
**Financial Sector Assessment Program
Czech Republic**

**Volume III:
Assessment of Observance with Six Key International
Standards and Codes**

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EXECUTIVE SUMMARY

This volume contains the element-by-element assessment of the standards assessed in the context of Czech Republic's stability assessment. The Czech Republic's observance with six key international standards was carried out as part of the FSAP work. These included (1) the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Transparency Code)*; (2) *Basel Core Principles for Effective Banking Supervision (BCP)*; (3) *IAIS Core Principles for Insurance Supervision (ICP)*; (4) *IOSCO Objectives and Principles of Securities Regulation (SCP)*; (5) *OECD Principles of Corporate Governance (OCG)*; and (6) *Committee on Payment and Settlement System Core Principles for Systemically Important Payment Systems (CPSIPS)*. The assessments were carried out on the basis of the information provided by the Czech authorities, discussions with relevant officials, and research done by the mission.

The FSAP mission comprised Messrs. Hassanali Mehran (IMF, Mission Chief), Roberto Rocha (World Bank, Deputy Mission Chief), Arne B. Petersen, Udaibir S. Das, Edward Frydl, Dimitri Tzanninis, Plamen Yossifov (all IMF); Dimitri Vittas, Jeppe Ladekarl, Luc Laevan, Donald McIsaac, Douglas Webb, Gordon Johnson (all World Bank); Andrew Beadle (IMF Expert, U.K. FSA); James Dingle (IMF Expert, Bank of Canada); Andrew Procter (World Bank Expert, Hong Kong Securities and Futures Commission); and Antonio Jose Vieira Aguas (IMF Expert, Bank of Portugal).

In the Czech Republic, the authorities have placed high priority on implementing and observing the international standards relevant for financial stability. This effort has been spurred by the prospects of EU accession and the attempts at institutional and legal reform at harmonizing with the EU standards. Consequently, a significant effort is underway at revamping the regulatory, supervisory and transparency framework and strengthening the market infrastructure.

The assessments helped in identifying the strengths and the shortcomings of the official sector oversight over the Czech financial system. It brought out the institutional and operational vulnerabilities that helped support the overall stability assessment. The main supervisory and regulatory vulnerabilities are arising out of the changing financial structure and the challenges they are posing for the regulators and supervisors. The capacity constraints, and the administrative and judicial processes were, however, proving a major constraint toward the full implementation of the key standards. A high level of observance was assessed with respect to transparency practices relating to monetary and banking supervisory policies. However, transparency practices relating to insurance, securities, and payment system polices needed further strengthening.

I. OVERVIEW

1. Observance of standards is not a guarantee against vulnerabilities. However, an objective of assessment of standards in the context of FSAP is to examine whether the observance of standards is adequate to address the identified systemic vulnerabilities and risks. The assessment also provides input in formulating an overall assessment of financial system stability in the macroeconomic context, identify areas for improvement and develop a corrective action plan in areas of non-observance that require immediate follow up.

2. The FSAP mission conducted an assessment of the Czech Republic's observance with seven key international standards relevant for financial stability, in the following areas:

Financial sector regulation and supervision

- Banking: Basel Core Principles for Effective Banking Supervision
- Insurance: IAIS Core Principles for Insurance Supervision
- Securities: IOSCO's Objectives and Principles of Securities Regulation

Institutional and market infrastructure

- Corporate governance: OECD Corporate Governance Principles
- Payment systems: CPSS Core Principles for Systemically Important Payment Systems

Policy transparency

- Monetary policy: IMF Code of Good Practices on Transparency in Monetary and Financial Policies
- Financial policies (banking, insurance, securities and payments system): IMF Code of Good Practices on Transparency in Monetary and Financial Policies

3. The assessments were carried out on the basis of the information provided by the Czech authorities, discussions with relevant officials, and research done by the mission. The assessment of the regulatory and supervisory framework relating to the banking and securities sectors was based on the self-assessments completed by the Czech National Bank (CNB) and the Czech Securities Commission (CSC). Meetings were held with selected banks, insurance companies, pension funds, and investment and securities companies, and the auditing, accounting, and bankers' associations. The mission's assessment was also based on the analysis of various relevant statutes and regulations as well as responses to FSAP questionnaires. It also drew upon the work previously done by the World Bank in the areas of enterprise restructuring, insolvency regimes, and capital markets. The assessors consisted of IMF and World Bank staff and experts from cooperating official institutions

(Financial Services Authority, United Kingdom; Hong Kong Securities and Futures Commission, Hong Kong SAR) and central banks (Bank of Canada and Bank de Portugal).

Financial sector regulation and supervision

4. Significant progress has been made in the legislative and regulatory framework aimed toward harmonization with EU standards. There are, however, areas where further improvement is necessary to reduce vulnerabilities and strengthen the framework within which the financial system operates. In particular, capacity constraints and administrative and judicial processes were proving to be major constraints toward the full implementation of supervisory practices in a rapidly changing financial system.

5. In **banking supervision**, the regime was compliant or largely compliant with 20 of the 25 Basel Core Principles. Areas where the need for strengthening was identified included consolidated supervision and risk based supervision emphasizing the need for more rigorous monitoring of risk-adjusted capital adequacy positions. In **insurance supervision**, 8 of 17 IAIS Core Principles were either observed or largely observed. A major shortcoming is the failure to conduct on-site inspections with any frequency and with a risk focus. The supervisory authority also lack sufficient legal and operational independence. In the area of **securities regulation**, 29 of 30 IOSCO Core Principles had been implemented or partially implemented. The laws and regulations of the Czech Republic give sufficient functions and powers to the CSC to permit effective regulation of the securities markets but there are practical limitations to the capacity of the CSC to discharge its responsibilities because of its young and inexperienced staff.

Institutional and market infrastructure

6. Payment and settlement infrastructure is broadly in place to support transparent and reliable money and capital market operations. Further improvements are required in improving corporate governance, improving accountability and market discipline and more efficient exit of companies and banks.

7. In **payment systems**, 8 of the 10 CPSS Core Principles for systemically important payment system were being observed. With respect to CP 1, the system largely observes the requirement for a well-founded legal basis at the present time. The planned Payment Systems Act should bring the legal basis into harmony with the requirements of the EU (and this Principle) in the course of 2001. With respect to CP 10, the system's transparency could be improved by the publication of aggregate information on emergency support by the central bank. As regards **corporate governance**, 8 of the 13 OECD Principles of Corporate Governance were either observed or largely observed. There has been a concerted effort from the side of the Czech authorities to improve the mechanisms of corporate governance in the Czech Republic. The most clear example of this effort is the recent package of amendments to the Commercial Code, the Securities Law, the Auditing Law and other related pieces of legislation. There has been less success in improving the external mechanisms of governance. Creditor rights remain weak in the Czech Republic, despite recent amendments to the

Bankruptcy and Composition Act, and the introduction of a new Law on Public Auctions. The lack of strong creditor rights weakens the important monitoring and disciplining role of creditors.

Policy transparency

8. A high level of observance was assessed with respect to transparency practices relating to **monetary policy**. However, transparency relating to the institutional relationship between monetary and fiscal operations carries several gaps and assumes importance during a period of financial and corporate restructuring. Another aspect relates to the lack of consultation with the market participants on the when substantive technical changes are made in the structure of monetary regulations and monetary policy operations. Steps in this direction would help improve governance and accountability.

9. As regards **financial policies**, while good practices in transparency in banking supervisory policies were in place, transparency practices relating to insurance, securities and payment system policies need further strengthening

II. TRANSPARENCY OF MONETARY POLICY

Information and methodology

10. The assessment of CNB's observance with good transparency practices relating to monetary policy was carried out as part of the joint Fund-Bank Financial Sector Assessment Program (FSAP). The assessment was undertaken by a two-member staff team¹ and was based on: (1) a pre-FSAP questionnaire response; (2) Czech Republic ROSC (IMF, 2000); (3) information available on the CNB website; (4) relevant laws; and (5) discussions with CNB officials and five commercial banks. The assessment was based on the *IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Transparency Code)*. No assessment methodology has been developed as yet, but the assessment has taken into account the implementation issues mentioned in the *Supporting Document* to the Code.

11. The Czech authorities cooperated fully with the assessment and provided all the necessary information and clarifications. During the course of the assessment, Act No 6/1993 on the CNB was substantially amended with the passage of Act No. 442/2000 Coll. by Parliament. While these changes took effect from January 1, 2001, the assessment has taken them into account.

¹ Udaibir S. Das and Plamen Yossifov, IMF.

Legal, institutional, and policy framework

12. The Constitution of the Czech Republic (Constitution) establishes the CNB as the central bank of the Czech Republic. The CNB's responsibilities for the formulation and conduct of monetary policy are defined in the CNB Act. Prior to 1998, the CNB interpreted the rather general formulation of its ultimate objective as a mandate to maintain the external value of the domestic currency (koruna). Starting in 1998, the CNB adopted inflation targeting to achieve internal stability of the koruna vis-à-vis a specified basket of goods. In the period 1998-2001, targets were set for the "net inflation," which is calculated as the rate of change of the Consumer Price Index (CPI), excluding the effects of changes in administered prices, indirect taxes, and customs duties. Targets were defined for the value of the 12-month percentage change in the monthly net CPI in December of the following year.

13. In April 2001, the CNB—in agreement with the government—announced changes to its inflation targeting framework, to become effective January 2002. The main changes involve the introduction of a continuous target band and a switch to targeting headline inflation.² Specifically, the CNB announced a moderately declining target band for headline inflation, beginning at 3-5 percent in January 2002 and ending at 2-4 percent in December 2005. The new framework will increase the transparency of the inflation concept being targeted, while the longer horizon of the target and the specification of the intra-year bands will help to better pin down short- and medium-term inflation expectations. Details of the new framework are yet to be announced. These include (1) how to produce and communicate to the general public the CNB's inflation forecasts; (2) procedures concerning the communication and understanding between the CNB and the government with respect to administered price and indirect tax adjustments; and (3) the design and use of escape clauses.

14. In pursuance of its monetary policy objective, the CNB relies on four monetary policy instruments—the two-week repo tender, the discount facility, the Lombard facility, and the minimum reserve requirement ratio. Due to persistent excess liquidity in the banking sector, in recent years the most actively used instrument is the two-week repo tender. The two-week repo tender of domestic currency bills issued by the CNB is used for liquidity withdrawal and is carried out daily. Based on the CNB's forecast of the amount of excess liquidity in the banking system, the CNB decides on the amount to be borrowed, which is not disclosed to the market. At the start of the tender, the CNB announces the limit repo rate and accepts all bids below or equal to it up to the borrowing limit.

15. The governing body of CNB is its Bank Board, which consists of seven members, including the governor and two vice governors. All of its members are appointed and recalled by the President of the Czech Republic. Changes in the setting of monetary policy

² Under the existing inflation targeting framework, the CNB announces an end-year target range for net inflation (i.e., headline inflation excluding administered price adjustments and the impact of indirect tax changes).

instruments made by the Board are publicly announced in a press release immediately following the respective meeting. On the same day the governor and other Board members hold a press conference to discuss the monetary policy decisions taken by the Board and the previous month's monetary developments. The changes in the setting of monetary policy instruments also appear in the minutes of the Bank Board meetings, published in the monthly bulletin "Commentary on Monetary and Economic Developments."

Practice-by-practice assessment

16. The detailed assessment has taken into account the fact that monetary policy operating arrangements differ from one country to another, as do the domestic circumstances. However, it needs to be recognized that a major factor bearing on the CNB in terms of its accountability, independence and transparency in relation to monetary policy making is the intent to harmonize with the EU standards. Another related factor guiding the intentions of monetary policy is the massive restructuring in the banking sector and the consequent changes of the banking sector balance sheet data required for the conduct of the monetary policy. The recently amended CNB Act now also places new requirements on the CNB in terms of its financial and operational autonomy and public accountability.

17. The assessment of observance with each practice of the *MFP Transparency Code* is made on a qualitative basis based on existing laws and regulations, and practices. A five-part assessment system is used: observed; broadly observed; partly observed, not observed and not applicable: **observed**, implying full observance or with insignificant shortcomings; **broadly observed**, where minor weaknesses exist and these are not seen as being of a significant nature so as to raise serious doubts about the authority's ability to achieve the objective of that practice; **partly observed**, where shortcomings are sufficient to raise doubts about the authority's ability to achieve observance and which could affect the operational process and effectiveness of monetary policies; **not observed**, where the practice is not being observed and no substantive progress has been recorded toward achieving the objectives of the practice; and **not applicable**, where, due to the country circumstances and the institutional and legal framework, the transparency practice is not applicable.

Table 1. Monetary Policy Transparency: Practice-by-Practice Assessment

I. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS FOR MONETARY POLICY	
1.1	The ultimate objective(s) and institutional framework of monetary policy should be clearly defined in relevant legislation or regulation, including, where appropriate, a central bank law.
Description	<p>The primary objective of monetary policy, as defined in the Constitution, is to ensure the stability of the Czech national currency. The recently amended Act on the CNB (CNB Act) details this rather general formulation to be understood as maintaining price stability. The CNB Act further stipulates that without prejudice to its primary objective, the CNB shall support the general economic policies of the government leading to sustainable economic growth and that CNB shall act in accordance with the principle of an open market economy. The CNB Act sets the monetary policy framework as one of inflation targeting. While on one hand, the CNB Act grants the central bank full independence in the pursuit of its primary objective from the government, president, Parliament and other administrative and regional authorities, on the other hand it requires that the inflation target be set by agreement between the CNB and the government.</p> <p>References: Constitution,³ Article 98; CNB Act,⁴ Articles 1(1), 2, 5(1), 9, 35.</p>
Assessment	Broadly observed
Comments	The different formulations of the primary objective of CNB in the Constitution and the recently amended CNB Act can potentially convey confusing signals to the public. The requirement in the recently amended CNB Act that the inflation target be set by “agreement” between the CNB and the government obscures the institutional framework of monetary policy and can potentially undermine the markets’ perception of the credibility of the primary objective of monetary policy.
1.1.1	The ultimate objective(s) of monetary policy should be specified in legislation and publicly disclosed and explained.
Description	<p>The primary objective of monetary policy is defined in the Constitution and detailed in the CNB Act. It is disclosed and explained in the CNB Annual Report (www.cnb.cz/en/o_cnb/vz.htmhttp://www.cnb.cz/en/o_cnb/hospodareni_cnb.htm) and in the quarterly Inflation Report (www.cnb.cz/en/mpolitika/inflace/index.htmhttp://www.cnb.cz/en/mpolitika).</p> <p>References: Constitution, Article 98; CNB Act, Article 2.</p>
Assessment	Observed
Comments	
1.1.2	The responsibilities of the central bank should be specified in legislation.
Description	<p>The responsibilities of the central bank are specified in the CNB Act. They are related to the public on the CNB website and in press briefings given by respective CNB section staff.</p> <p>References: CNB Act, Articles 2, 14, 30, 31, 35, 36, 40; Budgetary Rules of the Republic Act⁵; Act on Bonds;⁶ Foreign Exchange Act.⁷</p>
Assessment	Observed

³ Constitutional Act of the Czech National Council of December 16, 1992.

⁴ Act No. 6/1993 Coll. on the CNB, as amended through December 2000.

⁵ Act No. 576/1990 Coll. on Rules of Performance with Budgetary Means of the Czech Republic and Municipalities.

⁶ Act No. 530/1990 Coll. on Bonds.

⁷ Act No. 528/1990 Coll. on Foreign Exchange.

Comments	The responsibilities of the central bank, as defined in the CNB Act are to conduct monetary policy, set the inflation target and the exchange rate regime in agreement with the government, conduct payment systems oversight and banking supervision, issue banknotes and coins, control foreign exchange transactions and gold trade, manage monetary reserves in gold and foreign exchange, keep the accounts of the state budget, and manage on behalf of the government the internal and external public debt.
1.1.3	The legislation establishing the central bank should specify that the central bank has the authority to utilize monetary policy instruments to attain the policy objective(s).
Description	The CNB Act entitles the central bank to use instruments in the implementation of monetary policies. These instruments are explicitly stated in the law. The instruments currently used by the central bank are explained on the CNB website (www.cnb.cz/en/mpolitika/d.html http://www.cnb.cz/en/mpolitika/mon_policy_instr.htm). References: CNB Act, Articles 5, 23, 25, 28, 29, and 32.
Assessment	Observed
Comments	The CNB Act lists a wide range of direct and indirect monetary policy instruments that include selective credit controls limiting either the amount or the interest charged on bank credits, setting of the minimum rates of interest on deposits accepted by banks, minimum reserve requirements, various refinancing facilities and open market operations.
1.1.4	Institutional responsibility for foreign exchange policy should be publicly disclosed.
Description	The CNB Act states that the exchange rate regime shall be set by agreement between CNB and the government. The CNB and the MoF jointly submit to the government draft legislation on foreign currency management. References: CNB Act, Articles 35, 36, 37; Foreign Exchange Act. ⁸
Assessment	Observed
Comments	
1.1.5	The broad modalities of accountability for the conduct of monetary policy and for any other responsibilities assigned to the central bank should be specified in legislation.
Description	The CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of the Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed and testify. In addition, upon a resolution of the Chamber of Deputies, the CNB must submit within thirty days an extraordinary report on monetary development. The resolution of the Chamber of Deputies must state what the extraordinary report should contain. The Chamber of Deputies can either acknowledge the report on monetary development or ask for a more accurate and complete report, which must be submitted within six weeks and should be in compliance with the requirements of the Chamber of Deputies. The CNB Act stipulates that the CNB's operating and investment budget must be approved by the Chamber of Deputies. Furthermore, the CNB Act requires the CNB to submit within three months after the end of the calendar year its annual financial report to the Chamber of Deputies for review. The Chamber of Deputies can either approve, acknowledge, or reject the financial report of the CNB. If the Chamber of Deputies rejects the financial report of the CNB, the CNB is obliged to submit within six weeks a more accurate and complete report in compliance with the requirements of the Chamber of Deputies. The CNB Act also obliges the central bank to inform the general public on monetary

⁸ Foreign Exchange Act No. 219/1995 Coll.

