with a 41.1% share) was Treasury and other bills, up 5.3 points against 1997. The share of cash and current accounts with other commercial banks in the total volume of liquid assets was negligible.

Chart 31 Cumulative net position as % of assets
for banks with valid licences as of 31 Dec. 1998



An important part of liquidity management is the harmonisation of maturities between the asset and liability items of the balance sheet. Taking into account the certain degree of constancy of demand deposits, the structure of assets and liabilities in the banking sector as a whole is relatively balanced in the long run. In relation to total assets, the absolute value of the difference between the volume of balance sheet assets and liabilities with maturities of up to three months is below 4%; if off-balance sheet items are included, the situation is even more favourable.

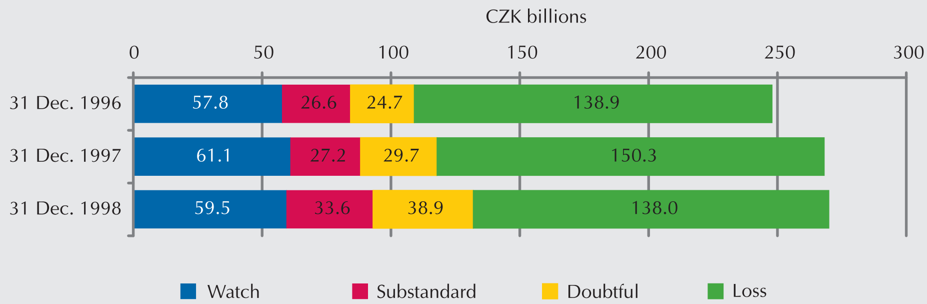
8.2 Quality of assets

(for banks with valid licences as of 31 December 1998, excluding Konsolidační banka)

Credit portfolio quality remains one of the main problems of the Czech banking sector. The large proportion of classified loans in bank portfolios has its origin largely in the period of transformation and privatisation of the economy, but the current recession has also begun to make its mark. Nevertheless, banks have improved their methods for granting credit in the last two years, especially with respect to assessing client creditworthiness. The curtailment of lending activities is a logical consequence of tighter internal credit-granting procedures.

The overall volume of classified loans as of 31 December 1998 was CZK 270.0 billion, or 0.7% more than a year earlier. This relatively positive development is the result of a comparatively high level of write-offs of loss receivables against provisions.

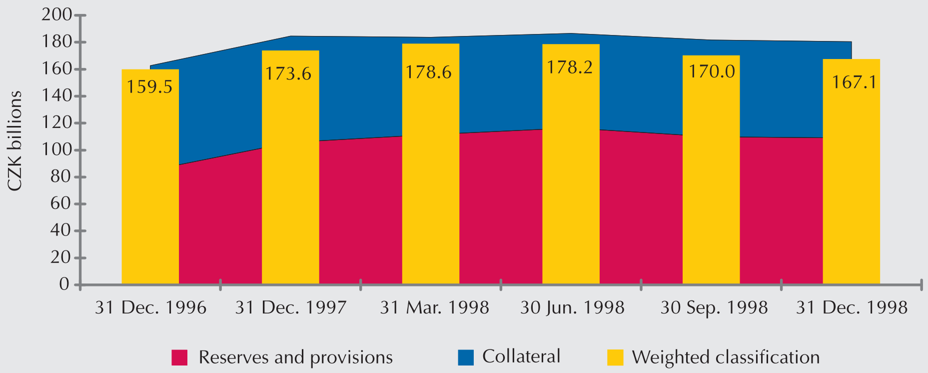
Chart 32 Structure of classified credits
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



Loss loans made up the major part of classified credits, accounting for 51.1% as of 31 December 1998, down by 4.9 points from a year earlier. Watch and substandard credits, ie those with the lowest risk, accounted for 34.5% of the total volume of credits at the end of 1998, up 1.6 points against a year earlier. This relatively high proportion of low-risk credits is connected with the current practice of many banks of classifying all new clients in these lowest categories and transferring them to the standard category only after verifying their creditworthiness.

The share of classified credits in overall credits granted rose by 0.2 points during 1998 to 27.1%. This still large volume of classified credits ensues primarily from banks' inability to recover their claims by seizing collateral, particularly in the case of real estate. The main reason for this situation remains the complicated legal processes. Another reason is the unwillingness of some banks to write off loss receivables against provisions. In particular, the holding of loss loans in the banks' balance sheets is leading to further increases in these loans through the capitalisation of unpaid interest.

Chart 33 Coverage of potential losses from the credit portfolio
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka

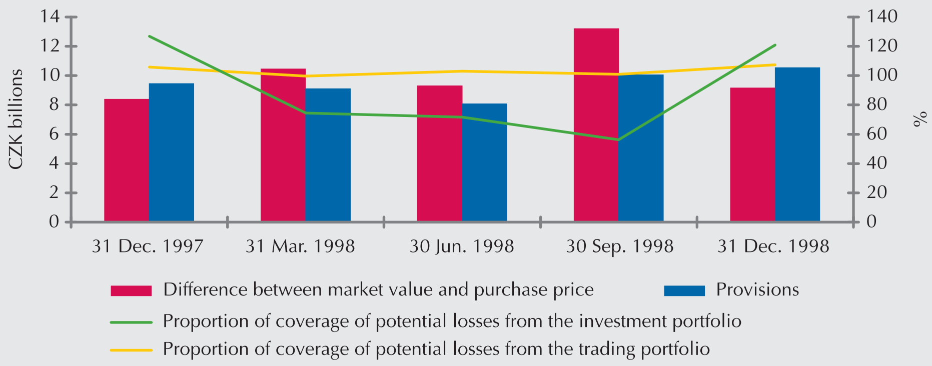


The favourable developments in the structure of classified loans fed through into a fall in the weighted classification, which reflects the risk-weighted structure of classified loans. This was down by 3.7% to CZK 167.1 billion against the end of 1997.