	<p>developments at least once every three months and in its Annual Report. The former requirement is met with the publication of the quarterly Inflation Report.</p> <p>References: CNB Act, Articles 3, 5, 47, 48.</p>
Assessment	Observed
Comments	The requirement that the Governor of the CNB must testify before the Chamber of Deputies of the Parliament at least twice a year was introduced with the recent amendments to the CNB Act, which also introduced the Parliament's control over the CNB's operating and investment budget. Prior to these amendments, the CNB was only required to submit a report on monetary development twice a year.
1.1.6	If, in exceptional circumstances, the government has the authority to override central bank policy decisions, the conditions under which this authority may be invoked and the manner in which it is publicly disclosed should be specified in legislation.
Description	<p>In the pursuit of this objective, the central bank is granted independence from the government, the President, Parliament, and other administrative and regional authorities by the CNB Act. The CNB Act provides for the possibility of a member of the government, usually the Minister of Finance, to attend the deliberations of the Bank Board of the CNB in an advisory capacity and submit to it proposals for discussions. Anecdotal evidence suggests that in some cases the presence of the Minister of Finance at Bank Board meetings has influenced their outcome.</p> <p>References: CNB Act, Articles 9, 11.</p>
Assessment	Not applicable
Comments	The power of the government's representative at the Bank Board's meetings to submit proposals for discussions was introduced with the recent amendments to the CNB Act.
1.1.7	The procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing body of the central bank should be specified in legislation.
Description	<p>The procedures for appointment, terms of office, and the general criteria for removal of the heads and members of the governing body of the CNB are specified in the CNB Act.</p> <p>References: Constitution, Article 62; CNB Act, Articles 5 and 6.</p>
Assessment	Observed
Comments	
1.2	The institutional relationship between monetary and fiscal operations should be clearly defined.
Description	<p>The responsibilities of the central bank to keep the accounts of the state budget, manage on behalf of the government the internal and external public debt, and transfer the residual profits from its operations to the state budget are defined in the CNB Act, Budgetary Rules of the Republic Act, and the Act on Bonds.</p> <p>References: CNB Act, Articles 5, 30, 31, 40, 47, 59; Budgetary Rules of the Republic Act; Act on Bonds, Article 19(2).</p>
Assessment	Observed
Comments	
1.2.1	If credits, advances, or overdrafts to the government by the central bank are permitted, the conditions when they are permitted, and any limits thereof, should be publicly disclosed.
Description	<p>The newly amended CNB Act precludes any possibility for central bank lending to the government in any form.</p> <p>References: CNB Act, Article 30.</p>
Assessment	Not applicable

Comments	Prior to the December 2000 amendment of the CNB Act, the latter provided for the possibility of extension of short-term credit to the government by the central bank through purchases of treasury bills on the primary market within prespecified limits. The conditions when central bank lending to the government was permitted and the amounts lent were not publicly disclosed.
1.2.2	The amounts and terms of credits, advances, or overdrafts to the government by the central bank and those of deposits of the government with the central bank should be publicly disclosed.
Description	The newly amended CNB Act precludes any possibility for central bank lending to the government in any form. The amounts of government deposits at the central bank appear in the ten-day balance sheet of CNB under the category “Other payables to the state budget.” The 10-day balance sheet of CNB is published eight days after the end of the reference period as a press release available upon request from the central bank and on the central bank’s website (www.cnb.cz/en/o_cnb/dbilance/db_archiv.htm). The terms of government deposits at the central bank are specified in a service agreement with the MoF, the details of which are not publicly disclosed. References: CNB Act, Article 30.
Assessment	Broadly observed
Comments	The practice is not observed in the part requiring disclosure of the terms of government deposits at the central bank.
1.2.3	The procedures for direct central bank participation in the primary markets for government securities, where permitted, and in the secondary markets, should be publicly disclosed.
Description	The recently amended CNB Act prohibits CNB from direct participation in the primary market for government securities. The procedures for central bank participation in the secondary market of government securities are not publicly disclosed.
Assessment	Not observed
Comments	The practice is not observed in the part requiring disclosure of the procedures for central bank participation in the secondary market of government securities.
1.2.4	Central bank involvement in the rest of the economy (e.g., through equity ownership, membership on governing boards, procurement, or provision of services for fee) should be conducted in an open and public manner on the basis of clear principles and procedures.
Description	Prior to 2000, CNB shareholdings in outside companies were not adequately disclosed to the general public. Even though details on these shareholdings appeared in the notes to the CNB’s financial statements, the notes were not published but were only available directly from CNB. In 2000, CNB began publishing the notes to its financial statements on the CNB Website (www.cnb.cz/en/o_cnb/rz/index.htm). Under the CNB Act, the central bank can keep accounts and provide other banking services to its employees and juridical persons. The CNB also provides other services for fee (clearing operations, above standard emission operations, etc.). The list of the CNB monetary and commercial services and related fees is published in a circular available from the central bank upon request. References: CNB Act, Article 34.
Assessment	Observed
Comments	Starting in 2000 the practice is observed. Previously, the CNB shareholdings in outside companies were not adequately disclosed to the general public. In the past, the CNB owned 26.5 percent of Československá obchodní banka (CSOB) and had one wholly-owned subsidiary acquired in March 1997—Česká Finanční (CF). The CNB stake in CSOB was sold to KBC Bank N.V. in June 1999, whereas the ownership of CF was transferred to Konsolidační banka in the second half of 2000. The fact that the CNB owned a

	share in CSOB was never disclosed in the CNB Annual Reports. Information on CNB ownership of CF was published with considerable delay in the 1998 Annual Report of CNB. Prior to 2000, the notes to the CNB's financial statements, which contained details on these shareholdings, were not published but were only available directly from CNB.
1.2.5	The manner in which central bank profits are allocated and how capital is maintained should be publicly disclosed.
Description	<p>The CNB Act stipulates that central bank's profits shall be used to replenish the general reserves and other funds created from profits, as well as for other purposes as provided for in the CNB budget. Any remaining profits are transferred to the state budget.</p> <p>Prior to 2000, specific information on the allocation of the CNB's profits and the maintenance of its capital was not readily available to the public. Even though such information appeared in the notes to the CNB's financial statements, the notes were not published but were only available directly from CNB. In 2000, the CNB began publishing the notes to its financial statements on the CNB Website (www.cnb.cz/en/o_cnb/rz/index.htm).</p> <p>References: CNB Act, Article 47.</p>
Assessment	Observed
Comments	Starting in 2000 the practice is observed. Previously, information on the allocation of the CNB's profits and the maintenance of its capital was not readily available to the public.
1.3	Agency roles performed by the central bank on behalf of the government should be clearly defined.
Description	<p>The CNB's responsibilities to keep the accounts of the state budget and manage the internal and external public debt are defined in relevant legislation.</p> <p>References: CNB Act, Articles 10, 11, 28, 30, 31, 35, 36, 37, 40; Budgetary Rules of the Republic Act; Act on Bonds.</p>
Assessment	Observed
Comments	
1.3.1	Responsibilities, if any, of the central bank in (i) the management of domestic and external public debt and foreign exchange reserves, (ii) as banker to the government, (iii) as fiscal agent of the government, and (iv) as advisor on economic and financial policies and in the field of international cooperation, should be publicly disclosed.
Description	<p>The CNB's responsibilities for the management of domestic and external public debt, foreign exchange reserves, as banker, and advisor on economic and financial policies of the government, are promulgated in the CNB Act. These responsibilities, however, are not systematically disclosed in the CNB's Annual Report, monthly bulletin and website.</p> <p>References: CNB Act, Articles 10, 11, 30, 31, 35, 36, 37, 40; Budgetary Rules of the Republic Act; Act on Bonds.</p>
Assessment	Broadly observed
Comments	The CNB's responsibilities for the management of domestic and external public debt, foreign exchange reserves, as banker, and advisor on economic and financial policies of the government, are not systematically disclosed in the CNB publications. The CNB and the MoF are in the process of preparing a formal agreement on the priorities of public debt management. At this stage, it is not clear whether this document will be made public.
1.3.2	The allocation of responsibilities among the central bank, the MoF, or a separate public agency, for the primary debt issues, secondary market arrangements, depository facilities, and clearing and settlement arrangements for trade in government securities, should be publicly disclosed.
Description	The CNB's responsibilities for primary government debt issues and clearing and settlement arrangements for trade in government securities are specified in relevant legislation. Related

	<p>regulations are published on the CNB website (http://wdb.cnb.cz/cnb/cnb.wvw_main.main?p_cornerid=320&p_currcornerid=87&p_language=cs&p_edit=0&p_full=1&p_cornertype=item&p_iscornerlink=1) and in non-periodic publication “Vestnik.” The issue calendar, the schedule of auctions, and the results from auctions of treasury bills and government bonds are disclosed on the CNB website: (http://wdb.cnb.cz/cnbeng/cnbeng.wvw_main.main?p_cornerid=541&p_currcornerid=38&p_language=us&p_edit=0&p_full=1&p_cornertype=item&p_iscornerlink=1).</p> <p>The CNB operates the TKD System, which is used for the issuance, registration in book-entry form (i.e., registered only in electronic form) and settlement of all short-term treasury bills (with maturities up to one year) and CNB bills. Private sector participants that issue short-term debt instruments may also use the TKD System. Information on the CNB’s responsibilities for the operation of the TKD System and related regulations are available on the CNB website (www.cnb.cz/en/_platebni_styk/tkd.htm).</p> <p>The CNB has no responsibilities for secondary market arrangements.</p> <p>References: CNB Act, Articles 28, 31; Act on Bonds.</p>
Assessment	Observed
Comments	
II. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS	
2.1 The framework, instruments, and any targets that are used to pursue the objectives of monetary policy should be publicly disclosed and explained.	
Description	<p>In 1998, the CNB adopted inflation targeting as the framework of its monetary policy. The CNB announced a short-term (end of calendar year) and medium-term (three years ahead) inflation targets, following a decision of the Bank Board, in a press conference, press release, and in the minutes of the Board meetings published in the monthly bulletin “Commentary on Monetary and Economic Developments” (www.cnb.cz/en/_mpolitika/komentar/index.htm) and on the CNB website. The inflation target is set by agreement between the CNB and the government. The principles for setting inflation targets together with the inflation target for 2001 are published in the document “The Setting of the Inflation Target for 2001,” available on the CNB website (www.cnb.cz/en/_mpolitika/pdf/stanoveni_cile.pdf). The instruments currently used by the central bank are explained on the CNB website (www.cnb.cz/en/_mpolitika/d.htmlhttp://www.cnb.cz/en/_mpolitika/mon_policy_instr.htm).</p> <p>References: CNB Act, Articles 23, 25, 28.</p>
Assessment	Observed
Comments	
2.1.1 The procedures and practices governing monetary policy instruments and operations should be publicly disclosed and explained.	
Description	<p>The instruments currently used by the central bank are explained on the CNB website (www.cnb.cz/en/_mpolitika/d.htmlhttp://www.cnb.cz/en/mpolitika/mon_policy_instr.htm). The procedures governing their use are specified in CNB regulations published as circulars, in non-periodic publication “Vestnik,” and are available in Czech on the CNB website (http://wdb.cnb.cz/cnb/cnb.wvw_main.main?p_cornerid=320&p_currcornerid=87&p_language=cs&p_edit=0&p_full=1&p_cornertype=item&p_iscornerlink=1).</p>
Assessment	Observed
Comments	

2.1.2	The rules and procedures for the central bank's relationships and transactions with counterparties in its monetary operations and in the markets where it operates should be publicly disclosed.
Description	Regulations concerning the repo tenders organized by the CNB are published as circulars, in non-periodic publication "Vestnik," and are available in Czech on the CNB website (http://wdb.cnb.cz/cnb/cnb.wvw_main.main?p_cornerid=320&p_currcornerid=87&p_language=cs&p_edit=0&p_full=1&p_cornertype=item&p_iscornerlink=1).
Assessment	Partly observed
Comments	The rules and procedures for the central bank's relationships and transactions with counterparties in the foreign exchange market and the market of government securities are not publicly disclosed.
2.2	Where a permanent monetary policy making body meets to assess underlying economic developments, monitor progress toward achieving its monetary policy objective(s), and formulate policy for the period ahead, information on the composition, structure, and functions of that body should be publicly disclosed.
Description	The Bank Board, which is the supreme managing body of the CNB, sets monetary policy and the instruments for the implementation of these policies, and decides on the measures to be taken in the sphere of monetary policy. The composition, structure, and functions of the Bank Board are defined in the CNB Act and disclosed in the CNB Annual Reports. References: CNB Act, Articles 5, 6, 7.
Assessment	Observed
Comments	
2.2.1	If the policy-making body has regularly scheduled meetings to assess underlying economic developments, monitor progress toward achieving its monetary policy objective(s), and formulate policy for the period ahead, the advance meeting schedule should be publicly disclosed.
Description	The Bank Board meets weekly. Monetary policy decisions are taken in the last meeting of each month. In December and June, the advance meeting schedule of the CNB Board for the next six months is publicly disclosed on the CNB website (www.cnb.cz/en/o_cnb/bankovni_rada/harmonogram2000b.htm).
Assessment	Observed
Comments	
2.3	Changes in the setting of monetary policy instruments (other than fine-tuning measures) should be publicly announced and explained in a timely manner.
Description	Changes in the setting of monetary policy instruments are publicly announced in a press-release immediately after the meeting of the Bank Board, on which they were made. In the afternoon of the same day, a press conference is held by the governor and other members of the board on the monetary policy decisions taken by the Board and on the monetary developments in the past month. The changes in the setting of monetary policy instruments also appear in the minutes of the Bank Board meetings, published in the monthly bulletin "Commentary on Monetary and Economic Developments." (www.cnb.cz/en/mpolitika/komentar/index.htm http://www.cnb.cz/en/mpolitika/bulletin/index.htm) and on the CNB's website (http://wdb.cnb.cz/cnbeng/cnbeng.wvw_main.main?p_language=us&p_cornerid=563&p_full=1) with a delay of two weeks or less.
Assessment	Observed
Comments	
2.3.1	The central bank should publicly disclose, with a preannounced maximum delay, the main considerations underlying its monetary policy decisions.
Description	The main considerations underlying monetary policy decisions are publicly disclosed and explained monthly in a press-conference held by the governor and other members of the

	board after the monetary policy meeting of the Bank Board. They also appear in the minutes of the Bank Board meetings, published in the monthly bulletin “Commentary on Monetary and Economic Developments” (www.cnb.cz/en/_mpolitika/komentar/index.htm http://www.cnb.cz/en/_mpolitika/bulletin/index.htm) and on the CNB website (http://wdb.cnb.cz/cnbeng/cnbeng.www_main.main?p_language=us&p_cornerid=563&p_full=1) with a delay of two weeks or less.
Assessment	Observed
Comments	
2.4	The central bank should issue periodic public statements on progress toward achieving its monetary policy objective(s) as well as prospects for achieving them. The arrangements could differ depending on the monetary policy framework, including the exchange rate regime.
Description	The monthly bulletin “Commentary on Monetary and Economic Developments” (www.cnb.cz/en/_mpolitika/komentar/index.htm http://www.cnb.cz/en/_mpolitika/bulletin/index.htm) and the quarterly Inflation Report (www.cnb.cz/en/_mpolitika/inflace/index.htm http://www.cnb.cz/en/_mpolitika/) explain the progress made toward achieving price stability and prospects therein. These are also presented in the CNB Annual Report (www.cnb.cz/en/_o_cnb/vz.htm).
Assessment	Observed
Comments	
2.4.1	The central bank should periodically present its monetary policy objectives to the public, specifying, inter alia, their rationale, quantitative targets and instruments where applicable, and the key underlying assumptions.
Description	The objectives, rationale, quantitative targets and instruments are published prior to the start of the calendar year in the report “The Setting of the Inflation Target” (www.cnb.cz/en/_mpolitika/p.html)
Assessment	Observed
Comments	
2.4.2	The central bank should present to the public on a specified schedule a report on the evolving macroeconomic situation, and their implications for its monetary policy objective(s).
Description	The CNB Act obliges the central bank to inform the general public on monetary developments at least once every three months. This requirement is met with the publication of the quarterly Inflation Report (www.cnb.cz/en/_mpolitika/inflace/index.htm http://www.cnb.cz/en/_mpolitika/). Monetary and economic developments are also covered in the CNB Annual Report (www.cnb.cz/en/_o_cnb/vz.htm http://www.cnb.cz/en/_o_cnb/hospodareni_cnb.htm) and its monthly bulletin “Commentary on Monetary and Economic Developments” (www.cnb.cz/en/_mpolitika/komentar/index.htm http://www.cnb.cz/en/_mpolitika/bulletin/index.htm).
	References: CNB Act, Article 3.
Assessment	Observed
Comments	
2.5	For proposed substantive technical changes to the structure of monetary regulations, there should be a presumption in favor of public consultations, within an appropriate period.
Description	Changes in monetary regulations are not consulted with market participants and other interested parties.
Assessment	Not observed
Comments	

2.6	The regulations on data reporting by financial institutions to the central bank for monetary policy purposes should be publicly disclosed.
Description	CNB provisions on the presentation and methodology of compilation of financial data, which banks and branches of foreign banks are required to submit to CNB, are published in the CNB's publication "Vestnik."
Assessment	Observed
Comments	
III. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY	
3.1	Presentations and releases of central bank data should meet the standards related to coverage, periodicity, timeliness of data and access by the public that are consistent with the International Monetary Fund's data dissemination standards.
Description	The Czech Republic meets the SDDS specifications for the coverage, periodicity, and timeliness of the data and for dissemination of advance release calendars (http://dsbb.imf.org/country/czecats.htm). The Czech Republic does not participate in the GDDS.
Assessment	Observed
Comments	The aggregate amounts of refinancing credits to domestic banks is not, however, published as part of the SDDS data template (www.cnb.cz/en/statistika/sdds.htm#FinancialSector), despite the statement to the opposite effect posted on the IMF's Dissemination Standards Bulletin Board (http://dsbb.imf.org/country/cze/aacbase.htm).
3.2	The central bank should publicly disclose its balance sheet on a preannounced schedule and, after a predetermined interval, publicly disclose selected information on its aggregate market transactions.
Description	<p>Following the legislative requirements, the CNB issues a 10-day balance sheet as circular and on its website (www.cnb.cz/en/o_cnb/dbilance/db_archiv.htm) eight days after the end of the reference period. The CNB annual balance sheet and profit-and-loss statement are submitted to the Chamber of Deputies and published in its Annual Report (www.cnb.cz/en/o_cnb/vz.htm) within three months after the end of the calendar year. An advance release schedule for the next fifteen months is issued in a press release "Schedule of CNB Data Publishing" in January of each year and faxed to the media and on the CNB website. Changes in the schedule are announced in the economic daily "Hospodarske Noviny."</p> <p>The CNB holdings of government bonds appear in the 10-day balance sheet of CNB under the category "Other receivables from the state budget." Monthly data on the outstanding stock of CNB bills, used in repo operations with banks, are published on the CNB website (www.cnb.cz/en/statistika/statistika/mb.htm).</p> <p>References: CNB Act, Articles 47 and 48.</p>
Assessment	Observed
Comments	
3.2.1	Summary central bank balance sheets should be publicly disclosed on a frequent and preannounced schedule. Detailed central bank balance sheets prepared according to appropriate and publicly documented accounting standards should be publicly disclosed at least annually by the central bank.
Description	Following the legislative requirements, CNB issues a 10-day balance sheet as a circular and on its website (www.cnb.cz/en/o_cnb/dbilance/db_archiv.htm) eight days after the end of the reference period. The CNB annual balance sheet and profit-and-loss statement are submitted to the Chamber of Deputies and published in its Annual Report (www.cnb.cz/en/o_cnb/vz.htm) within three months after the end of the calendar year. In 2000, the CNB began publishing the notes to its financial statements on the CNB website (www.cnb.cz/en/o_cnb/rz/index.htm). An advance release schedule for the next 15 months is issued in a press release "Schedule of CNB Data Publishing" in January of each year and

	faxed to the media and on the CNB website. Changes in the schedule are announced in the economic daily “Hospodarske Noviny.”
Assessment	Observed
Comments	The categories in the annual CNB balance sheet and profit and loss account, published in the CNB Annual Report, change every year, which makes it difficult to conduct consistent comparisons of monetary developments over time.
3.2.2	Information on the central bank’s monetary operations, including aggregate amounts and terms of refinance or other facilities (subject to the maintenance of commercial confidentiality) should be publicly disclosed on a preannounced schedule.
Description	The CNB holdings of government bonds appear in the 10-day balance sheet of CNB under the category “Other receivables from the state budget.” Monthly data on the outstanding stock of CNB bills, used in repo operations with banks, are published on the CNB website (www.cnb.cz/en/_statistika/statistika/mb.htm). Results from CNB repo tenders are announced immediately after the end of the tender on Reuters, Bloomberg, Telerate, and on the CNB website (http://wdb.cnb.cz/cnbeng/contrib620_prezentace.contrib620_pg1_en.show). The CNB’s foreign exchange operations are publicly disclosed on its website (www.cnb.cz/en/_fintrhy/devizobchody.htm). The use of the automatic deposit and credit facilities is also not adequately disclosed, as their amounts do not appear as separate items in the CNB’s balance sheet. The terms of use of the automatic deposit and credit facilities appear in respective regulations published as circulars, in non-periodic publication “Vestník,” and available in Czech on the CNB website.
Assessment	Broadly observed
Comments	The aggregate amounts of refinancing credits to domestic banks is not published as part of the SDDS data template (www.cnb.cz/en/_statistika/sdds.htm#FinancialSector), despite the statement to the opposite effect posted on the IMF’s Dissemination Standards Bulletin Board (http://dsbb.imf.org/country/cze/aacbase.htm). Data on such credits appear in the CNB’s monetary base statistics (http://www.cnb.cz/en/_statistika/statistika/mb.htm) but only on a net basis.
3.2.3	Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by the central bank should be publicly disclosed through an appropriate central bank statement when such disclosure will not be disruptive to financial stability.
Description	Aggregate information on emergency financial support by the central bank is not publicly disclosed. The amounts of emergency financial support are reflected in the 10-day balance sheet of the CNB in the lump-sum category “Receivables from domestic banks.”
Assessment	Not observed
Comments	In the latest case of provision of emergency financial support, CNB lent Investiční a Poštovní banka (IPB) an amount of the magnitude of CZK 10 billion on June 16. Press releases on the imposition of conservatorship on IPB by the CNB on June 16 and the subsequent sale of IPB to Československá obchodní banka (CSOB) on June 19 were issued on these same days on the CNB website (www.cnb.cz/en/_media/frequent/ipb/tz.htm). The press releases do not, however, disclose the fact that emergency financial support was extended to IPB and subsequently repaid by CSOB. In a report submitted to the Parliament dated June 2000, which was posted on the CNB website, it is only mentioned that on the morning of June 16 IPB requested a loan of up to CZK 10 billion in order to maintain its liquidity.
3.2.4	Information about the country’s foreign exchange reserve assets, liabilities and commitments by the monetary authorities should be publicly disclosed on a preannounced schedule, consistent with the International Monetary Fund’s Data Dissemination Standards.
Description	The Czech Republic meets the SDDS specifications for the coverage, periodicity, and timeliness of the data on the country’s foreign exchange reserve assets, liabilities and commitments by the monetary authorities and for dissemination of advance release calendars (http://dsbb.imf.org/country/cze/ilvbase.htm). The data are available on the CNB’s website (www.cnb.cz/en/_statistika/statistika/devrez_struktura.htm).