To cover potential losses, banks have to create loan loss provisions in accordance with the CNB Provision regulating credit classification. As of 31 December 1998, total reserves and provisions created for this purpose amounted to CZK 109.1 billion, up by 3.2% from a year earlier despite CZK 29.6 billion of them being used for direct write-offs of loss receivables. Reserves and provisions covered 65.3% of the volume of the weighted classification. The remainder was covered by high-quality collateral, which exceeded the necessary volume by roughly CZK 13 billion.

Securities are the second most important risk component of assets. Banks provision for the securities in their investment portfolios and in their trading portfolios separately and under different rules. The main risks ensuing from the inclusion of a substantial volume of securities in a bank's balance sheet are fluctuations in market prices and the limited liquidity of many issues.

Chart 34 Coverage of potential losses from the securities portfolio
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



The provisions set aside for securities in trading portfolios were sufficient throughout 1998 to cover the deficit generated by the fall in market prices against the original purchase prices. This is in compliance with CNB regulations, which require provisioning in such cases for the negative differences between market value and purchase price on a daily basis. With respect to the investment portfolio, this obligation is set on an annual basis, which explains the certain shortage of provisions during 1998. However, as of the end of 1998 all differences in the investment portfolio had been covered. The total volume of provisioning stood at CZK 10.6 billion as of 31 December 1998 and exceeded the required volume by CZK 1.4 billion.

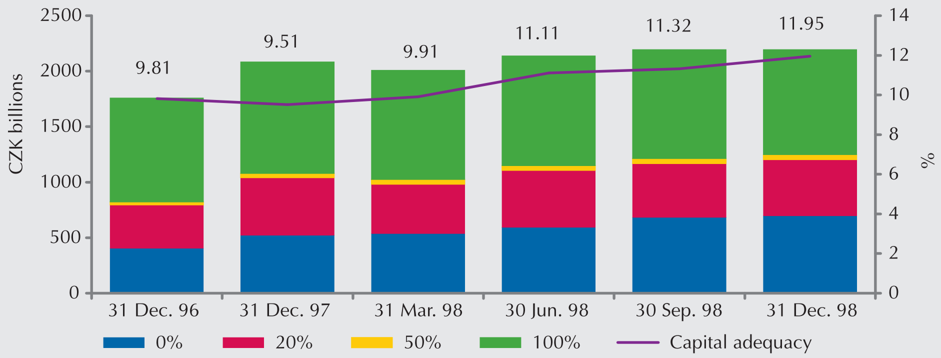
8.3 Capital adequacy

(for banks with valid licences as of 31 December 1998, excluding Konsolidační banka)

Capital adequacy is a basic and internationally applied standard for expressing the real level of capital in individual banks. The level of capital adequacy of Czech banks is being negatively affected by the current pressure to create reserves and provisions. These negative effects take the form either of growth in deductible items from the bank's capital (if provisioning is the cause of the bank's overall loss) or of a lower volume of profit that may be used to boost reserve funds or initial capital.

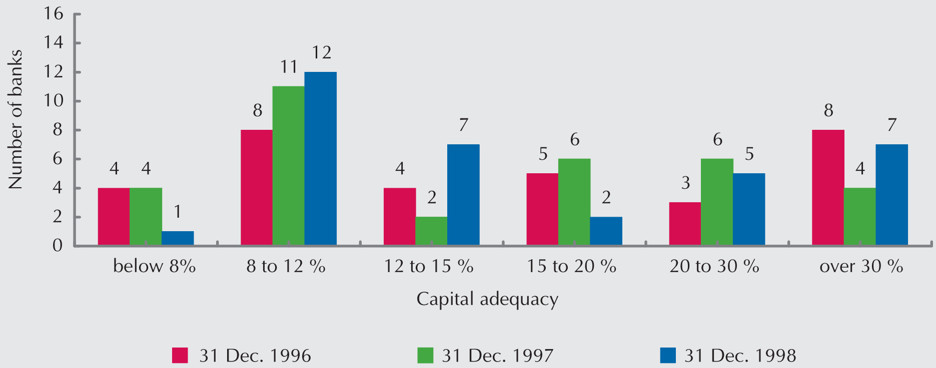
The overall volume of banking sector capital was CZK 127.6 billion as of 31 December 1998, 19.1% higher than a year earlier. This growth stemmed from an increase in initial capital of CZK 10.6 billion to CZK 70.7 billion, in particular a rise in supplementary capital in the form of subordinated debt, which almost quadrupled in comparison with a year earlier. The volume of risk-weighted assets fell by 5.2% to CZK 1,067.8 million, largely because of the curtailed lending activity and the preference given to quick assets, which have lower risk weight in the capital adequacy calculation. These favourable developments resulted in capital adequacy increasing by 2.5 points during 1998 to 12.0%.

Chart 35 Structure of assets by risk weight
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



Of the 34 banks with valid licences (excluding foreign bank branches), only one failed to meet the 8% minimum capital adequacy requirement as of 31 December 1998. The largest number of banks is concentrated in the group with capital adequacy of 8%–12%. The 12% level, often recommended by experts for banks operating in the higher-risk environment of the Czech economy, was exceeded by 21 banks as of the end of 1998, a year-on-year increase of 3 banks.