Assessment	Observed
Comments	
3.3	The central bank should establish and maintain public information services.
Description	The CNB's Public Relations Division is responsible for issuing press releases, organizing press conferences, and maintaining the CNB website (www.cnb.cz/en/). The Freedom of Information Act ⁹ requires CNB to respond in writing to individual requests for information within 15 days.
Assessment	Observed
Comments	
3.3.1	The central bank should have a publications program, including an Annual Report.
Description	The CNB publishes its Annual Report (www.cnb.cz/en/_o_cnb/vz.htm http://www.cnb.cz/en/_o_cnb/hospodareni_cnb.htm) and a quarterly Inflation Report (www.cnb.cz/en/_mpolitika/inflace/index.htm http://www.cnb.cz/en/_mpolitika/). The CNB also publishes a monthly bulletin "Commentary on Monetary and Economic Developments" (www.cnb.cz/en/_mpolitika/komentar/index.htm). In addition, all Board decisions are published as a press release. The monthly bulletin is published only on the Internet.
Assessment	Observed
Comments	
3.3.2	Senior central bank officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.
Description	The CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed, and testify. Members of the Bank Board attend regular press conferences held immediately following the Bank Board meeting, on which monetary policy decisions have been taken. The Freedom of Information Act requires CNB to respond in writing to individual requests for information within 15 days. References: CNB Act, Article 3.
Assessment	Observed
Comments	The requirement that the Governor of the CNB must testify before the Chamber of Deputies of the Parliament at least twice a year was introduced with the recent amendments to the CNB Act. Prior to these amendments, the CNB was only required to submit a report on monetary development twice a year.
3.4	Texts of regulations issued by the central bank should be readily available to the public.
Description	CNB regulations are issued as circulars, published in the non-periodic publication "Vestník," and some of them are available on the CNB website (www.cnb.cz/en/legislativa/vybrane.htm). A list of all regulations issued by the CNB is available on its website (www.cnb.cz/legislativa/seznam/p/seznam-p1.htm). These regulations are available for inspection at the CNB Special Library in Prague and in the secretariats of the Executive Directors of CNB branches.
Assessment	Observed
Comments	

⁹ Act No. 106/1999 Coll., on Freedom of Information.

IV. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK	
4.1	Officials of the central bank should be available to appear before a designated public authority to report on the conduct of monetary policy, explain the policy objective(s) of their institution, describe their performance in achieving their objective(s), and, as appropriate, exchange views on the state of the economy and the financial system.
Description	The CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed, and testify. References: CNB Act, Article 3.
Assessment	Observed
Comments	The requirement that the Governor of the CNB must testify before the Chamber of Deputies of the Parliament at least twice a year was introduced with the recent amendments to the CNB Act. Prior to these amendments, the CNB was only required to submit a report on monetary development twice a year.
4.2	The central bank should publicly disclose audited financial statements of its operations on a preannounced schedule.
Description	The CNB financial report is submitted to the Chamber of Deputies within three months after the end of the budgetary year and published in its Annual Report (www.cnb.cz/en/o_cnb/vz.htm) CNB's annual financial statements are audited by an internationally reputable independent auditor. References: CNB Act, Article 48.
Assessment	Observed
Comments	
4.2.1	The financial statements should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.
Description	The annual financial statements of the CNB are audited by an internationally reputable independent auditor. The auditor's report is an integral part of the publicly disclosed financial statements. References: CNB Act, Article 48.
Assessment	Observed
Comments	
4.2.2	Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.
Description	The CNB's internal governance procedures are not publicly disclosed.
Assessment	Not observed
Comments	The CNB's internal governance procedures are not explained to the public.
4.3	Information on the expenses and revenues in operating the central bank should be publicly disclosed annually.
Description	The information on the expenses and revenues related to CNB operations form part of its annual financial statements, which are published in its Annual Report (www.cnb.cz/en/o_cnb/vz.htm). A more detailed breakdown of the CNB's expenses and revenues appear in its annual financial report submitted to the Chamber of Deputies, which starting in 2000 is available on CNB's website (www.cnb.cz/en/o_cnb/rz/index.htm).
Assessment	Observed
Comments	
4.4	Standards for the conduct of personal financial affairs of officials and staff of the central bank and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.
Description	There is no code of conduct of CNB officials and staff. Officials and staff of the CNB are not

	allowed to have a second job without the Bank Board's permission. These rules are not publicly disclosed.
Assessment	Not applicable
Comments	
4.4.1	Information about legal protections for officials and staff of the central bank in the conduct of their official duties should be publicly disclosed.
Description	There are no legal protections for CNB officials and staff.
Assessment	Not applicable
Comments	

Table 2. Monetary Policy Transparency: Observance of Individual Practices

Practice	Gradings					Comments
	O ¹⁰	BO ¹¹	PO ¹²	NO ¹³	NA ¹⁴	
I. Clarity of roles, responsibilities and objectives of central banks for monetary policy						
1.1 The ultimate objective(s) and institutional framework of monetary policy should be clearly defined in relevant legislation or regulation, including, where appropriate, a central bank law.		X				The different formulations of the primary objective of the CNB in the Constitution and the recently amended CNB Act can potentially convey confusing signals to the public. The requirement in the recently amended CNB Act that the inflation target be set by agreement between the CNB and the government contradicts the stated independence of the CNB and can potentially undermine the markets' perception of the credibility of the primary objective of monetary policy.
1.1.1 The ultimate objective(s) of monetary policy should be specified in legislation and publicly disclosed and explained.	X					
1.1.2 The responsibilities of the central bank should be specified in legislation.	X					
1.1.3 The legislation establishing the central bank should specify that the central bank has the authority to utilize monetary policy instruments to attain the policy objective(s).	X					
1.1.4 Institutional responsibility for foreign exchange policy should be	X					

¹⁰ O: Observed.

¹¹ BO: Broadly observed.

¹² PO: Partly observed.

¹³ NO: Nonobserved.

¹⁴ NA: Not applicable.

publicly disclosed.						
1.1.5 The broad modalities of accountability for the conduct of monetary policy and for any other responsibilities assigned to the central bank should be specified in legislation.	X					The requirement that the Governor of the CNB must testify before the Chamber of Deputies of the Parliament at least twice a year was introduced with the recent amendments to the CNB Act, which also introduced the Parliament's control over the CNB's operating and investment budget. In practice, since 1998 the central bank prepared only an annual report, which is submitted to the budget committees of both chambers of Parliament together with the CNB financial report.
1.1.6 If, in exceptional circumstances, the government has the authority to override central bank policy decisions, the conditions under which this authority may be invoked and the manner in which it is publicly disclosed should be specified in legislation.					X	The power of the government's representative at the Bank Board's meetings to submit proposals for discussions was introduced with the recent amendments to the CNB Act.
1.1.7 The procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing body of the central bank should be specified in legislation.	X					
1.2 The institutional relationship between monetary and fiscal operations should be clearly defined. ²	X					
1.2.1 If credits, advances, or overdrafts to the government by the central bank are permitted, the conditions when they are permitted, and any limits thereof, should be publicly disclosed.					X	Prior to the December 2000 amendment of the CNB Act, the latter provided for the possibility of extension of short-term credit to the government by the central bank through purchases of treasury bills on the primary market within prespecified limits. The conditions when central bank lending to the government was permitted and the amounts lent were not publicly disclosed.
1.2.2 The amounts and terms of credits, advances, or overdrafts to the government by the central bank and those of deposits of the government with the central bank should be publicly disclosed.		X				The practice is not observed in the part requiring disclosure of the terms of government deposits at the central bank.
1.2.3 The procedures for direct central bank participation in the primary markets for government securities, where permitted, and in the secondary markets, should be publicly disclosed.				X		The procedures for CNB participation in the secondary market of government securities are not publicly disclosed.

1.2.4 Central bank involvement in the rest of the economy (e.g., through equity ownership, membership on governing boards, procurement, or provision of services for fee) should be conducted in an open and public manner on the basis of clear principles and procedures.	X					Starting in 2000 the practice is observed. Previously, CNB shareholdings in outside companies were not adequately disclosed to the general public.
1.2.5 The manner in which central bank profits are allocated and how capital is maintained should be publicly disclosed.	X					Starting in 2000 the practice is observed. Previously, information on the allocation of the CNB's profits and the maintainance of its capital was not readily available to the public.
1.3 Agency roles performed by the central bank on behalf of the government should be clearly defined.	X					
1.3.1 Responsibilities, if any, of the central bank in (i) the management of domestic and external public debt and foreign exchange reserves, (ii) as banker to the government, (iii) as fiscal agent of the government, and (iv) as advisor on economic and financial policies and in the field of international cooperation, should be publicly disclosed.		X				CNB responsibilities for the management of domestic and external public debt, foreign exchange reserves, as banker, and advisor on economic and financial policies of the government, are not detailed and explained in CNB publications.
1.3.2 The allocation of responsibilities among the central bank, the MoF, or a separate public agency, three for the primary debt issues, secondary market arrangements, depository facilities, and clearing and settlement arrangements for trade in government securities, should be publicly disclosed.	X					
II. Open process for formulating and reporting monetary policy decisions						
2.1 The framework, instruments, and any targets that are used to pursue the objectives of monetary policy should be publicly disclosed and explained.	X					
2.1.1 The procedures and practices governing monetary policy instruments and operations should be publicly disclosed and explained.	X					
2.1.2 The rules and procedures for the central bank's relationships and transactions with counterparties in its monetary operations and in the markets where it operates should be publicly disclosed.			X			Regulations concerning the repo tenders organized by the CNB are disclosed. The rules and procedures for the CNB's relationships and transactions with counterparties in the foreign exchange market and the market of government securities are not, however, publicly disclosed.

<p>2.2 Where a permanent monetary policy making body meets to assess underlying economic developments, monitor progress toward achieving its monetary policy objective(s), and formulate policy for the period ahead, information on the composition, structure, and functions of that body should be publicly disclosed.</p>	X					
<p>2.2.1 If the policy making body has regularly scheduled meetings to assess underlying economic developments, monitor progress toward achieving its monetary policy objective(s), and formulate policy for the period ahead, the advance meeting schedule should be publicly disclosed.</p>	X					
<p>2.3 Changes in the setting of monetary policy instruments (other than fine-tuning measures) should be publicly announced and explained in a timely manner.</p>	X					
<p>2.3.1 The central bank should publicly disclose, with a preannounced maximum delay, the main considerations underlying its monetary policy decisions.</p>	X					
<p>2.4 The central bank should issue periodic public statements on progress toward achieving its monetary policy objective(s) as well as prospects for achieving them. The arrangements could differ depending on the monetary policy framework, including the exchange rate regime.</p>	X					
<p>2.4.1 The central bank should periodically present its monetary policy objectives to the public, specifying, inter alia, their rationale, quantitative targets and instruments where applicable, and the key underlying assumptions.</p>	X					
<p>2.4.2 The central bank should present to the public on a specified schedule a report on the evolving macroeconomic situation, and their implications for its monetary policy objective(s).</p>	X					
<p>2.5 For proposed substantive technical changes to the structure of monetary regulations, there should be a presumption in favor of public consultations, within an appropriate period.</p>				X		<p>Changes in monetary regulations are not consulted with market participants and other interested parties.</p>

2.6 The regulations on data reporting by financial institutions to the central bank for monetary policy purposes should be publicly disclosed.	X					
III. Public availability of information on monetary policy						
3.1 Presentations and releases of central bank data should meet the standards related to coverage, periodicity, timeliness of data and access by the public that are consistent with the International Monetary Fund's data dissemination standards.	X					
3.2 The central bank should publicly disclose its balance sheet on a preannounced schedule and, after a predetermined interval, publicly disclose selected information on its aggregate market transactions.	X					
3.2.1 Summary central bank balance sheets should be publicly disclosed on a frequent and preannounced schedule. Detailed central bank balance sheets prepared according to appropriate and publicly documented accounting standards should be publicly disclosed at least annually by the central bank.	X					The categories in the annual CNB balance sheet and profit and loss account, published in the CNB Annual Report, change every year, which makes it difficult to conduct consistent comparisons of monetary developments over time.
3.2.2 Information on the central bank's monetary operations, including aggregate amounts and terms of refinance or other facilities (subject to the maintenance of commercial confidentiality) should be publicly disclosed on a preannounced schedule.		X				The use of the automatic deposit and credit facilities is also not adequately disclosed, as their amounts do not appear as separate items in the CNB's balance sheet.
3.2.3 Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by the central bank should be publicly disclosed through an appropriate central bank statement when such disclosure will not be disruptive to financial stability.				X		The amounts and terms of emergency financial support by the central bank is not publicly disclosed.
3.2.4 Information about the country's foreign exchange reserve assets, liabilities and commitments by the monetary authorities should be publicly disclosed on a preannounced schedule, consistent with the International Monetary Fund's Data Dissemination Standards.	X					
3.3 The central bank should establish and maintain public information services.	X					

3.3.1 The central bank should have a publications program, including an Annual Report.	X					
3.3.2 Senior central bank officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.	X					
3.4 Texts of regulations issued by the central bank should be readily available to the public.	X					
IV. Accountability and assurances of integrity by the central bank						
4.1 Officials of the central bank should be available to appear before a designated public authority to report on the conduct of monetary policy, explain the policy objective(s) of their institution, describe their performance in achieving their objective(s), and, as appropriate, exchange views on the state of the economy and the financial system.	X					
4.2 The central bank should publicly disclose audited financial statements of its operations on a preannounced schedule.	X					
4.2.1 The financial statements should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.	X					
4.2.2 Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.				X		The CNB's internal governance procedures are not explained to the public.
4.3 Information on the expenses and revenues in operating the central bank should be publicly disclosed annually.	X					
4.4 Standards for the conduct of personal financial affairs of officials and staff of the central bank and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.					X	
4.4.1 Information about legal protections for officials and staff of the central bank in the conduct of their official duties should be publicly disclosed.					X	

Response to the assessment and recommended action plan

Response to the assessment

18. The CNB provided some useful factual clarifications relating to practices (1.1.1), (1.2.2), (1.2.4), (1.2.5), (2.6), (3.2.1) and (3.2.2), which have been incorporated in the final assessment.

19. The CNB expressed some reservations regarding the assessors' recommendation to institute procedures for consultation with market participants and other interested parties on changes in monetary regulations. It feels that such consultations would result in delays in the implementation of regulatory changes without affecting the final outcome, as the CNB would not be bound to take into account market participants' views. The CNB further noted that if the reason for the proposed consultations is to acquaint market participants with planned regulatory changes, it is already doing so.

20. The CNB also objected to the recommendation that its internal governance procedures should be explained to the general public on the grounds that such disclosure will compromise them.

Recommended action plan

21. While there is a high level of observance with respect to transparency practices relating to monetary policy, steps toward further strengthening the transparency framework should include:

Clarity of roles, responsibilities, and objectives of the central bank

22. The requirement in the recently amended CNB Act that the inflation target be set by "agreement" between the CNB and the government obscures the institutional framework of monetary policy and can potentially undermine the markets' perception of the credibility of the primary objective of monetary policy. Consideration might be given to fixing this inconsistency, especially in light of the planned EU accession of the Czech Republic.

23. The terms of government deposits at CNB should be publicly explained in its publications.

24. The CNB's responsibilities for the management of domestic and external public debt, foreign exchange reserves, as banker, and advisor on economic and financial policies of the government should be stated and explained in its Annual Report and other publications.

Open process for formulating and reporting monetary policy decisions

25. Internal regulations on the rules and procedures for the CNB's relationships and transactions with counterparties in the foreign exchange market and the market of government securities should be publicly disclosed.

26. Major changes in monetary regulations should be consulted with market participants and other interested parties.

Public availability of information on monetary policy

27. Data on the use of the automatic deposit and credit facilities should appear as separate categories respectively on the liabilities and assets side of the CNB balance sheet.

28. In compliance with the statement on data availability posted on the IMF's Dissemination Standards Bulletin Board, the Czech Republic as a subscriber to SDDS should publish the aggregate amounts of refinancing credits to domestic banks as part of its SDDS data template.

29. To ensure comparability of CNB balance sheet data across time, the CNB should avoid frequent changes in the grouping categories of its assets and liabilities. Thought might be given to reissuing its past balance sheets using consistent set of definitions of these categories.

30. Consistent with confidentiality and privacy of information on individual banks, aggregate information on emergency financial support by the CNB should be publicly disclosed.

Accountability and assurances of integrity by the CNB

31. The CNB's internal governance procedures should be periodically explained.

**III. BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION AND
TRANSPARENCY OF BANKING SUPERVISION**

A. Basel Core Principles

Information and methodology

32. The assessment was conducted by a three-member team¹⁵ based on the Basel Committee Methodology for assessing the Basel Core Principles. The assessment included an examination of key documents, and discussions with the supervisory authorities and other participants in the financial sector. The Czech Republic's compliance with the Core Principles (CPs) has been separately assessed against both "essential" criteria and "additional criteria." This implies that the Czech Republic in addition to seeking to fulfill the minimum standard also strives to apply international best practice. The documents examined included a recent self-assessment made by the CNB that was presented to the assessment team after its

¹⁵ Udaibir S. Das (IMF), Antonio J.V. Aguas (Banco de Portugal), and Andrew Beadle (Financial Services Authority, United Kingdom).

arrival, and an earlier one that was published as part of the ROSC by the IMF in August 1999. Relevant laws and regulations were referenced to, including the core laws comprising the *Act on Banks (1992)*, (AoB), the *Act on CNB (2000)* (CNB Act). Several decrees and prudential regulations issued by the MoF and the CNB. Relevant parts of the *Insurance Act (1999)*, the *Securities Law (1998)*, the Commercial Code (1964), the Civil Code (1964), the Act of Auditors (2000) were also studied. Since several laws are in a process of being amended and decrees and regulations are under preparation, notable changes are likely to be introduced in the near future. However, many of the proposed changes would require government approval and amendment of the AoB. These have therefore not been taken into account for the assessment itself but have been noted. The assessment, therefore is based on the present situation as to laws, regulations and practices.

33. Extensive discussions were held with the senior staff of the Banking Supervision and Banking Policy Departments of the CNB. Visits were made to five commercial banks as well as the accounting, auditing, and banking associations, and a major auditing firm. The assessment also benefited from information collected by other FSAP team members who made an assessment of the IAIS Core Principles, IOSCO Core Principles, CPSS Core Principles and the IMF *MFP Transparency Code* relating to monetary and banking supervisory policies. The assessment team enjoyed the full cooperation of its counterparts and received all the required information.

Institutional and macroprudential setting, market structure

34. The commercial banking sector has been in a prolonged state of restructuring and change since the 1990. The period during 1994–96 witnessed massive financial emergency support to the banking sector to stabilize the banking system following the deterioration in the health of a number of small banks. The period thereafter has been marked by a round of revocation of licenses, and privatization of state-owned banks.

35. The banking system presently consists of 40 licensed institutions—KOB, 13 Czech-owned banks, and 26 foreign banks—dominated by the three largest banks (CSOB, Komerční banka, and Česká spořitelna). The three banks have a combined market share of 60 percent. Subsidiaries and branches of foreign banks account for 31.3 percent of the total assets, while the small- and medium-sized domestic banks have a market share of 1.6 percent. Asset quality in the banking system remains poor, with classified loans comprising almost one-third of total loans.

36. Banking system reserves are held at the CNB against local and foreign currency bank deposits. The minimum reserve requirement as a monetary instrument has a low priority and stands at 2 percent, the level applied by EU. The CNB uses a set of four main instruments for monetary policy purposes: the two-week repo tender using the CNB bills, discount facility, Lombard facility, and minimum reserve requirements. The main monetary policy instrument is the two-week repo tender that is usually announced daily. The supplementary monetary policy instrument is the three-month repo tender. The two week repo rate is the most important policy rate for monetary policy purposes. The CNB at its discretion also initiates

fine tuning in the money, foreign, and government securities markets to conduct its monetary policy.

37. The CNB acts as the operator and overseer of the payment system. It operates the interbank clearing system which is a real time gross settlement (RTGS) system and is the sole payment clearing mechanism in the Czech Republic. Banks maintain deposit accounts with the CNB that are used for the settlement of all interbank payments. All funds transfers are irrevocable. The CNB extends short-term intraday credit on a collateralized basis to ensure smooth operation of the interbank payment system. The clearing and settlement services for trades in government securities are provided by the CNB.

38. Steps are underway to strengthen the legal framework and prudential requirements. The AoB has been amended 11 times since 1992, although the recent round of amendments, mainly in preparation for EU accession and to improve the CNB's oversight over the banking system, failed to receive Parliamentary approval and will need to be resubmitted. This will delay the required legal reforms in key supervisory areas such as consolidated supervision. The prudential framework was strengthened in April 2000 with the introduction of capital adequacy requirement for market risk on a solo basis. Reporting of capital and large exposures on a consolidated basis was introduced in January 2000. However, in this case the capital adequacy requirements cover credit risk only.

General preconditions for effective banking supervision

39. This assessment does not purport to evaluate the adequacy of the legal and judicial infrastructure needed for successful compliance with the Core Principles by the CNB. However, based on the discussions, the legal framework, particularly the general court procedures in which banking and financial markets function, needs considerable strengthening in order to provide an environment that fosters honoring and enforcing financial contracts. Enforcement of collateral, loan collection, and the capacity of the central banks to complete the inspection in time are seriously hampered by the extant legal and administrative procedures.

40. The laws and regulations for other parts of the financial sector are more recent than for banking. The CSC Act was passed in January 1998 while a new Insurance Act has been in place from January 2000. The regulatory and supervisory framework for the insurance sector is still underdeveloped.

41. Czech banks are required to follow Czech Accounting Standards. While close to International Accounting Standards (IAS), differences remain in the areas of consolidation and fair value accounting for financial instruments. By law, banks must appoint an external auditor and notify the CNB of the selection. The CNB has the legal authority to reject any name within 30 days of the receipt of such notification, in which case the bank must select a new auditor and notify the CNB within 30 days. Auditors' unqualified opinions must state that a bank's financial statements are audited in accordance with the Act on Auditors and the Chamber of Auditors, that they present fairly, in all material respects, the condition and the

results of the bank in accordance with the Act on Accounting, and that they are prepared from accounting records that are in accordance with the Act on Accounting. In the case of most major banks, accounts are also audited in accordance with International Standards on Auditing and their statements prepared in accordance with IAS.

42. There exists a deposit insurance under the AoB for bank depositors. It is administered by the Deposit Insurance Fund (DIF). The fund covers 90 percent of insured deposits, up to a maximum level of CZK 400,000 per single depositor. Only deposits held in Czech korunas are covered. However, in practice, payouts from the DIF have been much larger with some depositors of failed banks receiving up to CZK 4 million. An amendment to the AoB that was recently rejected would have raised the notional maximum level to €25,000 and extended coverage to foreign currency deposits. The DIF is funded primarily by contributions from banks, although currently in the event of a shortfall, 50 percent of the necessary funds will be provided by the state with the other 50 percent coming from the CNB. Legislation was recently introduced which removes the duty of the CNB and the MoF to provide funds to the DIF. During the existence of the DIF, depositors of 10 banks have received payments from the Fund to a total value of CZK 10.8 billion.

43. Secrecy provisions in the law continue to hamper financial sector supervision. The system of exchange of information about individual banks between supervisory authorities, both domestic and foreign needs strengthening. In the second half of 2000, cooperation among regulators was broadened to include coordination on licensing, consolidated supervision, disclosure, and on-site examination. The recent round of draft amendments to the banking law would have taken forward the legal framework for sharing information with home country regulators in the case of branches and subsidiaries of foreign banks.

44. Market regulation of banks also requires adequate procedures for the resolution of problem banks. In particular, the supervisors must have the ability to take prompt corrective action where problems have been identified. While in general terms the AoB does give the supervisors adequate powers and a range of options to take appropriate remedial action, the administrative procedures, and the fact that on-site examinations of banks have to be conducted in accordance with the Act on State Inspections, limits the ability of the supervisor to take timely action. Moreover, a lack of systematic interface between on- and off-site supervision results in delayed detection of problems. This situation potentially undermines the effectiveness of the supervisory process and creates a risk that the supervisor are hindered in taking prompt corrective action where appropriate.

Principle-by-principle assessment

45. The detailed assessment has taken into account the fact that banking systems differ from one country to another, as do the domestic circumstances. It also recognizes that a major factor behind the rapidly changing regulatory and supervisory framework is the intent to harmonize with the EU standards. A related factor is the experience learnt from the decade long problem and restructuring in the banking sector. The banking structure is changing fast with privatization and consolidation. Financial markets are developing both in depth and

product coverage. The CNB is intending to initiate appropriate steps toward further strengthening of its supervisory system and move toward closer compliance with the Core Principles. This assessment, while fully acknowledging the current efforts, has attempted in an objective manner to highlight those areas where improvements would help CNB to meet the emerging challenges in the financial system. Given the universal nature of Czech banks, cross holdings with insurance, securities and other nonbank financial intermediaries and the fast developing derivatives portfolio, it is vital to quickly establish a risk based inspection system and intensify the inspection process. The CNB needs to put in place a formal mechanism for closer interaction between on-site and off-site supervision, and improved functional relationship among the banking insurance and securities regulators.

46. The assessment of compliance with each CP is based on a five-part assessment system is used: compliant; largely compliant; materially non-compliant; and non-compliant. To achieve a “compliant” assessment with a CP, all essential criteria must be met without any significant deficiencies. A “largely compliant” assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority’s ability to achieve the objective of that CP. A “materially non-compliant” assessment is given when the shortcomings are sufficient to raise grave doubts about the authority’s ability to achieve compliance, but substantive progress has been made. A “non-compliant” assessment is given when no substantive progress toward compliance has been achieved.

Table 3. BCP: Principle-by-Principle Assessment

Principle 1.	Objectives, Autonomy, Powers, and Resources An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers 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.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	Essential criteria. As the agency responsible for banking supervision in the Czech Republic, the CNB’s responsibilities and objectives are defined in the CNB Act and the Act on Banks (AoB). The CNB has power to issue regulations (Provisions) that prescribe the framework for the prudential supervision of banks. In practice, however, enforcement of some of the regulations is also dependent on other laws, such as the Act on State Inspections (AoSI) which sets out minimum standards for on-site inspections. This can lead to difficulties in timely and conclusive enforcement. The AoB empowers the CNB to give prior consent to the acquisitions of a direct or indirect share in a bank, take an active part in bank resolutions, such as the decision to impose conservatorship and appoint and recall the conservator, and to revoke a license. The AoB has been updated as many as eleven times since 1992, mainly in response to the changing situation in the banking sector and as a result of attempts to harmonize legislation with EU requirements and internationally accepted best practice. Certain aspects of the regulatory framework, such as the accounting policies and audited financial accounts are issued

	<p>by the MoF. Similarly, securities business of banks is supervised both by the CNB and the CSC. A tripartite agreement is in place between the CNB, the MoF, and the CSC to discuss issues of mutual interest.</p> <p>Additional criteria. The supervisory objectives are set out in the AoB and detailed in a Board note <i>Conception for the further development of banking supervision</i> prepared by the CNB's Banking Supervision Departments. The Board note is updated annually incorporating the effect of the changes in the banking sector on the supervisory work program. The CNB issues a separate publication on banking supervision that describes supervisory operations during the year and provides an account of the trends and progress in the banking sector. In addition, the Governor of the CNB reports on the activities of the CNB to Parliament twice a year. There is however no formal system for evaluating supervisory performance and its adequacy. The CNB has an explicit provision relating to quarterly release of information by banks on their activities and performance. The CNB also issues a quarterly press release on capital and its adequacy and classified credits. This disclosure however is only on a solo basis and no information is as yet being disclosed on a consolidated basis.</p>
Assessment	<p>The CNB is largely compliant in both the Essential and Additional criteria.</p> <p>Recommendation. The CNB's supervisory objectives could be made more explicit in the legislation and a formal system of appraising supervisory performance introduced and publicly disclosed. Action also needs to be taken to address the judicial barriers and administrative ambiguity relating to a timely resolution of problem banks. The coordination mechanism with the MoF and CSC on banking sector issues should be strengthened and publicly explained. Public reporting of information on the financial condition of the bank on a consolidated basis should be introduced.</p>
Comments	<p>While the supervisory authority participates in deciding when and how to effect the orderly resolution of problem bank situations, no basic procedures have been drawn up for such situations. At present, the CNB is working on a systematic approach to bank liquidation, which is to be incorporated into the AoB.</p>
Principle 1(2)	<p>Each such agency should possess operational independence and adequate resources.</p>
Description	<p>Essential criteria. The operational independence of the CNB on banking supervisory matters is set out in the CNB Act. In practice, the CNB consults with the MoF on issues relating to granting or revoking of a banking license prior to making a decision, although the final decision rests with the CNB. As no new banks have been licensed in the very recent past, the nature of the consultation was difficult to assess, the reputation of the CNB's Banking Supervision Division has been improving with the market acknowledging a greater degree of professionalism among the supervisory staff. While the CNB has financial independence to support efforts at strengthening its supervisory resources, recent amendments to the CNB Act are being viewed as a retrograde step in terms of financial autonomy. In particular they could impact adversely on the CNB's ability to recruit and retain banking supervisors. Already the CNB's supervisory resources are limited and relatively inexperienced in areas such as supervision of market risk and consolidated supervision (also see CP12).</p> <p>Additional criteria. The head of the CNB—the Governor—is appointed for a minimum term and can be removed from office only in certain and specified cases. There is, however, no practice of public disclosure of the reasons in case of removal.</p>
Assessment	<p>The CNB is materially non-compliant with respect to the Essential criteria and largely compliant in terms of Additional criteria.</p> <p>Recommendation. Given the supervisory challenges ahead, the CNB needs full financial independence in terms of budgetary resources required for effective and timely supervision. For compliance with the Additional criteria, the CNB Act should be amended to provide greater protection from <i>ad hoc</i> dismissal for the Governor.</p>

Comments	
Principle 1(3)	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	The CNB licenses banks as per Articles 4 and 5 of the AoB. As mentioned earlier, while granting licenses, the CNB consults with the MoF prior to making the decision. While the decision is that of the CNB, it was difficult to assess the exact manner in which this arrangement works and whether the CNB actually makes its own determination while licensing. It is incumbent on the CNB as per the CNB Act and AoB to supervise the licensed entities and ensure adherence to conditions set forth in the banking license. The CNB is fully empowered to issue regulations under the AoB for prudential supervision and oversee compliance with rules governing the activities of banks.
Assessment	The CNB complies with the Essential criteria (there are no Additional criteria).
Comments	
Principle 1(4)	A suitable legal framework for banking supervision is also necessary, including ... powers to address compliance with laws as well as safety and soundness concerns.
Description	The AoB enables the CNB to address compliance with laws and with regulations issued by the CNB to ensure the safety and soundness of the banks. However, the law remains ambiguous regarding the scope that the CNB has to apply qualitative judgments and in terms of its rights to demand information from banks outside of an on-site inspection. The CNB Act and the Act on State Inspections only allows the CNB to obtain files from a bank during an on-site inspection. As regards the CNB's legal powers to take remedial action and/or impose sanctions, while the AoB provides an adequate legal basis for such measures, in practice there is a high burden of proof on the supervisor before any action can be taken.
Assessment	The CNB is materially non-compliant with respect to the Essential criteria (there are no Additional criteria). <i>Recommendation.</i> The AoB should be amended to allow the CNB unfettered access to any information it needs from banks in the discharge of its supervisory responsibilities and oversight. Similarly the Act needs to allow for the exercise of both quantitative and qualitative judgments on the part of the supervisor. The doubts relating to the rights of off-site examiners to access documents or information held in a bank represents a fragility that may hinder the efficiency of the supervisory authority. Similarly, remedial action based on supervisory judgment should be permitted, although within a more transparent and accountable framework so that the integrity of supervisory action can be maintained.
Comments	The CNB staff, however, maintains that in practice the banks provide all the required information upon request, although this requires the supervisor to physically visit the bank.
Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including ... legal protection for supervisors.
Description	Neither the CNB Act nor the AoB provide explicit legal protection to the supervisory authority and its staff against lawsuits for actions taken while discharging their duties in good faith. The staff is not protected against the costs of defending their actions while discharging their duties.
Assessment	The CNB is materially non-compliant with respect to the Essential criteria (there are no Additional criteria). <i>Recommendation.</i> Supervisors should be granted legal protection against lawsuits while discharging official duties.
Comments	The principle of "acting in good faith" is not recognized under Czech law. According to the AoSI the state is responsible for any damage caused during an on-site examination. The CNB intends to draft an amendment to the Code of Criminal Procedure and submit it to the Ministry of Justice but has indicated that it is a matter of the long term.
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	A trilateral agreement between the CNB, the MOF, and the CSC has been in place since 1998.

	<p>However, in practice legal obstacles and other administrative procedures have hampered the system of cooperation and information sharing between domestic agencies. Information sharing needs to be systematized and improved. A system of cooperation with foreign regulators is only now being established. So far the CNB has concluded one MOU with an overseas supervisor. A major legal constraint relates to restrictions on the conduct of on-site examination by foreign supervisors and in providing confidential information to another supervisor.</p>
Assessment	<p>The CNB is largely compliant with respect to the Essential criteria (there are no additional criteria).</p> <p><i>Recommendation.</i> More practical use should be made of the existing trilateral agreement. This agreement allows for a wide range of supervisory cooperation including focused on-site inspections of firms under other agencies' supervision. There should also be periodic consultations covering bank holding companies with insurance and securities affiliates. Legal impediments on the conduct of on-site examinations by foreign supervisors and on information sharing need to be removed.</p>
Comments	<p>An amendment had been proposed to the AoB under which the legal obstacles to the conduct of on-site examinations by foreign supervisors and external auditors were to be removed. It would also have been possible to provide information obtained from foreign supervisors to third parties with the consent of the supervisor. This would however have also required an amendment to the Code of Criminal Procedure. The new Act on Insurance Industry and the Act on Additional Pension Insurance have already removed confidentiality clauses relating to regulated insurance firms.</p>
Principle 2.	<p>Permissible Activities 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.</p>
Description	<p>Essential criteria. The term "bank" is defined in the AoB as are the limitations on the use of the term. Deposits can only be accepted by banks and credit unions (governed under the Act on Savings and Loan Associations). In practice, there are instances of the unauthorized use of the term "bank" and CNB's powers in enforcing the law are not explicit. The Act also determines that no person may accept deposits from the general public without a banking license unless stipulated otherwise in a special Act.</p>
Assessment	<p>The CNB is largely compliant with respect to the Essential criteria (there are no Additional criteria).</p> <p><i>Recommendation.</i> The CNB's enforcement powers in ensuring the legitimate use of the term "bank" should be made explicit in the AoB. The CNB should also propose revisions to the relevant laws to increase the enforceability of protection of the term "bank." Licenses should be reviewed to ensure that the scope of banking business being conducted by each bank is consistent with the law and, where necessary, licenses should be reissued.</p>
Comments	<p>The CNB plans to issue an internal manual covering the licensing procedures. The credit unions, while regulated by a separate legislation, are viewed by the general public as a type of a bank. These are supervised by the Office of Credit Union Supervision and have been facing insolvencies and closures.</p>
Principle 3.	<p>Licensing Criteria The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization'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 organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p>Essential criteria. In granting licenses, the CNB is empowered to prescribe minimum criteria and also has the right to reject licenses. As mentioned earlier, the CNB is required to consult</p>

	<p>with the MoF when granting or rejecting a license application. However, since there have been significant changes in the supervisory regime, and no new license has been issued in the last two years, it was difficult to assess if the licensing criteria were, in practice, consistent with those applied in ongoing supervision. A serious shortcoming relates to the lack of emphasis on the determination of the legal, managerial and operational structure of the bank. This assumes importance in light of the fact that a bank can undertake business with cross linkages with the insurance and securities sectors. This issue has come to the fore in the context of the licenses reissued during the course of the recent round of mergers and privatizations. In evaluating the suitability of senior staff the CNB does not have legal authority to assess the suitability of senior management (below Board level) in terms of their relevant expertise. In practice, the CNB does undertake a review of managerial competence but has no powers to object managerial appointments that do not meet the fit and proper test. The review of banks' strategic and operational plans is also based on some general principles. The law requires banks to set out a corporate governance framework although the procedures for undertaking a systematic assessment of corporate governance during the licensing process need strengthening. The consent of the home country supervisor, in the case of the licenses granted to branches and subsidiaries, is provided for in CNB Provision No. 33/1999. Since foreign banks were licensed prior to the issuance of this provision, such consent was not obtained in all cases. However, refusal to grant a license based on the non-consent of a foreign supervisor has not been provided for in the AoB. The CNB makes an assessment of the financial strength of a prospective bank owner by reviewing pro forma financial statements and projections</p> <p>Additional criteria. There are no specified criteria on which a determination of the owner's capacity to bring in additional capital can be made. No legal requirement or regulation exists that prescribes the required expertise for the directors. However, in practice the CNB carries out a broad check on their professional background. The assessment of the preparedness of an existing bank to undertake new activity is done through an on-site examination. In the case of newly licensed banks no special procedures exist during the early phase of operation for monitoring progress in meeting business and strategic goals or to determine that supervisory requirements outlined in the license approval are being met.</p>
Assessment	<p>The CNB is largely compliant with both the Essential and Additional criteria.</p> <p>Recommendation. The licensing process should be strengthened to include an assessment of the senior management team (below Board level). Supervisors should be given the right to object to appointments that do not meet the fit and proper test. The review of a bank's strategic and operational plans should also include an assessment of the corporate governance framework. Closer monitoring during the initial stages of operation should also be introduced.</p>
Comments	The CNB is planning to issue an internal manual covering, <i>inter alia</i> , the licensing procedures.
Principle 4.	<p>Ownership 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.</p>
Description	<p>Essential criteria. The AoB defines significant ownership in terms of qualifying holding. CNB's prior approval is required at each level of control if a legal entity or natural person intends acquiring a direct or indirect share in a bank representing at least 10 percent, 20 percent, 33 percent, or 50 percent of the voting rights, or to increase its direct or indirect share in such a way that it reaches or exceeds these limits. The supervisor has the authority to reject any proposal for a change in significant ownership and may administratively suspend the exercise of the following voting rights. In practice, this has yet to be put to test. No legal or regulatory specificity exists with respect to the process through which suspending voting rights or forfeiting ownership interests could be applied.</p> <p>Additional criteria. While no periodicity has been prescribed, the banks supply to the CNB, in advance of the general shareholder meeting, a statement of shareholders from the shares register.</p>