Chart 36 Banks by capital adequacy
for banks with valid licences as of 31 Dec. 1998, excluding Konsolidační banka



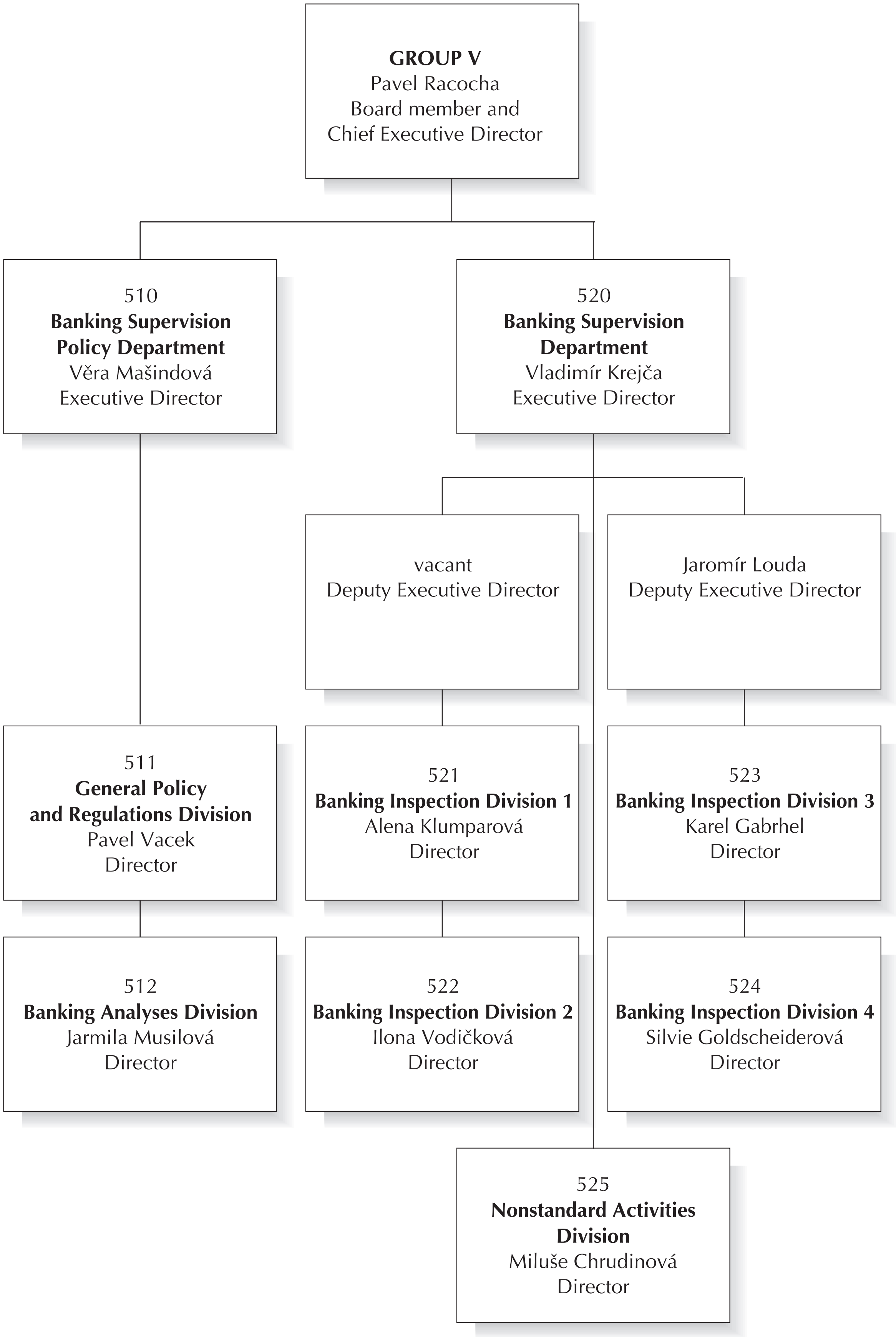
The present calculation of capital adequacy includes only credit risk. From the year 2000, capital adequacy will be evaluated also with respect to market risks in compliance with a Provision currently being prepared by the CNB banking supervisor. This Provision is fully compliant with EU directives.

C.

APPENDICES

Organisational structure of Banking Supervision

as of 31 May 1999



BREAKDOWN OF BANKS INTO GROUPS

I. Large banks

1. Česká spořitelna, a.s.
2. Československá obchodní banka, a.s
3. INVESTIČNÍ A POŠTOVNÍ BANKA, a.s.
4. Komerční banka, a.s.
5. Konsolidační banka, s.p.ú.

II. Small banks

1. BANKA HANÁ, a.s.
2. Foresbank, a.s.
3. Moravia banka, a.s.
4. PLZEŇSKÁ BANKA, a.s.
5. První městská banka, a.s.
6. Union banka, a.s.
7. UNIVERSAL BANKA, a.s.
8. EXPANDIA BANKA, a.s.

III. Foreign banks

1. Bank Austria Creditanstalt Czech Republic a.s.
2. BNP-Dresdner Bank (ČR), a.s.
3. Citibank, a.s.
4. CREDIT LYONNAIS BANK PRAHA, a.s.
5. Erste Bank Sparkassen (CR) a.s.
6. GE Capital Bank, a.s.
7. HypoVereinsbank CZ a.s.
8. IC Banka, a.s. Praha
9. Interbanka, a.s.
10. J & T Banka, a.s.
11. Raiffeisenbank a.s.
12. VOLKSBANK CZ, a.s.
13. Živnostenská banka, a.s.

IV. Foreign bank branches

1. ABN AMRO BANK N.V.
2. COMMERZBANK AG
3. Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka
4. ING Bank N.V.
5. Midland Bank plc - pobočka Praha

6. Raiffeisenbank im Stiftland Waldsassen eG, odštěpný závod Cheb
7. SOCIETE GENERALE, pobočka PRAHA
8. Sparkasse Mühlviertel - West banka, pobočka České Budějovice
9. Všeobecná úverová banka, a.s., pobočka Praha
10. Waldviertler Sparkasse von 1842

V. Specialised banks

1. Raiffeisen stavební spořitelna a.s.
2. Českomoravská stavební spořitelna, a.s.
3. ČS-stavební spořitelna, a.s.
4. HYPO stavební spořitelna, a.s.
5. Všeobecná stavební spořitelna Komerční banky, a.s.
6. Wüstenrot-Stavební spořitelna, a.s.
7. Českomoravská záruční a rozvojová banka, a.s.
8. Českomoravská hypoteční banka, a.s.
9. Česká exportní banka, a.s.