	During on-site examinations the inspectors review the list of shareholders owning interests of 5 percent or more in the total share capital of the bank.
Assessment	The CNB is largely compliant with respect to the Essential and Additional criteria.
Comments	The CNB is planning to draft procedures covering the acquisition and increase of qualified participation in a bank. This also constitutes an area where closer collaboration with the CSC would be beneficial for those banks that are listed legal entities. This will also ensure that the Securities Act is consistent with the AoB and the relevant regulations issued by the CNB.
Principle 5.	Investment Criteria 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.
Description	Essential criteria. Under the law, banks can merge but they must have prior consent of the CNB. The CNB has to approve the bank's control over another bank. The CNB monitors the bank's control over financial institutions and ancillary banking service undertakings. The law prohibits banks from exercising control over non-financial corporations, with the exception of ancillary banking services' undertakings. For this purpose, a financial institution is understood to be an investment company, an investment fund or an insurance company that performs its activities pursuant to special Acts. A bank is not allowed to exercise control over another legal entity, other than those mentioned above, and the qualifying holding in that legal entity must not exceed: (1) 15 percent of the bank's capital, and (2) a total of 60 percent of the bank's capital in the sum of all legal entities. These limitations do not apply to acquisitions resulting from a claim against such legal entity, providing the bank holds the qualifying holding for a maximum of one year from the date of acquiring it, and to acquisitions in virtue of the bank's participation in the issuing of securities and the rendering of such services, provided the bank holds the qualifying holding for a maximum of six months. The law however is not specific with respect to investments in limited partnership and cross border investments and acquisitions. No criteria for judging acquisitions and investments on an individual basis exists. While the CNB reviews proposals to ensure that the acquiring bank is not exposed to excessive risks, or will create a structure that will hinder effective supervision, there is no methodology for evaluation.
Assessment	The CNB complies with the Essential criteria. There are no Additional criteria. Recommendation. Given the universal banking system and cross holdings by bank holding companies in insurance, securities and nonbank areas, as well as the absence of any limitations on overseas investments by Czech banks or acquisitions by foreign firms, the CNB should develop criteria for an assessment of acquisitions and investments.
Comments	
Principle 6.	Capital Adequacy Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.
Description	Essential criteria. All banks are required to maintain a minimum prescribed ratio of capital and reserves to risk weighted assets of 8 percent. A CNB regulation sets out in detail a definition of regulatory capital and risk weighted assets. It follows closely the Basel capital accord. The minimum capital adequacy ratio is applied on a daily basis but only at a "solo" level. It does not apply to foreign bank branches. The law does not allow the CNB to prescribe differentiated capital ratios. On a solo basis, the regulation on capital adequacy incorporates credit risk and market risk, in line with current international recommendations. On a consolidated basis, the CNB does not require capital charges for market risks. This is due to change from 2002 when the capital adequacy requirement will be amended to reflect both credit and market risk. Furthermore, the scope of the supervision of credit risk on a consolidated basis excludes holding companies that are not controlled by a bank. Should a bank's risk asset ratio fall below two-thirds of its minimum ratio, the CNB has to impose one or more remedial measures. These

	<p>include requiring an increase in the bank's initial capital, limiting the bank to the acquisition of assets with a risk weighting of less than 100 percent, or prohibiting the granting of credit to any person with special relations to the bank. Banks submit capital adequacy returns on a monthly basis and the external auditors are required to verify their accuracy annually. The first annual returns on a consolidated basis are to be submitted in early 2001 showing the position as at end-September 2000. The frequency of reporting will change to a quarterly basis from 2002.</p> <p>Additional criteria. The definition of capital and capital adequacy applies equally to domestic and foreign banks incorporated in the Czech Republic. No provision exists for corrective actions that the CNB can take in the event that the absolute level of capital falls below the minimum requirement (CZK 500 million). Similarly, there are no requirements for banks to set up internal processes to assess their overall capital adequacy in relation to their risk profile. Despite the problems that Czech banks have faced over the past few years and the structural changes that the banking sector has undergone, the CNB has not judged it necessary to increase the minimum capital adequacy ratio.</p>
Assessment	<p>The CNB is largely compliant with respect to the Essential criteria and materially non-compliant with regard to the Additional criteria.</p> <p>Recommendation. The CNB should take into account the risk profile of a bank when setting its capital adequacy ratio. This would require the power to set different capital adequacy ratios for each bank. There should also be a requirement for capital allocation to cover market risk at a consolidated as well as a solo-consolidated level. As a fall in capital is a good early warning signal of problems in a bank, CNB should prescribe rules and guidelines for actions that it would initiate on receiving such a signal. Powers should be given to the CNB to adjust capital adequacy requirements in situations where the risks and vulnerabilities to, or the risk profiles of banks are changing.</p>
Comments	<p>In the recent amendments to the AoB it was proposed to raise the minimum amount of capital to CZK 800 million. With effect from 2002 the CNB is proposing to extend capital adequacy requirements to include market risk on a consolidated basis.</p>
Principle 7.	<p>Credit Policies An essential part of any supervisory system is the independent 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.</p>
Description	<p>Essential criteria. No specific regulation exists that requires banks to put in place a management and board approved loan and investment policy, including a credit risk management process. However, under the CNB's regulation on capital adequacy, the supervisor requires that banks should develop a management information system for credit and market risk to provide information on positions and exposures to individual entities, groups of connected debtors, sectors and geographical territories. Banks are also required to prepare an annual Bank Performance Report (BPR) that includes a description of credit risk management processes. The BPR has to be verified by an external auditor. The auditor must express a view on the timeliness and accuracy of management reporting systems. During on-site examinations, the CNB verifies that the internal systems relating to credit management are adhered to. The AoB prohibits banks from concluding agreements with persons connected to the bank under conspicuously disadvantageous conditions for the bank. During on-site inspections credit granting and limit monitoring procedures are reviewed, thereby indirectly verifying the non-existence of conflicts of interests. The dissemination of limits within each bank, although not explicitly required within the regulations, is verified during on-site inspection visits. The CNB has full access to information in banks' credit and investment portfolios and to the lending officers of banks during on-site examinations. These powers do not exist for information required to monitor credit and investment policies and practices through the off-site mechanism.</p> <p>Additional criteria. There is no regulatory requirement for decisions on major credits or</p>

	investments, above a certain amount or percentage of a bank's capital, to be decided at an appropriate managerial level. The same is true of credits or investments that are outside of a bank's traditional business activities. The CNB's provision on capital adequacy requires that banks put in place a management information system that provides essential details on the condition of the loan and investment portfolios. During on-site examinations the CNB inspectors verify that management monitor the total indebtedness of entities to which they extend credit.
Assessment	<p>The CNB is materially non-compliant with respect to both Essential and Additional criteria.</p> <p>Recommendations. While in practice credit management systems are reviewed during on-site inspections, several of the Essential criteria in this Core Principle do not have a formal basis within the Czech banking regulations. These should be formalized. In particular banks should be required to implement a credit policy that sets out the decision making process for loans above a certain level or which fall outside of the bank's usual business activities.</p>
Comments	The CNB intends to issue a regulation containing general prudential standards for banks including various requirements relating to credit-risk management.
Principle 8.	<p>Loan Evaluation and Loan Loss Provisioning 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.</p>
Description	<p>Essential criteria. The CNB requires banks to undertake a periodic review of the loan portfolio, including the adequacy of provisions. In 1998 the requirements for creating the provisions for loss credits collateralized by real estate were tightened. This measure was a response to the inability to enforce lien of real estate. The classification and provisioning rules are verified during on-site examinations. The system for classification and provisioning concerning off-balance sheet exposures is however not adequately addressed by the regulations. The supervisory authority determines that banks have appropriate policies to ensure that loan loss provisions reflect, as a minimum, the CNB's provisioning requirements. No requirement has been set for the establishment of a system of writing off claims. There are also no requirements for banks to have appropriate procedures and organizational structures for the monitoring of problem credits and for collecting past due loans. The AoB gives power to the CNB to require a bank to strengthen its lending practices, credit-granting standards, level of provisions and reserve, and overall financial strength if it deems the level of problem assets to be of concern. In addition the CNB can require verification of credit systems by an external auditor. The CNB receives monthly reports on classified credits and other assets, and the extent of provisioning. CNB requires banks to put in place systems to assess the quality of collateral. Such a system must include categorization of collateral, monitoring mechanism and procedure for appraisal and re-appraisal of the value of collateral. During on-site examinations supervisors assess the quality of guarantees and collateral, including the frequency of re-appraisal.</p> <p>Additional criteria. The CNB requires banks to classify loans on a rising scale when payments are in arrears of 30, 90, 180, and 361 days. It prohibits any improvement in the classification for refinanced loans that would otherwise fall into arrears. The regulation requires valuation, classification, and provisioning for loans, regardless of size.</p>
Assessment	The CNB is largely compliant in respect to both Essential and Additional criteria.
Comments	While the laws relating to bankruptcy proceedings and auctions have recently been updated, it remains difficult for banks to realize collateral in a timely manner.

Principle 9.	<p>Large Exposure Limits 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.</p>
Description	<p>Essential criteria. The CNB regulation on capital adequacy defines a “group of connected debtors” by providing some illustrative examples rather than through an explicit definition. The regulations covering prudent limits on large exposures to a single borrower or “group of connected debtors” includes all on- and off-balance sheet exposures. During on-site inspections the supervisor verifies that banks have in place information systems that enable management to identify on a timely basis concentrations within the credit portfolio. This is done on both a solo and consolidated basis.</p> <p>Additional criteria. Although the definition of a “large exposure” has not been set out explicitly, banks are required to report credit exposures of 10 percent or more of their capital. The aggregate of large exposures cannot exceed 800 percent of capital. Twenty five percent of capital has been prescribed as the limit for individual large exposures to private borrowers or a “group of connected debtors.” Excesses are required to be reported to the CNB, including remedial steps.</p>
Assessment	<p>CNB is largely compliant with the Essential and Additional criteria.</p> <p>Recommendation. The supervisors should be allowed greater discretion in interpreting the definition of a “connected or related parties.”</p>
Comments	<p>The risk concentration and reporting on a consolidated basis have only recently been introduced.</p>
Principle 10.	<p>Connected Lending 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.</p>
Description	<p>Essential criteria. The AoB defines a “person with special relation to the bank,” but the supervisory authority has no discretion to make judgments about the existence of connections between the bank and parties other than those specified in the Act. Banks cannot undertake transactions with such persons on a preferential basis. The decision to lend must be approved by the statutory body and subject to a proper evaluation. The CNB, however, does not explicitly require procedures that prevent beneficiaries from being involved in the lending decision. A limit of 20 percent of the bank’s capital is applied to credit exposures to persons with a special relation to the bank. The CNB has powers to prohibit the bank from providing credit to a related party when the bank’s capital adequacy ratio is lower than two-thirds of the minimum required level. There are no formal requirements to put in place an information system that identifies loans to connected and related parties or the amount lent. Nor are such loans required to be monitored through an independent credit administration process. During on-site examinations supervisor obtains and reviews information on aggregate lending to connected and related parties.</p> <p>Additional criteria. The definition of a “person with a special relation to a bank” is narrow, and the CNB does not have a mandate to expand it. The limit on aggregate exposures to a “person with a special relation to a bank” is set at 20 percent of capital and is lower than that applied to other parties (25 percent)</p>
Assessment	<p>The CNB is largely compliant with the Essential and Additional criteria.</p> <p>Recommendation. More discretion should be given to the supervisory authority to make judgments about the “connectedness” of persons to whom a bank is lending. This could be achieved by providing a broader definition of “connected or related parties.”</p>
Comments	<p>In practice, the CNB relies on its on-site review to make a determination about possible abuse</p>

	through connected lending. The CNB, however, acknowledges that in practice the detection of connected lending has been difficult.
Principle 11.	Country Risk 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 risks.
Description	Essential criteria. Article 66 of the Provision on Capital Adequacy Incorporating Market Risk requires that banks put in place a credit and market risk management system that, inter alia, provides consistent and accurate information on exposures to “geographical territories” and countries. As a complement to this, in early 2000 the CNB introduced a supervisory return for banks to report exposure by individual country. The off-site examiners review the return. As part of the on-site assessment of a bank’s risk management systems, the CNB verifies that an internal control system is in place to control country risk. In addition the annual Bank Performance report includes a review of “state solvency risk,” including the measurement and monitoring of such risk and the risk management methods employed by each institution. The CNB does not prescribe provisioning levels against individual country risk. Article 3 of the Provision on the Principles of Classification of Claims on Credits and Creation of Provisions for Such Claims requires that banks, in determining the appropriate level of provisions, take into account “other external economic and political factors” that could affect the quality of a loan.
Assessment	The CNB is largely compliant in respect of the Essential criteria. There are no Additional criteria. Recommendation: The CNB and the banks already identify country and transfer risk as a part of banks’ overall risk management systems. However, CP 11 requires banks to have a systematic framework for managing country and transfer risk and consequently the requirements for the identification, monitoring and control of country and transfer risk should be made explicit within banking regulations.
Comments	Czech banks have minimal country/transfer risk, either on- or off-balance sheet. Almost three-quarters of non-Czech exposure is to other OECD countries. The CNB intends to issue a regulation containing basic prudential standards for banks, including management of country and transfer risk.
Principle 12.	Market Risks 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.
Description	Essential Criteria. There are no explicit policy requirements in relation to the identification, measurement, monitoring and control of market risk. However, the AoB and the Provision on Capital Adequacy Incorporating Market Risk (Article 66) sets out general requirements for management of market risk (interest rate risk, equity risk, foreign exchange risk, commodity risk and options contracts), commensurate with the size and complexity of the business, including the ability to monitor positions on a daily basis. Risk management systems are reviewed as part of the CNB’s on-site inspections, including an assessment of adherence to internal limit structures. The CNB prescribes limits for FX positions. For other market risks banks are required to establish and observe internal limits. The provision on capital adequacy also stipulates the general procedure for calculating the capital charge to cover market risks. The supervisor cannot impose a specific capital charge or specific limits on market risk exposures on an individual bank basis. Article 3 of the Provision on Capital Adequacy Incorporating Market Risk requires that “trading portfolio instruments are revalued by fair values on a daily basis.” Banks are required to submit to the CNB an annual assessment, signed by an external auditor, confirming that the system of preparing reports for the CNB accurately reflected fair values. There are no explicit requirements to perform scenario analysis, stress testing or contingency planning in relation to the trading book although Article 60 of the provision on capital adequacy requires banks using their own internal models to calculate capital requirements for market risk

	<p>to undertake stress testing. No bank has applied to the CNB for model recognition and consequently the CNB has very limited experience in this area. However, the CNB is establishing a team to undertake assessments of VaR models and staff are undergoing training on market risk issues. In addition, the CNB is seeking secondment opportunities to overseas regulators where VaR model assessments are being undertaken.</p> <p>Additional Criteria. The expertise of senior management in the area of market risk is assessed by the supervisor during interviews with bank staff, although the CNB does not have the power to remove individuals in the event that their required skills be judged to be inadequate. So far no banks have applied for VaR model recognition.</p>
Assessment	<p>The CNB is largely compliant with respect to the Essential and the Additional criteria.</p> <p>Recommendation. The CNB should be given the power to impose a specific capital charge and/or specific limits on market risk. The requirement for banks to perform scenario analysis, stress testing and contingency planning should be made explicit in the regulations. It is vital that the CNB is able to develop its expertise in the area of market risk supervision in general and VaR models in particular. To this end, the Bank’s efforts to train staff on market risk issues should be welcomed. Until such time as the CNB has managed to develop sufficient market risk expertise, banks should be denied the opportunity to determine their capital requirements using VaR models.</p>
Comments	<p>The level of market risk being run by the Czech banks is still small although it is growing as the market develops and as the banks become more sophisticated. The ability to set differential capital ratios for individual banks based on their risk profile (including market risk) would be a valuable supervisory tool.</p>
Principle 13.	<p>Other Risks 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.</p>
Description	<p>Essential Criteria. Other than for market risk in the trading book, Czech banking regulations do not explicitly require banks to put in place a detailed risk management process to identify, measure, monitor and control other material risks. The Provision on Liquidity Rules of Banks sets out basic requirements for liquidity management. Requirements for stress testing and separate liquidity management for domestic and foreign currencies are not explicitly set. However, banks are required to break down assets and liabilities (both on- and off-balance sheet) by currencies (with focus on Czech koruna, convertible and non-convertible currencies) within their management information systems. Liquidity management systems are verified during on-site examinations while off-site examiners monitor liquidity positions through the monthly liquidity returns. The CNB does not set mismatch guidelines or a stock of liquidity requirement, although Article 14 of the AoB requires the CNB to set rules in relation to a “minimum level of liquid funds.” The Provision on Liquidity Rules for Banks (Article 5) also stipulates that the CNB can require banks to meet their own liquidity limits and has the right to revise these limits if it believes such action to be necessary. Interest rate risk management is verified during on-site inspections although the method of gapping analysis is not prescribed. Operational risk is not defined in Czech banking regulation. Other than for liquidity risk there is no explicit requirement for banks to promulgate limits and risk management procedures to appropriate staff or to ensure that responsibility for adhering to those limits and procedures is placed with the relevant business area. However, responsibilities for “limit” monitoring and risk management procedures are defined in practice and these are reviewed by the CNB during on-site inspections.</p> <p>Additional Criteria. The AoB allows the CNB to stipulate capital requirements for risks in addition to credit and market risk. The CNB has no requirements or recommendations that banks</p>

	<p>issue public statements on their risk management policies (although a draft regulation for the MoF is under preparation that will require disclosure of risk management policies within the annual accounts). Nor does the CNB collect sufficient data to enable it to identify institutions carrying out significant foreign currency liquidity transformation. However, where appropriate, multiple currency strategies and evaluation systems are verified during on-site examinations.</p>
Assessment	<p>The CNB is materially non-compliant on the Essential criteria and the Additional criteria.</p> <p>Recommendation. The regulations should explicitly require individual banks to have in place comprehensive risk management processes (including oversight responsibilities) to identify, measure, monitor and control material risks. In addition, the CNB needs to set more explicit standards for management of interest rate, foreign exchange and operational risk. For liquidity risk the CNB should consider setting guidelines (either on a mismatch basis or via a stock of liquidity guideline) on a bank-by-bank basis.</p>
Comments	<p>In practice, most Czech banks have in place risk management systems, relevant to the size and complexity of their business. However, in general terms these requirements need to be made explicit in the banking regulations. A new provision on liquidity is under preparation, which will bring the CNB's approach into line with recent BIS recommendations. Some thought is being given to setting basic prudential standards for banks, including management of interest rate risk and operational risk</p>
Principle 14.	<p>Internal Control and Audit</p> <p>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.</p>
Description	<p>Essential criteria. The Commercial Code sets out the general responsibilities of the Board of Directors with respect to corporate governance. The Board is ultimately responsible for ensuring that there is effective control over risk management although the Board's responsibilities are not set down in detail. At the point of authorization the CNB undertakes a review of the Board of Directors and the skills set of the members of the senior management team. Ongoing assessments of senior management competence are made through on-site examinations. Although the CNB theoretically has the power to require changes in Board membership, in practice this power has not been exercised; if it were to be, it may be difficult to enforce if the bank's shareholders proved resistant to the change. The AoB and Article 66 of the Provision on Capital Adequacy Incorporating Market Risk requires that "incompatible business activities" are separated. The CNB assesses the organizational structure of each bank during the authorization process. The existence of an Internal Audit function in the banks is considered as an integral part of a bank's control process and a review of the Internal Audit department is included in the annual Bank Performance Report produced by the external auditors. However, the requirement to establish an internal audit department is not set out explicitly in law. The Banking Association has published a code for internal audit practice which is followed by all banks but which does not have a statutory basis. The CNB examines auditors' reports as part of the on-site review of a bank's internal control systems. The off-site examiners can also request reports although their right to access these reports is ambiguous.</p> <p>Additional Criteria. There is no concept of a Non-Executive Director nor is there a formal requirement to create an audit committee within Czech banks. Where such committees do exist, they comprise members of the statutory board (the board of directors). In practice, Czech banks do have internal audit departments that report to the CEO or to a committee comprising members of the supervisory board.</p>

Assessment	<p>The CNB is largely compliant with this principle in terms of the Essential criteria. The Additional criteria are not applicable.</p> <p>Recommendation. The requirements relating to internal control and audit should be set out more explicitly in the prudential regulations.</p>
Comments	<p>The Bank Performance Report, which is verified by an external auditor, is an important source of information on the adequacy of a bank's internal control systems. At present an external auditor would not be able to approach the CNB to discuss an issue on the BPR unless he had the prior consent of the relevant bank. There is, however, a proposal that from 2001 the external auditor will be able to make direct contact with the supervisor provided that he tells the bank that he is doing so at the same time. An amendment to the Act on Banks that was rejected by Parliament in late 2000 would have introduced a formal requirement to establish an internal audit department.</p>
Principle 15.	<p>Money Laundering 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.</p>
Description	<p>Essential criteria. The CNB has responsibility for checking compliance with various provisions of Czech anti-money laundering legislation (Act No. 61/1996 Coll. on Some Anti-Money Laundering Measures (as amended)). Article 9 of Act No. 61/1996 obliges financial institutions to implement a system of internal rules, procedures and controls to prevent money laundering through their facilities. Article 2 of Act No. 61/1996 requires identification of any person concluding a transaction exceeding CZK 500,000. Article 4 requires that any financial institution discovering an unusual transaction report this to the Financial Analytical Department within the MoF within a five-day period. Article 37 of the Act on Banks obliges banks to seek proof of a client's identity for transactions exceeding CZK 100,000 and requires banks to maintain a record of the identification documentation for a 10-year period following the completion of the transaction. A bank's compliance with these requirements is checked during on-site inspections. There is no explicit requirement to appoint a senior officer with responsibility for ensuring that a bank's policies and procedures are in accordance with local statutory regulatory anti-money laundering requirements. There is also no requirement for banks to report to the supervisor any suspicious activities and incidents of fraud material to the safety, soundness or reputation of the bank. Banks are not required to produce a policy statement on ethics and professional behavior.</p> <p>Additional criteria. It is not clear whether there is a legal requirement for the CNB to inform the criminal authorities of any suspicious transactions that it becomes aware of. This position needs to be clarified.</p>
Assessment	<p>The CNB is materially non-compliant on both the Essential and the Additional criteria.</p> <p>Recommendation: The CNB should incorporate detailed "know-your-customer" requirements into the regulations. The regulations should also require banks to report to the supervisor suspicious activities and incidents of fraud which might threaten the safety, soundness or reputation of the bank. Banks should be required to produce a policy statement on standards expected of staff in terms of ethical and professional behavior. Finally the legal position requiring the reporting of suspicious transactions by the CNB should be clarified with a legal obligation placed on the CNB to report suspicious transactions to the relevant criminal authorities.</p>
Comments	<p>The Act established a Financial Analytical Section (FAU) at the MoF, responsible for implementing and supervising observance of the anti-money laundering law. All the aforementioned financial institutions report suspicious transactions to the FAU. The FAU collects and analyzes all information on suspicious transactions and is authorized to take legal</p>

	action (including issuing orders to suspend transactions, initiating prosecutions, etc.). The Banking Association has supported the implementation of the law by issuing a special <i>Codex</i> for this purpose. The <i>Codex</i> is followed by all member banks.
Principle 16.	On-Site and Off-Site Supervision An effective banking supervisory system should consist of some form of both on- and off-site supervision.
Description	<p>Essential criteria. The CNB has an integrated framework of on- and off-site supervision. Off-site surveillance involves regular monitoring and evaluation of the positions of individual banks from the viewpoint of their observance of the prudential rules and their current financial position. It also involves an assessment of the organizational structure of a bank, its shareholder structure, its management, and its ownership links with other entities in both the financial and non-financial areas. On-site examinations cover an assessment of the quality of the bank's management systems, its internal audit system, its information system, its credit portfolio, compliance with the applicable law and regulations, in particular provisioning regulations, reliability of the information provided by the bank and its risk management and internal control systems. Corporate governance is not investigated and no methodological base exists. Comprehensive on-site examinations are conducted once every two to three years, and more frequently in problem banks.</p> <p>Additional criteria. There is no regular procedure in place to assess the effectiveness of on-site supervision. It is theoretically possible for the supervisors to see Internal Audit reports at any time although as indicated in CP 1(4) doubts remain about the level of access in real terms outside of on-site inspections. The CNB already operates a numerical rating system based on the CAMEL criteria. However, the scores derived from the system do not directly influence the supervisory resources allocated to the supervision of each bank and there is no formal risk based system in place to determine where supervisory resources should be most effectively applied. The supervisory authority is required by law to treat information received as part of the supervisory process as confidential. There is little reliance placed on the work of banks' own internal audit functions.</p>
Assessment	<p>The CNB is largely compliant in the Essential criteria and materially non-compliant in relation to the Additional criteria.</p> <p>Recommendation. The CNB should continue to move toward a risk based system of supervision. Supervisors also need to maintain and reinforce their expertise in monitoring and controlling market and operational risks. In particular, supervisors must be capable of undertaking VaR model reviews. Greater emphasis needs to be placed on rigorous monitoring of risk adjusted capital adequacy positions and insistence for the banks to put in place put in place risk management processes for credit, market, liquidity, operational and reputational risks. The CNB should consider establishing an internal "quality assurance" function to review the effectiveness of its on- and off-site supervision.</p>
Comments	Although the CNB does not currently operate a risk-based system of supervision, there are indications that "risk" is becoming a factor in determining the supervisor's work program.
Principle 17.	Bank Management Contact Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.
Description	<p>Essential criteria. The supervisory authority meets with the board of directors of banks at least once a year to discuss operational matters. There is also a regular and ad hoc program of meetings with senior and middle management. In addition to on-site examinations the CNB also uses off-site surveillance as a tool for monitoring banks' activities. Significant changes in activities that fall within the framework of the license are not required to be notified to the CNB nor is there a specific requirement within the banking regulations for institutions to report any material adverse developments apart from a breach of the capital adequacy ratio below two-thirds of the target ratio. If the statutory body or supervisory board of a bank believes that the</p>

	institution is or is likely to become insolvent or that it will probably incur losses that have caused or may cause a decrease in its ratio of capital to risk weighted assets to below two-thirds of the ratio laid down by the CNB, it must notify the CNB without delay (Article 26b of the AoB). The quality of management is assessed by the CNB as part of the licensing process and on an ongoing basis through on-site interviews with members of the management team.
Assessment	Largely compliant in the Essential criteria (there are no Additional criteria). Recommendation. Explicit requirements regarding the prior notification to the CNB of substantive changes in the activities of a bank should stipulated within the AoB.
Comments	Banks generally notify the supervisory authority of any substantive changes in their activities, although they are not obliged to do so by the AoB.
Principle 18.	Off-Site Supervision Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
Description	Essential criteria. According to the law [Article 41(2) of the AoB], the CNB has the legal authority to require banking organizations to submit information and provide financial and prudential data, on a solo and consolidated basis, on their financial condition and performance, at regular intervals. General accounting techniques are established by the MoF. The CNB can enforce compliance with the requirement that the information must be submitted on a timely and accurate basis [Article 41(2)] and the supervisor has the power to impose penalties for mis-reporting and persistent errors. Senior management is, according the Commercial Code, responsible for all data transmitted to the CNB. The CNB has the authority to request relevant information from banks, but not from their related companies if these are not banks. The supervisory authority has in place an information system for the ongoing monitoring of the condition and performance of individual banks, based on financial and prudential information. This system is based on the CAMEL ratings. The supervisory authority collects data from banks at a variable frequency under the scope of the CNB regulations.
Assessment	The CNB is largely compliant in terms of the Essential criteria (there are no Additional criteria). Recommendation. The CNB should regulate the accounting rules concerning consolidation for prudential purposes and should have authority to request relevant information from related companies for prudential assessment on a consolidated basis (e.g., leasing companies, other non-banking financial entities, holding companies, and banking auxiliary companies). There should also be a regular exchange of information between the domestic supervisory agencies (the CNB, the MoF, and the CSC) regarding group companies that are subject to different regulatory regimes.
Comments	A tripartite agreement covering the exchange of information between the CNB, the MoF, and the CSC is already in place.
Principle 19.	Validation of Supervisory Information Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
Description	Essential criteria. The CNB has in place a process for planning and executing on-site examinations. Policies and informal procedures are in place to ensure that examinations are conducted on thorough and consistent basis, with clear responsibilities, objectives, and outputs. The supervisor holds meetings with banks and their auditors to discuss the findings and can require corrective measures. The CNB has no authority to monitor the quality of work done by external auditors but the supervisor can oppose the appointment of an auditor. This right has been exercised. Pursuant to Article 26 of the AoB, the supervisory authority may order an extraordinary audit at the expense of the bank. The supervisory authority has the legal right of access to all bank records, to the board, senior management and staff, when required, although as indicated in CP 1 (4) there is some ambiguity regarding the CNB's ability to demand files outside of an inspection visit. According to articles in the provisions on liquidity rules and

	<p>capital adequacy, banks are required to send to the CSC an annual review by an external auditor to confirm that information has been reported accurately to the CNB and that the bank's information systems reflect the true position of the bank.</p> <p>Additional criteria. The findings of on-site examinations are discussed with the bank's management. Once or twice a year, the supervisory authority meets with the external auditor to discuss matters of common interest.</p>
Assessment	<p>Largely compliant with regard to both the Essential and Additional criteria.</p> <p>Recommendation. The CNB should be given an explicit authority to monitor the quality of work performed by external auditors in the area of prudential supervision (e.g., the oversight of the information systems and reliability of prudential returns).</p>
Comments	
Principle 20.	<p>Consolidated Supervision</p> <p>An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.</p>
Description	<p>Essential criteria. CNB Provision No. 2/1999 sets out the rules for supervision on a consolidated basis for credit risk. However, the scope of the regulation is incomplete, as financial holding companies are not included in the assessment and there is no capital allocation to cover market risk on a consolidated basis. There is also no framework that evaluates the risks presented by non-bank entities within banking groups, such as leasing companies and other financial institutions. The supervisory authority has no legal power to supervise subsidiaries that are not banks. The CNB collects, on an annual basis, consolidated financial information for banking groups. The CNB has no legal authority to limit or circumscribe the range of activities that a consolidated group may undertake or the overseas locations in which such activities occur. A system of information sharing between the domestic regulators (of banking, insurance and securities) exists. However, the information shared between the agencies relates principally to limit breaches and suspected criminal activities. There is no focus on the underlying risks present within each banking group.</p> <p>Additional criteria. The law does not impede corporate ownership of banks. However, the supervisory authority is not allowed to review the activities of parent companies and of companies affiliated with the parent company. In cases where bank owners operate to the detriment of the prudent and sound management of the bank, or their actions can be reasonably expected to do so, the CNB can impose administrative procedures, including the suspension of voting rights. The supervisor assesses the bank's owners as part of the licensing process, but does not have the authority to apply a fit and proper test with respect to the senior management of parent companies that are not banks.</p>
Assessment	<p>Materially non-compliant in both the Essential and the Additional criteria.</p> <p>Recommendation. The CNB should be given powers to assess whether the management of financial holding companies of banks are fit and proper on an on-going basis. Furthermore, the CNB should have legal powers to seek information from holding companies and other entities within a banking group. The CNB should also be able to undertake on-site inspections of financial holding companies of banks and their subsidiaries if, in the judgment of the supervisors, these entities pose a threat to the bank itself.</p>
Comments	<p>As of 2001, returns on a consolidated basis should be received in CNB quarterly. An amendment to the AoB concerning, among others, the enlargement of the scope of supervision on a consolidated basis was recently presented to Parliament, but was rejected.</p>

<p>Principle 21.</p>	<p>Accounting Standard 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.</p>
<p>Description</p>	<p>Essential criteria. The relevant legislation (AoB, Act on Accounting, and the Commercial Code) ascribes responsibility for the reliability of accounting data to management. The accuracy and timely submission of data is required by accounting laws and by CNB provisions. Banks are required to have their accounting statements and prudential reports verified by an external auditor while on-site inspections are conducted by the CNB to verify, <i>inter alia</i>, the accuracy of bank record keeping. The CNB is able to discuss issues with an external auditor although only with the prior approval of the relevant bank. Reporting requirements, including the structure and content of prudential reports, are specified by the CNB and originate from special accounting procedures for banks which have been stipulated by the MoF. These are not fully compliant with international accounting standards. All information on individual banks is treated as confidential by the CNB. Banks are required to produce annual statements that are audited to Czech Accounting Standards (CAS). CAS are gradually being harmonized with IAS although some differences remain. Most Czech banks also produce IAS-equivalent accounts. The CNB can revoke the appointment of a bank's auditor.</p> <p>Additional criteria. Banks are required to provide through their premises selected information on their activities and financial indicators. These must be provided quarterly. Auditors are required to report, with the prior knowledge of the bank, any matters of material significance that could adversely impact on the bank's performance.</p>
<p>Assessment</p>	<p>The CNB is largely compliant with CP 21 in both the Essential and Additional criteria.</p> <p>Recommendation. CAS should continue to be brought into line with international accepted accounting principles and procedures. It is important that the external auditor has free access to the supervisor to discuss any issues of concern and that the prior consent of an institution should not be a pre-requisite to such discussions.</p>
<p>Comments</p>	<p>The requirement to receive prior consent of the bank before the auditor is able to speak to the CNB on matters which have a direct relevance to the performance of that bank is a barrier to effective supervision.</p>
<p>Principle 22.</p>	<p>Remedial Measures 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 license or recommend its revocation.</p>
<p>Description</p>	<p>Essential criteria. Article 26 of the AoB sets out a range of remedial actions and sanctions that the CNB may take in the event that shortcomings are detected in a bank or foreign branch. These include the power to restrict the permitted activities of the bank (including asset transfers) or to order the cessation of unpermitted activities, to impose conservatorship, to demand that the bank replace persons in management or members of the supervisory board, to impose fines up to CZK 50 million, or to reduce the capital of the bank where a loss exceeds 20 percent of the bank's capital base. There is no explicit power to suspend payments to shareholders although shareholder voting rights can be suspended where they have obtained an unauthorized stake in a bank or where their activities have been detrimental to the bank. The right to bar individuals from the banking sector is not laid down by law although the CNB does have the power to ask a bank to withdraw prospective members of the statutory board at the point of authorization. If serious shortcomings persist in the activities of a bank the supervisor can revoke its license after requesting the viewpoint of the MoF. Where the supervisor becomes aware of a deficiency at a</p>

	<p>bank through an on-site inspection, the CNB can take corrective action although the bank can contest the findings of the inspectors (the Act on State Inspection governs the conduct of on-site inspections, including the rights of the banks to contest the findings of the inspectors).</p> <p>Additional Criteria. There are no explicit provisions against forbearance. However, where the risk asset ratio of a bank falls below two-thirds of the minimum required by the CNB, the supervisor has to impose remedial measures. Where the ratio falls below one-third the CNB is obliged to revoke the license.</p>
Assessment	<p>The CNB is largely compliant in respect of both the Essential criteria and Additional criteria.</p> <p>Recommendation. The rules governing the conduct of on-site inspections should be reviewed to ensure that there are no barriers to the supervisor being able to implement prompt corrective action should weaknesses be identified during the course of an on-site inspection.</p>
Comments	<p>Although the supervisor can take action as soon as a deficiency is identified, in practice the bank has the right to provide a view on the suspected deficiency. If, after considering the bank's comments the supervisor still considers the bank to be deficient, the bank may appeal to the senior management of the CNB. In some cases this can lead to a delay in the implementation of remedial action.</p>
Principle 23.	<p>Globally Consolidated Supervision Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.</p>
Description	<p>Essential Criteria. The CNB is able to supervise the branches and subsidiaries of Czech banks abroad, subject to local laws. In practice, there is no direct supervision of the overseas branches; however, during on-site examinations to the head office of a Czech bank, the supervisor may review branch activities and branch management systems, including the information flow from the branch. The supervisor has no locus to restrict the activities of foreign subsidiaries of Czech banks nor can it prohibit directly the establishment of such subsidiaries unless a bank's capital adequacy falls below two-thirds of the minimum limit. There are no explicit powers available to the CNB to require the closure of a foreign bank branch, although the same effect could be achieved by restricting the activities of the bank contained in its license.</p> <p>Additional Criteria. The CNB does not have a policy for assessing whether it needs to conduct an on-site visit or require additional reporting from overseas offices although, as mentioned above, its powers to supervise overseas offices are restricted to one branch in Slovakia. No formal assessment has been made of the quality of Slovakian supervision.</p>
Assessment	<p>The CNB is materially non-compliant in relation to the Essential criteria and the Additional criteria.</p> <p>Recommendation. The CNB needs to put in place regulations covering the consolidated supervision of banking groups (including foreign subsidiaries of Czech banks and banking groups). This should include the power to require closure of a branch or a foreign subsidiary as well as the power to restrict their activities if the CNB determines that risk is not being managed properly in those offices.</p>
Comments	<p>At present overseas offices of Czech banks are limited to three subsidiaries (Poland, Russia, and Slovakia).</p>
Principle 24.	<p>Host Country Supervision A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.</p>
Description	<p>Essential criteria. Pursuant to Article 38 of the AoB, the exchange of information between the CNB and its overseas counterparts is not considered a breach of banking secrecy if the subject</p>

	<p>of the exchange is information on entities which are active or intend to start operations in the territory of the respective country. In 1999 the CNB signed an agreement on cooperation with the National Bank of Slovakia. An informal agreement is also in place with the German banking supervisor. MoUs are being pursued with the Austrian and Belgian supervisory authorities, while informal cooperation exists with the Dutch supervisor with the prospect of a formal agreement being signed at a later date. Initial contact has been made with the French Banking CSC. Informal cooperation also exists with the U.K. FSA and the U.S. Federal Reserve, although formal agreements are not expected owing to a lack of interest by the partner institutions. The supervisory authority cannot prohibit subsidiaries of banks or their affiliates from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision. Article 16 of the AoB stipulates a bank's duty to inform the CNB about its intention to open a branch or representative office abroad or to set up a legal entity abroad or to acquire an ownership interest abroad. The CNB can provide information to host country supervisors regarding the operations of Czech banks in that country. In practice, the CNB has provided information to the Slovakian supervisory authorities concerning a branch of a Czech bank operating in that county.</p> <p>Additional Criteria. In practice, the CNB has not yet imposed any corrective measures on the basis of information obtained from foreign supervisors. However, the law does not obstruct the supervisory authorities to take corrective measures.</p>
Assessment	<p>The CNB is largely compliant in both the Essential and Additional criteria.</p> <p>Recommendation: The CNB should be more proactive in seeking an exchange of information with home supervisory authorities.</p>
Comments	<p>The foreign branches and subsidiaries of Czech banks are immaterial and the supervisory authority does not consider this issue a priority.</p>
Principle 25.	<p>Supervision Over Foreign Banks' Establishments 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.</p>
Description	<p>Essential criteria. The regulatory framework is based on the principle of equal treatment for foreign and domestic investors. Banks controlled by foreign investors are subject to the same regulatory requirements as banks controlled by domestic capital. Branches of foreign banks have to be licensed by the CNB. Nevertheless, their parent banks are not asked to allocate regulatory capital in the Czech Republic. Consequently, the CNB as host country supervisor does not apply capital adequacy requirements to them. Foreign supervisors can carry out on-site examinations of branch control systems and review data at an aggregate level. However, banking secrecy laws prohibit overseas supervisors from obtaining information about individual clients. In the case of a material remedial action being taken in respect of a branch of a foreign bank, the CNB would advise the home country supervisor on a timely basis. The lack of supervision on a global consolidated basis by a "home country supervisor" would not prevent the granting of a banking license to a subsidiary of a foreign bank. Before issuing a license to a branch of a foreign bank, the supervisory authority determines that the home supervisor has no objections.</p> <p>Additional criteria. The CNB has requested from the home country supervisory authorities information on banking groups which have branches in the Czech Republic.</p>
Assessment	<p>The CNB is largely compliant in regard of the Essential and Additional criteria.</p> <p>Recommendation: The CNB should continue their efforts to establish MOUs with supervisory counterparts in other countries.</p>
Comments	<p>The CNB places considerable reliance on the "reputation" of the foreign banks that have been allowed to establish branches and subsidiaries in the Czech Republic.</p>

Table 4. BCP: Observance of Individual CPs

Core Principle	Gradings										Comments	
	Essential Criteria					Additional Criteria						
	C ¹⁶	LC ¹⁷	MNC ¹⁸	NC ¹⁹	NA ²⁰	C	LC	MNC	NC	NA		
1. Objectives, autonomy, and resources powers		X					X					
1.1 Objectives		X					X					
1.2 Independence			X				X					CNB requires financial independence on matters relating to supervisors resources.
1.3 Legal framework	X									X		
1.4 Enforcement powers			X								X	AoB to be amended to allow CNB unfettered access to individual bank information.
1.5 Legal protection			X								X	Legal protection is lacking.
1.6 Information sharing		X									X	
2. Permissible activities		X									X	
3. Licensing criteria		X					X					
4. Ownership		X					X					
5. Investment criteria	X										X	
6. Capital adequacy		X						X				Need to apply a charge for market risk on a consolidated basis.
7. Credit policies			X					X				Requirements for loan policies and procedures to be formalized.
8. Loan evaluation		X					X					
9. Large exposure limits		X					X					
10. Connected lending		X					X					
11. Country risk		X									X	
12. Market risks		X					X					No use of risk models to calculate capital requirements until supervisory expertise has been built up.
13. Other risks			X					X				Risk management procedures and policies should be in place for all risks.