Survey of banks and foreign bank branches operating in the Czech Republic as of 31 December 1998

I. Banks

Bank	Start of operation	Initial capital in CZK millions	Number of banking units		Number of employees
			in CR	abroad	
Česká spořitelna, a.s.	1 Jan. 1969	7 600	1 011	3	16 580
Československá obchodní banka, a.s	1 Jan. 1965	5 105	44	18	4 955
INVESTIČNÍ A POŠTOVNÍ BANKA, a.s.	1 Jan. 1990	13 383	201	5	4 956
Komerční banka, a.s.	1 Jan. 1990	9 502	355	6	14 097
Konsolidační banka, s.p.ú.	23 Feb. 1993	5 950	0	0	372
BANKA HANÁ, a.s.	11 Jan. 1991	5 101	98	0	856
Foresbank, a.s.	7 Sep. 1993	1 027	0	0	22
Moravia banka, a.s.	2 Jul. 1992	1 000	16	1	431
PLZEŇSKÁ BANKA, a.s.	1 Oct. 1993	1 000	1	0	49
První městská banka, a.s.	1 Sep. 1993	612	0	0	186
Union banka, a.s.	15 Nov. 1991	1 940	98	2	1 335
UNIVERSAL BANKA, a.s.	15 Feb. 1993	1 600	16	0	324
EXPANDIA BANKA, a.s.	1 Jan. 1991	500	0	0	216
Bank Austria Creditanstalt Czech Republic a.s.	1 Apr. 1991	1 997	16	0	705
BNP-Dresdner Bank (ČR), a.s.	12 May 1992	1 000	1	0	152
Citibank, a.s.	24 Jun. 1991	1 825	5	0	323
CREDIT LYONNAIS BANK PRAHA, a.s.	12 Nov. 1992	500	1	0	118
Erste Bank Sparkassen (CR) a.s.	1 Feb. 1993	700	6	0	201
GE Capital Bank, a.s.	22 Jun. 1998	500	276	0	2 483
HypoVereinsbank CZ a.s.	1 Jul. 1992	5 047	27	0	466
IC Banka, a.s. Praha	6 Apr. 1994	500	1	0	35
Interbanka, a.s.	1 Feb. 1991	1 359	0	0	95
J & T Banka, a.s.	18 Dec. 1992	501	0	0	47
Raiffeisenbank a.s.	1 Jul. 1993	1000	10	0	316
VOLKSBANK CZ, a.s.	1 Jan. 1994	650	8	0	132
Živnostenská banka, a.s.	1868	1 360	5	2	634
Raiffeisen stavební spořitelna a.s.	7 Sep. 1993	500	0	0	391
Českomoravská stavební spořitelna, a.s.	8 Sep. 1993	1 000	5	0	391
ČS-stavební spořitelna, a.s.	1 Jul. 1994	500	0	0	204
HYPO stavební spořitelna, a.s.	1 Oct. 1994	500	0	0	46
Všeobecná stavební spořitelna Komerční banky, a.s.	16 Dec. 1993	500	0	0	269
Wüstenrot-Stavební spořitelna, a.s.	11 Nov. 1993	500	0	0	130
Českomoravská záruční a rozvojová banka, a.s.	1 Mar. 1992	890	5	0	221
Českomoravská hypoteční banka, a.s.	10 Jan. 1991	1 128	20	0	337
Česká exportní banka, a.s.	1 Jul. 1995	1 500	0	0	97

II. Foreign bank branches

Bank	Start of operation	Home country	Number of banking units		Number of employees
			in CR	abroad (country)	
ABN AMRO BANK N.V.	6 May 1993	Netherlands	1	0	133
COMMERZBANK AG	1 Dec. 1992	Germany	1	0	162
Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka	1 Dec. 1993	Germany	0	0	84
ING Bank N.V.	1 Sep. 1993	Netherlands	0	0	166
Midland Bank plc - pobočka Praha	1 May 1997	Great Britain	0	0	26
Raiffeisenbank im Stiftland Waldsassen eG, odštěpný závod Cheb	2 Jan. 1995	Germany	0	0	20
SOCIETE GENERALE, pobočka PRAHA	15 Apr. 1991	France	2	0	165
Sparkasse Mühlviertel - West banka, pobočka České Budějovice	20 Mar. 1995	Austria	3	0	45
Všeobecná úverová banka, a.s., pobočka Praha	14 Jan. 1993	Slovakia	2	0	87
Waldviertler Sparkasse von 1842	1 May 1994	Austria	1	0	24

III. Banks in liquidation

Bank	Start of operation	Licence revocation
AB Banka, a.s.	1 Apr. 1991	15 Dec. 1995
Agrobanka Praha, a.s.	1 Jul. 1990	2 Sep. 1998
Banka Bohemia, a.s.	1 Feb. 1991	not revoked
Baska a.s.	13 Dec. 1990	31 Mar. 1997
Ekoagrobanka, a.s.	1 Nov. 1990	31 May 1997
Evrobanka, a.s.	1 Oct. 1991	30 Jun. 1997

IV. Banks in bankruptcy proceedings

Bank	Start of operation	Licence revocation	Beginning of bankruptcy proceedings
Česká banka, a.s.	28 Feb. 1992	14 Dec. 1995	28 Jun. 1996
Kreditní a průmyslová banka, a.s.	1 Apr. 1991	31 Aug. 1995	2 Oct. 1995
První slezská banka a.s.	12 Jan. 1993	13 May 1996	20 Nov. 1997
Realitbanka,a.s.	1 Nov. 1991	17 Apr. 1997	24 Mar. 1997
Velkomoravská banka, a.s.	3 Nov. 1992	10 Jul. 1998	2 Jul. 1998
Pragobanka, a.s.	1 Oct. 1990	24 Oct. 1998	19 Nov. 1998
Kreditní banka Plzeň, a.s.	1 Jan. 1991	8 Aug. 1996	21 Dec. 1998

V. Banks with licences revoked

Bank	Start of operation	Licence revocation
COOP BANKA, a.s.	24 Feb. 1992	6 May 1998

VI. Banks dissolved without liquidation

Bank	Start of operation	Licence termination	Reasons
Poštovní banka, a.s.	1 Jan 1991	1 Jan 1994	merger
Bank Austria a.s.	1 Jan 1992	30 Jun 1998	merger
Westdeutsche Landesbank (CZ), a.s.	operation not started	20 Jan 1998	operation not started
HYPO-BANK CZ a.s.	26 Feb 1992	31 Dec 1998	merger

Main indicators of monetary and economic developments in the Czech Republic

		1996	1997	1998
Gross domestic product	Value (in CZK billions) 1)	1 269.4	1 281.8	1 247.7
	Increase (%) 2)	3.9	1.0	-2.7
Output - increase in % 2)	Industry	2.0	4.5	1.6
	Construction	5.3	-3.9	-7.0
Prices	Inflation rate (%)	8.8	8.5	10.7
Unemployment 3)	Unemployment rate (%)	3.5	5.2	7.5
Foreign trade	Exports (in USD millions)	21 907.0	22 778.0	26 349.0
	Imports (in USD millions)	27 716.0	27 167.0	28 716.0
	Balance (in USD millions)	-5 809.0	-4 389.0	-2 367.0
Average wage 2)	Nominal (%)	18.4	10.5	9.3
	Real (%)	8.8	1.9	-1.3
Balance of payments	Current acount (in USD millions)	-4 292.2	-3 211.0	-1 046.1
	Financial acount (in USD millions)	4 296.7	1 081.9	2 630.7
Exchange rate 4)	CZK/USD	27.1	31.7	32.3
	CZK/DEM	18.1	18.3	18.3
Average interbank deposit	7 day	12.1	18.4	14.2
rate (PRIBOR) (%) 4)	3 month	12.0	16.0	14.3
	1 year	11.8	14.6	14.1
Discount rate (%) 3)		10.5	13.0	7.5
Lombard rate (%) 3)		14.0	23.0	12.5

1) 1994 constant prices
2) Increase in % against same period of previous year
3) End-of-period data
4) Annual averages

Assets

(banks with valid licences as of 31 December 1998)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
	in CZK millions					
Cash	25 583	27 256	24 781	27 814	25 172	27 169
Deposits and credits with CNB	136 128	193 780	216 957	243 821	286 759	271 497
of which required reserves	107 884	88 078	95 686	97 244	90 052	87 583
Deposits and credits with banks	386 638	487 702	405 569	498 574	467 100	498 958
of which: current accounts	19 512	18 937	12 349	24 535	18 439	18 169
time deposits	275 712	394 519	320 722	402 010	380 212	392 223
credits granted	91 415	74 246	72 498	72 029	68 448	88 566
T-bills	49 399	38 964	34 334	39 312	29 862	53 394
CNB bills	62 750	94 470	100 349	113 598	163 130	162 532
Credits granted	878 533	1 000 294	990 919	1 029 680	1 027 863	1 018 327
of which: to clients	874 386	985 468	972 141	1 006 315	1 005 613	992 915
to state and municipal authorities	4 146	14 827	18 777	23 366	22 249	25 412
Tradable securities	167 305	98 742	103 202	101 906	96 190	97 514
of which: debt securities	131 771	84 972	90 624	92 450	84 772	87 162
equity securities	33 528	10 052	8 787	6 157	6 361	4 651
Investment securities	19 980	91 197	93 738	94 822	98 865	92 878
Tangible and intangible assets	58 745	62 942	62 522	80 086	80 713	79 608
Other assets	125 723	152 030	147 209	142 932	152 959	138 866
Total assets	1 910 785	2 247 377	2 179 580	2 372 546	2 428 611	2 440 741
	in %					
Cash	1.34	1.21	1.14	1.17	1.04	1.11
Deposits and credits with CNB	7.12	8.62	9.95	10.28	11.81	11.12
of which required reserves	5.65	3.92	4.39	4.10	3.71	3.59
Deposits and credits with banks	20.23	21.70	18.61	21.01	19.23	20.44
of which: current accounts	1.02	0.84	0.57	1.03	0.76	0.74
time deposits	14.43	17.55	14.71	16.94	15.66	16.07
credits granted	4.78	3.30	3.33	3.04	2.82	3.63
T-bills	2.59	1.73	1.58	1.66	1.23	2.19
CNB bills	3.28	4.20	4.60	4.79	6.72	6.66
Credits granted	45.98	44.51	45.46	43.40	42.32	41.72
of which: to clients	45.76	43.85	44.60	42.41	41.41	40.68
to state and municipal authorities	0.22	0.66	0.86	0.98	0.92	1.04
Tradable securities	8.76	4.39	4.73	4.30	3.96	4.00
of which: debt securities	6.90	3.78	4.16	3.90	3.49	3.57
equity securities	1.75	0.45	0.40	0.26	0.26	0.19
Investment securities	1.05	4.06	4.30	4.00	4.07	3.81
Tangible and intangible assets	3.07	2.80	2.87	3.38	3.32	3.26
Other assets	6.58	6.76	6.75	6.02	6.30	5.69
Total assets	100.00	100.00	100.00	100.00	100.00	100.00