¹⁶ C: Compliant;

¹⁷ LC: Largely compliant;

¹⁸ MNC: Materially non-compliant;

¹⁹ NC: Non-compliant;

²⁰ NA: Not applicable

14. Internal control and audit		X							X	
15. Money laundering			X					X		Detailed “know-your-customer” requirements should be made explicit within the banking regulations.
16. On-site and off-site supervision		X						X		
17. Bank management		X							X	
18. Off-site supervision		X							X	
19. Validation of information		X					X			
20. Consolidated supervision			X					X		The CNB should have powers to supervise financial holding companies, mixed holding companies and non-bank subsidiaries of financial holding companies.
21. Accounting standards		X					X			
22. Remedial measures		X					X			
23. Global consolidated supervision			X					X		The CNB should be able to restrict the activities of Czech banks foreign operations where those operations pose a risk to the bank as a whole.
24. Host country supervision		X					X			
25. Sup/foreign establishments		X					X			

Response to the assessment and recommended action plan

Response to the assessment

47. The CNB representatives commented that they were content with the overall assessment. The conclusions had been broadly as they expected. On the issue of CP 6 (capital adequacy), the CNB clarified the actions open to it were a bank’s RAR to drop below 8 percent while remaining above the two thirds of the minimum RAR ratio that require the CNB to impose predetermined remedial measures. On the basis of that clarification, the assessment team agreed that the Essential criteria for CP 6 should be assessed as largely compliant. The initial evaluation had been materially non-compliant.

48. The CNB commented that they were generally in agreement with the overall assessment. On the CP relating to money laundering, the CNB was of the view that the existing

legislative and institutional arrangements were adequate. In particular, they noted that according to the law of anti-money laundering procedures, banks are required to report suspicious activities to the Financial Analytical Section of the MoF, which is responsible for implementing and supervising observance of the anti-money laundering law. The CNB in on-site examinations verifies that banks comply with this requirement. The introduction of separate CNB regulations on this matter would, therefore, only lead to duplication of efforts.

Recommended action plan

49. The assessment of the Czech Republic's compliance with the CPs required judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices of supervision are evolving swiftly. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Czech authorities with a reliable measure of the quality of its banking supervision in relation to the CPs, which are internationally acknowledged standards.

50. At an operational level, it is worth noting that the assessment highlighted a general improvement in the quality of supervision over the recent past. In particular, commercial bank contacts suggested that the knowledge base of the inspection teams had deepened, and it was noted that supervisors had made efforts to better understand the business and control risks faced by the Czech banks. The supervisory resources available to the CNB remains a key issue and high attrition rates amongst supervisory staff risk undermining the improvements that have been achieved so far. In this context it is a concern that CNB salaries are to be aligned with civil service salaries. This is likely to lead to a further loss of staff and a weakening of the CNB's ability to regulate the banking sector effectively. Given limited resources the CNB needs to consider a moving toward a more risk based approach to supervision, targeting resources on the key risks facing the banks on both a sector and individual bank basis.

51. More generally, the key supervisory gaps relate to the application of capital charges on a consolidated basis for credit risk only and the lack of consolidated supervision for financial holding companies and mixed holding companies. In addition although a number of key supervisory requirements are met in practice, it is sometimes the case that these requirements are not formalized within the banking supervision laws or provisions. Potentially this could lead to inappropriate policies and procedures being followed by the banks or might inhibit the CNB's ability to require banks to implement changes to their risk management processes. The main action points are set out below.

Areas requiring immediate attention

52. **CP 7** (credit risk). Credit risk is the main risk facing Czech banks at the current time. Although in practice most banks have in place credit risk management procedures and policies, there is no formal basis in the regulations for a number of the essential criteria under this Principle, including the formulation of a Board approved loan and investment policy.

The CNB intends to incorporate some basic prudential standards that will address a number of these concerns within a new regulation. This regulation needs to be implemented as a matter of priority.

53. **CP 13** (other risks). Apart from market risk (in the trading book) the regulations do not require risk management processes to be put in place to control material risks. In practice the banks do implement risk management procedures and these are verified during on-site inspections. However, the requirements for risk management processes need to be set out explicitly in the regulations. The CNB is considering a new regulation that will set out general prudential standards for banks including the requirement for adequate risk management procedures to be in place. This regulation should be implemented as a matter of priority.

54. **CP 15** (money laundering). To strengthen the anti-money laundering procedures, the CNB should incorporate detailed requirements into its supervisory regulations. The CNB should also require banks to report to the supervisor any suspicious activities and incidents of fraud which might threaten the safety, soundness or reputation of the bank.

55. **CP 20** (consolidated supervision). It is not possible for the CNB to apply consolidated supervision to financial holding companies or to access information from mixed holding companies where there is a bank presence. Furthermore there is no capital allocation to cover market risk on a consolidated basis. More generally the ability to set capital charges for market risk on a consolidated basis is expected to be implemented in January 2002. The planned amendment to the AoB should allow the CNB to require reporting from financial holding companies and give it greater access to information from mixed holding companies where there is a bank presence. In widening the scope of its consolidated supervision, it is essential that the CNB undertake qualitative as well as quantitative assessments of group structures. Regulations and supervisory powers with regard to information exchange among domestic supervisory authorities should be enhanced. Critical review is required of the regulations relating to the "double gearing" of capital within the group, i.e., using the same capital at different levels within the group to cover different risks.

56. **CP 23** (global consolidated supervision). The CNB has only limited powers to limit the activities of or insist on the closure of foreign subsidiaries or branches of Czech banks where it seems likely that those operations present particular risk to the bank as a whole. While this issue is not material at the moment, Czech banks do not have a significant overseas presence, it is important that the CNB is able to implement effective global consolidated supervision should the Czech banks begin to set up foreign operations on a large scale.

57. **Finally, the CNB, the MoF, and the CSC should strengthen, as a matter of priority, the systems for risk identification and risk monitoring across each financial group as well as the mechanisms for coordinating supervisory action wherever necessary.** As an interim measure, the agencies should consider setting up a **regulatory college** that would meet on a regular basis to consider the underlying risk issues in each financial group, licensed entities, and developments in each sector.

58. In addition, efforts are needed to improve the implementation and compliance with the following core principles where shortcomings were assessed. Specific recommended actions have been indicated in Table 3 against the respective principles: **CP 1** (objectives); **CP 2** (permissible activities); **CP 3** (licensing criteria); **CP 4** (ownership); **CP 6** (capital adequacy); **CP 8** (loan evaluation); **CP 9** (large exposures limits); **CP 10** (connected lending); **CP 11** (country risk); **CP 12** (market risk); **CP 14** (internal control and audit); **CP 16** (on-site and off-site supervision); **CP 17** (bank management); **CP 18** (off-site supervision); **CP 19** (validation of information); **CP 21** (accounting standards); **CP 22** (remedial measures); **CP 24** (host country supervision); and **CP 25** (supervision of foreign establishments).

B. Transparency of Banking Supervision

Information and methodology

59. The assessment of the CNB's observance with good transparency practices relating to banking supervision was undertaken by a two-member staff team²¹ and was based on: (1) a pre-FSAP questionnaire response; (2) Czech Republic ROSC (IMF, 2000); (3) information available on the CNB website; (4) relevant laws;²² and (5) discussions with CNB officials, five commercial banks, and the auditing, accounting, and bankers' associations. The assessment was based on the *IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Transparency Code)*. No assessment methodology has been developed as yet, but the assessment has taken into account the implementation issues mentioned in the *Supporting Document* to the Code.

Practice-by-practice assessment

60. The detailed assessment has taken into account the fact that supervisory arrangements and practices differ across countries, as do the domestic circumstances. In the Czech Republic, a major factor bearing on the CNB in terms of its supervisory framework, accountability and transparency is the undergoing effort of harmonization with the EU practices as a preliminary step for a possible EU accession. Another related factor is the massive restructuring in the banking sector and emerging risks, such as market risk and activities of financial conglomerates. Ownership structure is changing rapidly, new operating strategies are being put to work, and the data and information requirements are rising. The recently amended CNB Act also places new requirements on the CNB in terms of its financial and operational autonomy and public accountability.

61. The assessment of observance with each practice of the *MFP Transparency Code* is made on a qualitative basis based on existing laws and regulations, and practices. A five-part

²¹ Udaibir S. Das and Plamen Yossifov (IMF).

²² Act No 6/1993 on the CNB (CNB Act), as amended through December 2000. Act 21/1992 Coll. on Banks (Banks Act), as amended through December 2000.

assessment system is used: observed; broadly observed; partly observed, not observed and not applicable: **observed**, implying full observance or with insignificant shortcomings; **broadly observed**, where minor weaknesses exist and these are not seen as being of a significant nature so as to raise serious doubts about the authority's ability to achieve the objective of that practice; **partly observed**, where shortcomings are sufficient to raise doubts about the authority's ability to achieve observance and which could affect the operational process and effectiveness of financial policies; **not observed**, where the practice is not being observed and no substantive progress has been recorded toward achieving the objectives of the practice; and **not applicable**, where, due to the country circumstances and the institutional and legal framework, the transparency practice is not applicable.

Table 5. Banking Supervision Transparency: Practice-by-Practice Assessment

V. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF FINANCIAL AGENCIES RESPONSIBLE FOR FINANCIAL POLICIES	
5.1	The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.
Description	<p>The Banks Act assigns the responsibility for issuing secondary legislation regulating the activities of banks to the CNB. The CNB Act and the Banks Act stipulate the responsibility of the CNB for implementing banking supervision policies.</p> <p>Within the CNB, the Banking Supervision Policy Department is responsible for setting the regulations for the development of the banking sector, for banking supervision procedures and for comprehensive analysis of the Czech banking sector. The Banking Supervision Department is responsible for implementing banking supervision policies in the Czech Republic. A member of the Bank Board oversees and coordinates the activities of these two departments. She submits for deliberation and approval proposals for changes in secondary legislation on banking supervision to the Bank Board.</p> <p>The primary objective of state supervision of banks, as defined in the CNB Act, is to perform banking supervision of the activities of banks, foreign bank branches and any consolidated entities of which a bank having its registered address in the Czech Republic is a part, and see to the sound operation and purposeful development of the banking system in the Czech Republic.</p> <p>References: CNB Act,²³ Articles 2, 42, 45; Banks Act,²⁴ Article 15, 25.</p>
Assessment	Observed
Comments	
5.1.1	The broad objective(s) of financial agencies should be publicly disclosed and explained.
Description	<p>The primary objective of state supervision of banks, as defined in the CNB Act, is to perform banking supervision of the activities of banks, foreign bank branches and any consolidated entities of which a bank having its registered address in the Czech Republic is a part, and see to the sound operation and purposeful development of the banking system in the Czech Republic.</p> <p>The primary objective of state supervision of banks is also disclosed and explained in the Report on Banking Supervision in the Czech Republic, which is published annually by the CNB (www.cnb.cz/en/bd/rz.htmhttp://www.cnb.cz/en/bdohled/pdf/a-bd-parl.pdf).</p>

²³ Act No 6/1993 on the CNB, as amended through December 2000.

²⁴ Act 21/1992 Coll. on Banks, as amended through December 2000.

	References: CNB Act, Article 2.
Assessment	Observed
Comments	
5.1.2	The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.
Description	<p>CNB's responsibilities and the authority to implement financial policies in the area of banking supervision are defined in relevant legislation.</p> <p>References: CNB Act, Articles 29, 39, 44; Banks Act, Articles 25, 26.</p>
Assessment	Observed
Comments	<p>The responsibilities of the CNB in the area of banking supervision are to grant and revoke banking licenses, monitor the adherence to license terms, supervise banks' adherence to the relevant legal provisions, impose remedies and sanctions when breaches under the CNB Act and the Banks Act are detected, act as a lender of last resort by extending unsecured short-term credits to banks or secured by securities that are not accepted for standard repo operations.</p> <p>In carrying out these responsibilities, the CNB is authorized to demand that the respective bank or branch of a foreign bank remedy the situation within a specified period, and in particular that it should restrict some of its permitted activities or cease unpermitted activities, replace persons in the management or members of the supervisory board, create a corresponding volume of provisions and reserves, or that it should reduce its initial capital in a specified extent, replace or use its profit after tax preferentially for supplementing its reserve funds or for increasing its initial capital. The CNB can also change the banking license by excluding or restricting some of the permitted activities listed, order an extraordinary audit at the expense of the respective bank or branch of a foreign bank, impose conservatorship and fines, reduce the initial capital of the bank by the amount corresponding to the loss after its clearing with reserve funds and other funds on condition that the loss exceeds 20 percent of the bank's equity.</p>
5.1.3	Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.
Description	<p>The recently amended CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed and testify. In addition, upon a resolution of the Chamber of Deputies, the CNB must submit within thirty days an extraordinary report on monetary development. The resolution of the Chamber of Deputies must state what the extraordinary report should contain. The Chamber of Deputies can either acknowledge the report on monetary development or ask for a more accurate and complete report, which must be submitted within six weeks and should be in compliance with the requirements of the Chamber of Deputies. The reports mentioned above usually have a section on the developments in the banking sector and present current issues in banking supervision.</p> <p>The recently amended CNB Act stipulates that the CNB's operating budget must be approved by the Chamber of Deputies. The funding of the CNB departments responsible for regulating and supervising banks' activities is determined as part of this operating budget.</p> <p>The CNB Act also obliges the central bank to publish Annual Reports. In each Annual Report, there is a separate chapter on banking supervision (www.cnb.cz/en/o_cnb/vz.htm). In addition, the CNB publishes an Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm), which describes the activities of the CNB in the area of banking supervision and related developments in the banking sector.</p> <p>References: CNB Act, Articles 3, 5, 47, 48.</p>
Assessment	Observed

Comments	
5.1.4	Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.
Description	The procedures for appointment, terms of office, and the general criteria for removal of the heads and members of the governing body of the CNB are specified in the CNB Act. References: Constitution, Article 62; CNB Act, Articles 5 and 6.
Assessment	Observed
Comments	
5.2	The relationship between financial agencies should be publicly disclosed.
Description	The CNB shares supervisory responsibilities over banks with the CSC. The latter supervises only those activities of banks related to their investment and trading on the capital market. The CSC Act delineates these shared supervisory responsibilities by stating that in exercising its authority over banks the CSC shall proceed in such a manner so as not to interfere with the authority of banking supervision bodies. In compliance with Article 41 of the Act on the CSC, the CNB in cooperation with the MoF and the CSC has prepared a system of mutual cooperation in the area of capital markets. The resulting MOU also provides for cooperation in the other areas of financial supervision. This MOU, however, is an internal document, which is not publicly disclosed. The agreement specifies the scope of information transmitted to other regulator without his request and by his request. At the same time the confidential character of shared information is protected and the objectives of using of this information limited. The MOU further details the cooperation in the area of on-site inspections. This cooperation does not include creation of common teams; it is limited to (ad hoc) on-site inspections made by the request of other regulator. The MOU provides for regular consultations between the heads of the three agencies at least yearly, on the lower level at least every half year and irregular consultations whenever it is necessary. The regulatory agencies decided not to publish this agreement without specifying the reasons behind this decision. The AoB obliges the CNB to ask the MoF for its standpoint concerning the granting and revocation of banking license and concerning the imposition of conservatorship on banks. References: Act on the CSC, Article 41; Banks Act, Article 30.
Assessment	Not observed
Comments	The scope and procedures for cooperation and information sharing, laid down in 1998 MOU between the CNB, the MoF, and the CSC are not explained to the public.
5.3	The role of oversight agencies with regard to payment systems should be publicly disclosed.
Description	The CNB's oversight over the payment systems is assessed separately.
Assessment	Not applicable
Comments	
5.3.1	The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.
Description	See 5.3
Assessment	Not applicable
Comments	

5.4	Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.
Description	There are no self-regulatory organizations delegated with supervisory responsibilities in the area of banking supervision.
Assessment	Not applicable
Comments	
5.5	Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.
Description	See 5.4
Assessment	Not applicable
Comments	
VI. OPEN PROCESS FOR FORMULATING AND REPORTING OF FINANCIAL POLICIES	
6.1	The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.
Description	The regulatory framework of banking supervision is publicly disclosed. The legal framework of procedures governing the conduct of banking supervision at performing off-site surveillance and on-site examination are specified in the CNB regulation. The CNB maintains a rich publication program that informs the public on its activities in the area of banking supervision.
Assessment	Broadly observed
Comments	The internal procedures for the conduct of the banking supervision are not publicly available. The scope and procedures for cooperation laid in the MOU between the CNB, the MoF, and the CSC, are not publicly disclosed. The provisions of MOU with foreign banking supervisory authorities are not publicly explained.
6.1.1	The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.
Description	<p>The CNB regulations are published in the Collection of Laws, issued as circulars, published in the non-periodic publication “Vestník,” and some of them are available on the CNB website (www.cnb.cz/en/legislativa/vybrane.htm). A list of all regulations issued by CNB is available on its website (www.cnb.cz/legislativa/seznam/p/seznam-p1.htm). These regulations are available for inspection at the CNB Special Library in Prague and in the secretariats of the Executive Directors of CNB branches. In addition the Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm) presents a summary of regulatory changes in the area of banking supervision and explains the reasons for implementing them.</p> <p>The legal framework of procedures governing the conduct of banking supervision at performing off-site surveillance and on-site examination is specified in CNB regulation. The operating procedures of banking supervision (i.e., procedures for testing fit and proper criteria while granting licenses, evaluation of governance structures and internal control systems), however, are not publicly available.</p> <p>References: Banks Act, Article 15</p>
Assessment	Broadly observed
Comments	The internal procedures of the banking supervision (i.e., manuals) are not publicly available.
6.1.2	The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.
Description	The structure of reports (daily, monthly, quarterly) that banks and branches of foreign banks regularly submit to the CNB for the supervisory purposes is governed by CNB’s decree, which is publicly disclosed (see 6.1.1).
Assessment	Observed
Comments	