Liabilities

(banks with valid licences as of 31 December 1998)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
	in CZK millions					
Resources from CNB	67 509	73 929	59 204	78 454	61 081	52 843
Deposits and credits from banks	447 359	509 705	454 863	513 921	485 318	505 153
of which: current accounts	16 754	19 552	16 209	21 640	17 630	12 202
time deposits	317 441	366 693	313 097	368 096	334 269	343 906
credits received	113 163	123 461	125 557	124 185	133 419	149 046
Deposits accepted	952 877	1 108 537	1 075 361	1 144 181	1 161 363	1 205 323
of which: from clients	919 494	1 076 915	1 041 054	1 105 255	1 121 628	1 169 422
from state and municipal authorities	28 823	30 105	33 040	36 805	38 594	33 703
deposit certificates	4 560	1 517	1 267	2 120	1 141	2 199
Bond issues	62 940	92 724	96 421	98 843	93 435	92 588
Reserves	35 874	40 297	34 997	43 877	43 515	41 747
Reserve funds	63 673	72 350	71 666	74 094	74 031	73 959
Capital funds	18 703	19 449	19 368	13 672	33 401	34 017
Initial capital	58 378	66 829	71 972	74 858	76 688	76 882
Retained profit	1 853	1 332	11 136	3 513	2 983	2 110
Current year profit	14 445	11 185	4 602	9 323	12 114	11 160
Other liabilities	187 175	251 042	279 991	317 809	384 682	344 960
Total liabilities	1 910 785	2 247 377	2 179 580	2 372 546	2 428 611	2 440 741
	in %					
Resources from CNB	3.53	3.29	2.72	3.31	2.52	2.17
Deposits and credits from banks	23.41	22.68	20.87	21.66	19.98	20.70
of which: current accounts	0.88	0.87	0.74	0.91	0.73	0.50
time deposits	16.61	16.32	14.37	15.51	13.76	14.09
credits received	5.92	5.49	5.76	5.23	5.49	6.11
Deposits accepted	49.87	49.33	49.34	48.23	47.82	49.38
of which: from clients	48.12	47.92	47.76	46.59	46.18	47.91
from state and municipal authorities	1.51	1.34	1.52	1.55	1.59	1.38
deposit certificates	0.24	0.07	0.06	0.09	0.05	0.09
Bond issues	3.29	4.13	4.42	4.17	3.85	3.79
Reserves	1.88	1.79	1.61	1.85	1.79	1.71
Reserve funds	3.33	3.22	3.29	3.12	3.05	3.03
Capital funds	0.98	0.87	0.89	0.58	1.38	1.39
Initial capital	3.06	2.97	3.30	3.16	3.16	3.15
Retained profit	0.10	0.06	0.51	0.15	0.12	0.09
Current year profit	0.76	0.50	0.21	0.39	0.50	0.46
Other liabilities	9.80	11.17	12.85	13.40	15.84	14.13
Total liabilities	100.00	100.00	100.00	100.00	100.00	100.00

Off-balance sheet assets

(banks with valid licences as of 31 December 1998)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
	in CZK millions					
Credit and loan commitments provided	73 223	108 829	98 551	108 624	134 436	155 082
Receivables from guarantees	97 366	103 340	100 328	100 985	120 471	119 772
Receivables from letters of credit	x	19 225	18 337	19 784	17 041	15 462
Receivables from spot transactions	60 523	106 843	287 811	340 986	315 402	138 211
Receivables from futures, forwards, swaps	307 694	831 169	884 933	1 191 439	1 441 845	1 434 459
Receivables from options transactions	47 057	31 029	78 452	72 312	62 365	84 508
Total off-balance sheet assets	585 862	1 200 436	1 468 413	1 834 129	2 091 639	1 947 494
	in %					
Credit and loan commitments provided	12.50	9.07	6.72	5.92	6.43	7.96
Receivables from guarantees	16.62	8.61	6.83	5.51	5.76	6.15
Receivables from letters of credit	0.00	1.60	1.25	1.08	0.81	0.79
Receivables from spot transactions	10.33	8.90	19.60	18.59	15.08	7.10
Receivables from futures, forwards, swaps	52.52	69.24	60.26	64.96	68.94	73.66
Receivables from options transactions	8.03	2.58	5.34	3.94	2.98	4.34
Total off-balance sheet assets	100.00	100.00	100.00	100.00	100.00	100.00

Off-balance sheet liabilities

(banks with valid licences as of 31 December 1998)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
	in CZK millions					
Credit and loan commitments accepted	9 781	30 051	27 512	35 886	32 010	34 125
Payables from guarantees	130 891	218 493	213 219	218 519	228 824	276 282
Payables from letters of credit	4 587	1 106	1 117	1 443	1 421	758
Payables from spot transactions	60 849	103 698	284 071	336 045	316 795	137 892
Payables from futures, forwards, swaps	319 853	823 115	910 391	1 201 046	1 420 396	1 406 622
Payables from options transactions	46 560	31 293	78 003	72 052	61 522	83 136
Total off-balance sheet liabilities	572 521	1 207 756	1 514 313	1 864 991	2 060 967	1 938 815
	in %					
Credit and loan commitments accepted	1.71	2.49	1.82	1.92	1.55	1.76
Payables from guarantees	22.86	18.09	14.08	11.72	11.10	14.25
Payables from letters of credit	0.80	0.09	0.07	0.08	0.07	0.04
Payables from spot transactions	10.63	8.59	18.76	18.02	15.37	7.11
Payables from futures, forwards, swaps	55.87	68.15	60.12	64.40	68.92	72.55
Payables from options transactions	8.13	2.59	5.15	3.86	2.99	4.29
Total off-balance sheet liabilities	100.00	100.00	100.00	100.00	100.00	100.00

Revenues and costs

(banks with valid licences as of 31 December 1998, excluding Konsolidační banka, in CZK millions)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Interest earned	132 785	173 081	50 607	102 598	160 047	211 190
Interest paid	92 473	123 813	36 339	73 246	115 214	152 737
Interest yield	40 313	49 268	14 268	29 352	44 833	58 452
Fees and commissions earned	12 167	13 348	3 354	7 025	10 582	14 641
Fees and commissions paid	1 426	1 614	282	624	974	1 459
Fee and commission profit	10 742	11 735	3 071	6 400	9 608	13 183
Interest yield incl. fee and commission profit	51 054	61 002	17 339	35 752	54 441	71 635
Securities revenues	11 638	13 713	1 780	4 754	7 266	8 183
Foreign exchange operations revenues	6 258	12 852	3 535	7 216	10 577	13 001
Other banking operations revenues	1 346	1 366	750	1 520	2 444	3 457
Profit from banking activities	70 295	88 932	23 404	49 242	74 727	96 276
General operating costs	37 708	43 234	10 075	22 063	33 448	50 439
Reserve and provision creation (net)	3 167	30 028	5 748	11 329	8 528	12 181
Other operating revenues (costs)	-19 135	-18 862	-3 898	-15 597	-30 528	-41 494
Gross operating profit	10 285	-3 191	3 683	252	2 224	-7 839
Extraordinary revenues (costs)	252	707	17	58	144	1 880
Pre-tax gross profit	10 537	-2 485	3 700	310	2 368	-5 958
Taxes	445	1 082	677	951	1 604	3 067
Net profit	10 092	-3 567	3 024	-641	764	-9 025

Profitability and efficiency

(banks with valid licences as of 31 December 1998, excluding Konsolidační banka)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Profit from banking activities/assets in %	4.19	4.55	4.54	4.71	4.57	4.42
Gross profit/assets in %	0.63	-0.13	0.72	0.03	0.14	-0.27
Net profit/assets in %	0.60	-0.18	0.59	-0.06	0.05	-0.41
Net profit/core capital in %	19.61	-6.34	19.51	-1.99	1.52	-13.44
Total interest revenues/interest earning assets in %	10.83	11.95	12.83	12.83	12.86	12.76
Total interest costs/interest bearing liabilities in %	6.99	8.13	9.22	9.27	9.49	9.44
Interest rate spread in %	3.83	3.83	3.62	3.56	3.37	3.32
Net interest margin in %	3.05	3.21	3.08	2.98	2.63	2.59
Number of employees in banking sector	54 461	52 250	51 469	53 959	53 203	52 388
Per employee in CZK thousands:						
total assets	32 884	40 331	39 890	41 234	42 728	43 623
profit from banking activities	1 291	1 702	1 819	1 825	1 873	1 838
net profit	185	-68	235	-24	19	-172
operating costs	692	827	783	818	838	963

Credits

(banks with valid licences as of 31 December 1998;
credits granted in the Czech Republic; up to 1996 only CZK credits; from 1997 including credits in foreign currencies)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Total credits	785 917	1 072 101	1 078 160	1 132 254	1 127 638	1 127 665
of which: short-term	333 240	445 494	440 721	485 107	462 456	459 632
medium-term	187 690	247 835	246 694	246 689	255 267	254 736
long-term	264 987	378 772	390 745	400 458	409 915	413 297
Total credits	785 917	1 072 101	1 078 160	1 132 254	1 127 638	1 127 665
of which: to public sector	142 505	146 322	151 035	128 781	124 435	122 006
to private sector	538 654	772 724	766 972	818 148	816 055	790 403
to government sector	3 163	15 410	19 153	23 477	25 395	28 308
to small businesses	53 854	54 789	53 312	51 885	48 267	44 125
to households	37 414	49 782	50 525	54 443	58 004	63 313
other	10 327	33 074	37 163	55 520	55 482	79 510
of which: agriculture and forestry	28 797	29 092	32 250	34 500	31 490	29 481
manufacturing	259 737	333 080	334 313	352 649	320 989	321 517
construction	27 003	32 653	33 710	35 294	33 213	32 177
finance and insurance	33 938	63 693	59 930	70 975	105 557	76 418
transport and travel	15 342	32 244	32 006	32 597	32 687	29 787
trade and catering	181 923	238 741	240 644	239 342	235 698	225 120
other activities	239 177	342 598	345 307	366 897	368 004	413 165

Deposits

(banks with valid licences as of 31 December 1998;
deposits accepted in the Czech Republic; up to 1996 only CZK deposits; from 1997 including deposits in foreign currencies)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Total deposits	856 892	1 096 402	1 060 384	1 125 203	1 142 341	1 160 997
of which: demand	326 265	369 646	325 110	350 508	339 830	372 019
time	530 627	726 756	735 274	774 695	802 511	788 978
of which: short-term	322 345	509 310	524 540	557 793	587 648	570 465
medium-term	150 246	123 443	113 574	112 002	108 248	107 878
long-term	58 036	94 003	97 160	104 900	106 615	110 635
Total deposits	856 892	1 096 402	1 060 384	1 125 203	1 142 341	1 160 997
of which: public sector	82 575	55 459	48 717	52 826	53 409	44 961
private sector	236 496	286 895	247 000	255 020	257 626	270 816
government sector	26 442	31 061	34 313	38 504	41 241	37 281
small businesses	34 287	39 740	33 622	43 623	44 442	36 951
households	465 395	650 996	667 561	705 099	720 649	745 389
other	11 697	32 251	29 171	30 131	24 974	25 599
of which: agriculture and forestry	17 624	8 807	9 453	11 171	11 648	10 202
manufacturing	93 532	72 195	56 476	59 757	55 833	62 664
construction	24 971	20 918	16 543	18 424	19 164	22 150
finance and insurance	38 735	69 625	57 168	58 589	54 828	64 062
transport and travel	15 543	11 522	11 119	12 382	12 025	10 587
trade and catering	67 456	74 328	60 937	67 320	67 519	69 946
other activities	599 031	839 007	848 688	897 560	921 324	921 386

Capital, risk weighted assets and capital adequacy

(banks with valid licences as of 31 December 1998, excluding Konsolidační banka)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec
Core capital in CZK millions	93 380	96 978	101 540	103 593	105 912	100 732
Total capital in CZK millions	100 790	107 207	108 276	123 464	124 371	127 634
Total assets in CZK millions	1 758 756	2 083 841	2 007 643	2 137 072	2 192 955	2 196 439
of which by risk weight:						
0 %	404 662	523 806	537 249	593 011	683 805	698 978
20 %	391 739	518 182	445 169	514 211	485 224	509 958
50 %	27 079	37 403	43 657	43 718	44 942	43 431
100 %	935 275	1 004 449	981 568	986 132	978 985	944 072
Risk weighted assets in CZK millions	1 027 162	1 126 787	1 092 431	1 110 833	1 098 500	1 067 779
Risk weighted assets/total assets in %	58.40	54.07	54.41	51.98	50.09	48.61
Core capital/risk weighted assets in %	9.09	8.61	9.29	9.33	9.64	9.43
Capital/risk weighted assets in %	9.81	9.51	9.91	11.11	11.32	11.95

Reserve resources

(banks with valid licences as of 31 December 1998, in CZK millions)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Provisions	75 107	98 813	111 683	112 859	108 754	117 958
Reserves	35 874	40 297	34 997	43 877	43 515	41 747
Reserve funds	63 673	72 350	71 666	74 094	74 031	73 959
Capital funds	18 703	19 449	19 368	13 672	33 401	34 017
Total reserve resources	193 357	230 908	237 714	244 503	259 701	267 681

Quick assets

(banks with valid licences as of 31 December 1998, in CZK millions)

	31 Dec. 1996	31 Dec. 1997	1998			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Cash	25 583	27 256	24 781	27 814	25 172	27 169
Deposits and credits with the CNB	136 128	193 780	216 957	243 821	286 759	271 497
of which required reserves	107 884	88 078	95 686	97 244	90 052	87 583
Current accounts with banks	19 512	18 937	7 832	12 785	9 104	11 250
T-bills	49 399	38 964	34 334	39 312	29 862	53 394
CNB bills	62 750	94 470	100 349	113 598	163 130	162 532
Total quick assets	293 372	373 407	384 253	437 330	514 027	525 841
Tradable securities	167 305	98 742	103 202	101 906	96 190	97 514
of which: debt securities	131 771	84 972	90 624	92 450	84 772	87 162
equity securities	33 528	10 052	8 787	6 157	6 361	4 651
Total liquid assets	460 678	472 149	487 455	539 236	610 217	623 355
Share in total assets in %						
quick assets	15.35	16.62	17.63	18.43	21.17	21.54
liquid assets	24.11	21.01	22.36	22.73	25.13	25.54

Assets and liabilities by residual maturity as of 31 December 1997

(banks with valid licences as of 31 December 1998, in CZK millions)

	Total	of which								
		under 1 week	1 week to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 2 years	2 to 5 years	more than 5 years	nonspe- cified
Total assets	2 247 734	328 874	269 896	213 342	152 474	212 839	121 054	196 416	128 497	624 340
Total liabilities	2 247 734	700 074	288 378	202 975	107 938	157 211	179 222	178 571	101 510	331 856
Net balance sheet position	x	-371 200	-18 481	10 367	44 536	55 629	-58 167	17 845	26 987	292 484
Cumulative net balance sheet position	x	-371 200	-389 681	-379 314	-334 778	-279 149	-337 316	-319 471	-292 484	0
in % of total assets	x	-16.51	-17.34	-16.88	-14.89	-12.42	-15.01	-14.21	-13.01	0.00
Liabilities taking into account demand deposit liquidity	2 247 734	371 265	350 029	264 627	149 039	198 312	220 323	219 672	142 612	331 856
Net balance sheet position	x	-42 390	-80 133	-51 285	3 435	14 527	-99 268	-23 256	-14 115	292 484
Cumulative net balance sheet position	x	-42 390	-122 523	-173 808	-170 373	-155 845	-255 114	-278 370	-292 484	0
in % of total assets	x	-1.89	-5.45	-7.73	-7.58	-6.93	-11.35	-12.38	-13.01	0.00

Assets and liabilities by residual maturity as of 31 December 1998

(banks with valid licences as of 31 December 1998, in CZK millions)

	Total	of which								
		under 1 week	1 week to 1 month	1 to 3 months	3 to 6 months	6 months to 1 year	1 to 2 years	2 to 5 years	more than 5 years	nonspe-cified
Total assets	2 440 738	399 668	265 994	245 008	187 391	219 417	165 796	200 304	143 900	613 260
Total liabilities	2 440 738	783 428	333 439	203 328	146 811	162 397	133 276	189 071	107 055	381 933
Net balance sheet position	x	-383 760	-67 445	41 680	40 580	57 020	32 520	11 233	36 845	231 327
Cumulative net balance sheet position	x	-383 760	-451 204	-409 524	-368 944	-311 924	-279 404	-268 171	-231 327	0
in % of total assets	x	-15.72	-18.49	-16.78	-15.12	-12.78	-11.45	-10.99	-9.48	0.00
Liabilities taking into account demand deposit liquidity	2 440 738	459 639	394 149	264 038	187 284	202 870	173 750	229 545	147 529	381 933
Net balance sheet position	x	-59 971	-128 155	-19 030	106	16 546	-7 954	-29 241	-3 629	231 327
Cumulative net balance sheet position	x	-59 971	-188 126	-207 156	-207 050	-190 503	-198 457	-227 698	-231 327	0
in % of total assets	x	-2.46	-7.71	-8.49	-8.48	-7.81	-8.13	-9.33	-9.48	0.00