6.1.3	The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.
Description	The CNB has no supervisory authority over organized financial markets. This role is carried out by the CSC.
Assessment	Not applicable
Comments	
6.1.4	Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.
Description	The CNB bears all costs of banking supervision.
Assessment	Not applicable
Comments	
6.1.5	Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.
Description	<p>In compliance with Article 41 of the Act on the CSC, the CNB in cooperation with the MoF and the CSC has prepared a system of mutual cooperation in the area of capital markets. The resulting MOU also provides for cooperation and information sharing in the other areas of financial supervision. This MOU, however, is an internal document, which is not publicly disclosed. The agreement specifies the scope of information transmitted to other regulator without his request and by his request. In the same time the confidential character of shared information is protected and the objectives of using of this information limited. The MOU provides for regular consultations between the heads of the three agencies at least yearly, on the lower level at least every half year, and irregular consultations whenever it is necessary. The regulatory agencies decided not to publish this agreement without specifying the reasons behind this decision.</p> <p>The AoB obliges the CNB to ask the MoF for its standpoint concerning the granting and revocation of banking licenses and concerning the imposition of conservatorship on banks. The texts of MOUs with foreign banking supervisory authorities are not publicly disclosed.</p> <p>References: Act on the CSC, Article 41; Banks Act, Article 30.</p>
Assessment	Not observed
Comments	The scope and procedures for cooperation, laid in the Memorandum of Understanding between the CNB, the MoF, and the CSC, are not publicly disclosed. The provisions of MOUs with foreign banking supervisory authorities are not publicly explained.
6.2	Significant changes in financial policies should be publicly announced and explained in a timely manner.
Description	CNB regulations are promulgated in the Collection of Laws, issued as circulars, published in the non-periodic publication “Vestník,” and some of them are available on the CNB website (www.cnb.cz/en/legislativa/vybrane.htm). A list of all regulations issued by CNB is available on its website (www.cnb.cz/legislativa/seznam/p/seznam-p1.htm). These regulations are available for inspection at the CNB Special Library in Prague and in the secretariats of the Executive Directors of CNB branches. In addition the Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm) presents a summary of regulatory changes in the area of banking supervision and explains the reasons for implementing them.
Assessment	Observed
Comments	
6.3	Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.
Description	The CNB publishes Annual Reports, in which there is a separate chapter on banking supervision (www.cnb.cz/en/o_cnb/vz.htm). In addition, the CNB publishes an Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm), which describes

	the activities of CNB in the area of banking supervision and related developments in the banking sector.
Assessment	Observed
Comments	
6.4	For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.
Description	Until today all proposed changes of regulation has been discussed with banks (including branches of foreign banks) before they enter into force. The Czech Banking Association usually intermediates this discussion. It means that banks do have opportunity to express their opinion. The lengths of consultation period is at least one month. This year the CNB for the first time published proposed changes of one regulation namely of the CNB's Provision No. 193/1998 Coll. of 9 July 1998 on the Principles of Credit Claim Classification and Creation of Reserves and Provisions for these claims on its website.
Assessment	Observed
Comments	
VII. Public Availability of Information on Financial Policies	
7.1	Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.
Description	The CNB publishes Annual Reports, in which there is a separate chapter on banking supervision and developments in the banking sector (www.cnb.cz/en/o_cnb/vz.htm). In addition, the CNB publishes an Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm), which describes the activities of CNB in the area of banking supervision and related developments in the banking sector.
Assessment	Observed
Comments	
7.2	Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.
Description	Detailed aggregate data for the banking sector is published in the CNB's Annual Report, which contains a separate chapter on banking supervision and developments in the banking sector (www.cnb.cz/en/o_cnb/vz.htm) and in its Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm). The Czech Republic meets the SDDS specifications for the coverage, periodicity, and timeliness of banking sector data and for dissemination of advance release calendars (http://dsbb.imf.org/country/czecats.htm). The SDSS data template (www.cnb.cz/en/statistika/sdds.htm#FinancialSector) and additional data on the banking sector is published on CNB's website (www.cnb.cz/en/statistika/). In the second half of 2000, CNB started publishing a quarterly compendium of aggregate data on the banking sector "Basic Indicators of the Banking Sector" (www.cnb.cz/en/bd/zakladni_ukazatele_bs.htm). This publication, which is issued two months after the end of the reference quarter, provides a well documented data series on the structure of the banking sector, its consolidated assets and liabilities and indicators of profitability and efficiency.
Assessment	Observed
Comments	
7.3	Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.
Description	The Banking Supervision Policy Department and the Banking Supervision Department are part of the organizational structure of the CNB and their funding and expenditures are determined as part of the CNB's budget.
Assessment	Not applicable
Comments	
7.3.1	Consistent with confidentiality and privacy of information on individual firms, aggregate

	information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.
Description	Aggregate information on emergency financial support by the central bank is not publicly disclosed. The amounts of emergency financial support are reflected in the ten-days balance sheet of CNB in the aggregate category "Receivables from domestic banks."
Assessment	Not observed
Comments	In the latest case of provision of emergency financial support, the CNB loaned IPB an amount of the magnitude of CZK 10 billion on June 16. Press releases on the imposition of conservatorship on IPB by the CNB on June 16 and the subsequent sale of IPB to CSOB on June 19 were issued on these same days on the CNB website (www.cnb.cz/en/media/frequent/ipb/tz.htm). The press releases do not, however, disclose the fact that emergency financial support was extended to IPB and subsequently repaid by CSOB. In a report submitted to Parliament dated June 2000, which was posted on the CNB website, it is only mentioned that on the morning of June 16 IPB requested a loan of up to CZK 10 billion in order to maintain its liquidity.
7.4	Financial agencies should establish and maintain public information services.
Description	The Public Relations Division in the CNB is responsible for issuing press releases, organization of press conferences, and maintenance of the CNB website (www.cnb.cz/en/). The Freedom of Information Act ²⁵ requires the CNB to respond in writing to individual requests for information within 15 days.
Assessment	Observed
Comments	
7.4.1	Financial agencies should have a publications program, including a periodic public report on their principal activities issued at least annually.
Description	As related to banking supervision, CNB's Annual Report (www.cnb.cz/en/o_cnb/vz.htm) features a separate chapter on banking supervision. In addition, the CNB publishes an Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm), which describes the activities of CNB in the area of banking supervision and related developments in the banking sector. In the second half of 2000, CNB started publishing a quarterly compendium of aggregate data on the banking sector "Basic Indicators of the Banking Sector" (www.cnb.cz/en/bd/zakladni_ukazatele_bs.htm) issued two months after the end of the reference quarter. CNB regulations are promulgated in the Collection of Laws, issued as circulars, published in the non-periodic publication "Vestník."
Assessment	Observed
Comments	
7.4.2	Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.
Description	The CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed and testify. Members of the Bank Board attend regular press-conferences held immediately following the Bank Board meeting, on which monetary policy decisions have been taken. The Freedom of Information Act requires CNB to respond in writing to individual requests for information within fifteen days. References: CNB Act, Article 3.
Assessment	Observed
Comments	

²⁵ Act No. 106/1999 Coll., on Freedom of Information.

7.5	Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.
Description	CNB regulations are published in the Collection of Laws, issued as circulars, published in the non-periodic publication “Vestnik,” and some of them are available on the CNB website (www.cnb.cz/en/legislativa/vybrane.htm). A list of all regulations issued by CNB is available on its website (www.cnb.cz/legislativa/seznam/p/seznam-p1.htm). These regulations are available for inspection at the CNB Special Library in Prague and in the secretariats of the Executive Directors of CNB branches. In addition the Annual Report on Banking Supervision in the Czech Republic (www.cnb.cz/en/bd/rz.htm) presents a summary of regulatory changes in the area of banking supervision and explains the reasons for implementing them. References: Banks Act, Article 15
Assessment	Observed
Comments	
7.6	Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.
Description	Deposit insurance in the Czech Republic is conducted by the Deposit Protection Fund, which is an independent government agency.
Assessment	Not applicable
Comments	Practice does not apply to the CNB, as the banking supervisory agency.
7.7	Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.
Description	CNB does not defend clients of banks in their complaints to bank’s products and services, etc.
Assessment	Not applicable
Comments	
VIII. Accountability and Assurances of Integrity by Financial Agencies	
8.1	Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.
Description	The CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed and testify. References: CNB Act, Article 3.
Assessment	Observed
Comments	
8.2	Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.
Description	The Banking Supervision Policy Department and the Banking Supervision Department are part of the organizational structure of CNB and their funding and expenditures are determined as part of CNB’s budget.
Assessment	Not Applicable
Comments	
8.2.1	Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.
Description	See 8.2
Assessment	Not Applicable
Comments	

8.2.2	Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.
Description	CNB's internal governance procedures are not publicly disclosed.
Assessment	Not observed
Comments	CNB's internal governance procedures are not publicly disclosed.
8.3	Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.
Description	The Banking Supervision Policy Department and the Banking Supervision Department are part of the organizational structure of CNB and their funding and expenditures are determined as part of CNB's budget. <i>[Note: Under the amendment to the CNB Act (in force since January 1, 2001), the CNB budget is divided into two parts—a part concerning activities performed in providing the the primary objective of the CNB (approved by the CNB Board) and a part concerning operating and investment expenditures (approved by the Chamber of Deputies).]</i>
Assessment	Not Applicable
Comments	
8.4	Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.
Description	There is no code of conduct of CNB officials and staff. Officials and staff of the CNB are not allowed to have a second job without permission of the Bank Board. These rules are not publicly disclosed. The Act on State Control set forth the rights and duties of persons executing the state inspection and prohibits the conflict of interests of the persons executing the state inspection. The Act stipulates that inspectors are under the seal of professional secrecy, which can be removed exclusively on ad hoc basis (e.g., for an individual case) and only by the person who authorized the inspector to perform the on-site examination of the individual institution. Applied to the banking supervision it means that the governor of the CNB is authorized to free an inspector from this seal in an individual case. References: Act on State Control. ²⁶
Assessment	Broadly observed
Comments	Internal rules to prevent exploitation of conflicts of interest are not publicly disclosed.
8.4.1	Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.
Description	There are no legal protections for officials and staff of CNB.
Assessment	Not applicable
Comments	

²⁶ Act No. 552/1991 Coll. on State Control, as amended.

Table 6. Banking Supervision Transparency: Observance of Individual Practices

Practice	Gradings					Comments
	O ²⁷	BO ²⁸	PO ²⁹	NO ³⁰	NA ³¹	
V. Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies						
5.1 The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.	X					
5.1.1 The broad objective(s) of financial agencies should be publicly disclosed and explained.	X					
5.1.2 The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.	X					
5.1.3 Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.	X					
5.1.4 Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.	X					
5.2 The relationship between financial agencies should be publicly disclosed.				X		The scope and procedures for cooperation and information sharing, laid down in 1998 Memorandum of Understanding, between the CNB, the MoF and the CSC are not explained to the public.
5.3 The role of oversight agencies with regard to payment systems should be publicly disclosed.					X	CNB's oversight over the payment systems is assessed separately.
5.3.1 The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important					X	See 5.3

²⁷ O: Observed.

²⁸ BO: Broadly observed.

²⁹ PO: Partly observed.

³⁰ NO: Nonobserved.

³¹ NA: Not applicable.

Table 6. Banking Supervision Transparency: Observance of Individual Practices

	Gradings					
payment systems.						
5.4 Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.					X	There are no self-regulatory organizations delegated with supervisory responsibilities in the area of banking supervision.
5.5 Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.					X	See 5.4
VI. Open Process for Formulating and Reporting of Financial Policies						
6.1 The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.		X				See comments below.
6.1.1 The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.		X				The internal procedures for the conduct of the banking supervision are not publicly available.
6.1.2 The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.	X					
6.1.3 The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.					X	The CNB has no supervisory authority over organized financial markets. This role is carried out by the CSC.
6.1.4 Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.					X	The CNB bears all costs of banking supervision.
6.1.5 Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.				X		The scope and procedures for cooperation and information sharing, laid down in 1998 Memorandum of Understanding, between the CNB, the MoF and the CSC are not explained to the public. The provisions of MOUs with foreign

Table 6. Banking Supervision Transparency: Observance of Individual Practices

	Gradings					banking supervisory authorities are not publicly disclosed.
6.2 Significant changes in financial policies should be publicly announced and explained in a timely manner.	X					
6.3 Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.	X					
6.4 For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.	X					
VII. Public Availability of Information on Financial Policies						
7.1 Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.	X					
7.2 Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.	X					
7.3 Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.					X	The Banking Supervision Policy Department and the Banking Supervision Department are part of the organizational structure of CNB and their funding and expenditures are determined as part of CNB's budget.
7.3.1 Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.				X		The amounts of emergency financial support are reflected in the ten-days balance sheet of CNB in the lump-sum category "Receivables from domestic banks."
7.4 Financial agencies should establish and maintain public information services.	X					

Table 6. Banking Supervision Transparency: Observance of Individual Practices

	Gradings					
7.4.1 Financial agencies should have a publications program, including a periodic public report on their principal activities, issued at least annually.	X					
7.4.2 Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.	X					
7.5 Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.	X					
7.6 Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.					X	Practice does not apply to the banks' supervisor.
7.7 Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.	X					
VIII. Accountability and Assurances of Integrity by Financial Agencies						
8.1 Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.	X					
8.2 Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.					X	The Banking Supervision Policy Department and the Banking Supervision Department are part of the organizational structure of CNB and their funding and expenditures are determined as part of CNB's budget.

Table 6. Banking Supervision Transparency: Observance of Individual Practices

	Gradings					
8.2.1 Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.					X	See 8.2.
8.2.2 Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.				X		The CNB's internal governance procedures are not publicly disclosed.
8.3 Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.					X	See 8.2.
8.4 Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.		X				Internal rules to prevent exploitation of conflicts of interest are not publicly disclosed.
8.4.1 Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.					X	There are no legal protections for officials and staff of the CNB.

Response to the assessment and recommended action plan

Response to the assessment

62. The CNB was in agreement with the findings of the assessment.

Recommended action plan

63. **Public availability of information on financial policies.** The scope and procedures for cooperation and information sharing, laid down in 1998 MOU, between the CNB, the MoF, and the CSC should be explained to the public.

64. **Open process for formulating and reporting of financial policies.** The internal procedures for the conduct of the banking supervision should be publicly disclosed.

65. The provisions of MOUs with foreign banking supervisory authorities should be publicly disclosed.

66. **Public availability of information on financial policies.** Consistent with confidentiality and privacy of information on individual banks, aggregate information on emergency financial support by the central bank should be publicly disclosed.

67. **Accountability and assurances of integrity by financial agencies.** The CNB's internal governance procedures should be publicly disclosed.

68. Internal rules to prevent exploitation of conflicts of interest should be publicly disclosed.

IV. IAIS CORE PRINCIPLES AND TRANSPARENCY OF INSURANCE REGULATION

A. IAIS Insurance Core Principles

Information and methodology

69. The assessment focused mainly on the supervisory work of the Office of State Supervision of Insurance and Pension Funds within the MoF. It should be noted that, although the office is a separate unit within the MoF, it enjoys little autonomy and all important decisions, authority, and accountability belong to the Ministry.

70. The assessment is based on the legislation applying to insurance companies, specifically Act 363/1999 and the Decree No. 75/2000 that proclaimed the law into force. Reference was also had to Act No. 168/1999 on Motor Third Party Liability Insurance and, to the extent applicable, to the Act on Accounting, Act on Auditing, and the Commercial Code. Local authorities had also responded to a comprehensive questionnaire prior to the visit of the FSAP team and they also prepared a self-assessment against Core Principles. The government has made progress in its plans to revise the regulatory framework for insurance. These proposed, but not enacted, changes have not been taken into account in this assessment. The work was assisted by obtaining from the Czech Insurance Association a copy of its annual report showing insurance company statistics for 1999.

71. Interviews were held with the supervisory staff of the Office and also with the Association of Actuaries, the Czech Insurance Association, a number of audit firms that examine the financial statements of insurance companies, and a sample of insurance company executives.³² Several companies supplied the mission with copies of their recent financial statements and the mission also had access to the AXCO reports on insurance in the Czech Republic as well as the 1998 World Bank report on the Czech capital markets that also contained a chapter on the insurance sector. Excellent cooperation was received. The only difficulty arose from the confidentiality rules of the authorities that prevented the staff of the Office from providing data on individual companies' circumstances.

³² Undertaken by Donald McIsaac (World Bank).

72. The assessment was performed using the Core Principles Methodology report adopted by the IAIS at its meeting in October 2000. The IAIS has developed 17 principles for effective insurance regulation and supervision. A Principle will be considered **observed** whenever all essential criteria are generally met without any significant deficiencies. A Principle will be considered **largely observed** whenever only minor shortcomings are observed, which do not raise any concerns about the authority's ability and intent to achieve full observance with the principle within a prescribed period of time. A Principle will be considered **materially non-observed** whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance. A Principle will be considered **non-observed** whenever no substantive progress toward observance has been achieved. A Principle will be considered **not applicable** whenever the CP does not apply given the structural, legal and institutional features of a jurisdiction. It must be noted that extensive reliance was placed upon the self-assessment questionnaire prepared by local authorities, subject to revisions where interviews suggested that this was necessary.

Institutional and macroprudential setting, market structure

73. In order to carry on an insurance business in the Czech Republic, a company must be licensed by the MoF and the Office performs the analysis of applications for license. Once licensed, the Office is expected to monitor the performance and financial conditions of the companies and to report to the companies, and to the Minister, any cases where the financial situation of the company appears to be threatened. The Office also attempts to respond to consumer complaints and inquiries on an as needed basis.

74. The Office also has responsibilities for the supervision of private pension funds. In order to meet both these sets of duties, it has been organized into units that specialize in either industry. There are units that respond to legal and regulatory questions and also units that are responsible for the monitoring of financial strength of companies. A total of 35 persons are dedicated to the work with respect to insurance companies. There is no role in the process for self-regulatory organizations, although both the Czech Insurance Association and the Czech Association of Brokers administer Codes of Ethics and monitor the behavior of their members.

75. At present the insurance supervisory office lacks sufficient resources to properly discharge its mandate. On-site inspections are rarely conducted due primarily to the lack of resources. Without on-site inspections, it is doubtful that the office can maintain an in-depth knowledge of the financial condition of the licensed companies and of the risks that they must manage. However, the large local companies are strongly capitalized, while several other companies have strategic investments, often with managerial control, from large multinational insurance groups. The Office focuses its inspection work on the weaker companies.

76. The industry seems to be performing generally well, with adequate levels of capital and profitability. Insurance companies must have minimum amounts of capital to be licensed and following licensing must maintain capital at levels that follow the formula used for these

purposes in the European Union. As at the end of 1999, most companies had solvency positions that exceeded minimum requirements by a comfortable margin. For example, the average solvency margin for non-life companies was 4 times average requirements. The Office reports that only two companies, with market shares of 0.16 percent and 0.18 percent, respectively, failed to meet the minimum margin as at the end of 1999.

77. Insurance business in the Czech Republic is generally held to be profitable. The Office of supervision estimated that profits earned for 1999 represented 1.8 percent of premiums received for the industry as a whole. Return on assets was estimated at 0.72 percent. Technical results for both life and non-life lines of business were positive.

78. Professional liability insurance is compulsory for many professions in the Czech Republic. (Other compulsory lines include motor third-party liability and workers' compensation). Experience on the compulsory lines has been favorable and this likely reflects the fact that Czech society does not have a litigious nature. To date it is very rare for a client to launch a suit against the professional (lawyer, doctor, notary) who provides services. As a result this has been a profitable line of business, although this could change in the future.

General preconditions for effective insurance supervision

79. The legal system in the Czech Republic is similar to that which prevails in Germany. Companies are incorporated according to the Commercial Code and there is a Civil law which governs relationships with consumers. Unfortunately these laws have not been kept up to date. For example, the Civil law does not contain all the provisions that are needed to protect consumers of insurance policies. There have been discussions to create a special Insurance Contract Law as many countries have recently done (e.g., Argentina); a draft Insurance Contract law has been submitted to the government and is expected to be passed by Parliament in the near future. The legal framework for insurance is also weak in the area of corporate governance. Recent amendments to the Commercial Code that strengthen corporate governance will become in January 2001, and will also apply to insurance companies. This is a positive step, but the provisions in the Commercial Code are general, and do not go far enough in protecting the interests of policyholders and account-holders in financial institutions. The new Insurance Law, which became effective in April 2000, should include special provisions outlining the responsibilities of Directors and identifying certain key roles they must play. Unfortunately, these provisions were not included in the new Law.

80. In general, however, the new Insurance Law represents a significant improvement over the previous law and constitutes a good and modern piece of legislation. In particular, the new Law provides the supervisors with several important tools for dealing with distressed insurance companies. For example, the law prescribes certain actions that must be taken when a company's solvency margin falls below a specified level (the "guarantee" fund). In addition, there are special powers to be applied at the discretion of the supervisor when other less-threatening situations are presented.

81. Accounting and Auditing legislation are also relevant for the performance of the insurance sector. Accounting for insurance companies is governed by the general Law on Accounting. However, the Minister of Finance has authority to issue special accounting rules for insurance companies and this was done through a special regulation issued by the MoF. Recent amendments to the Auditing Law that will become effective in January 2001 may have important impact on the way the sector operates. These amendments include, inter alia, the legal obligation for the actuary or the auditor to inform the supervisor of any breaching of the law, or of a situation is developing that could impair the ability of the company to meet its obligations. Enforcement of this new provision remains to be tested, however.

82. The Czech Insurance Association has adopted a code of ethics for its members. In addition, through its monitoring activities, it is well-placed to give advance warning of companies that are headed for financial difficulties. The association is prepared to expel a member company that gives cause for concern. While it is not strictly speaking an SRO, it behaves in a similar manner.

Principle-by-principle assessment

Table 7. IAIS Core Principles: Principle-by-Principle Assessment

<p>Principle 1.</p>	<p>Organization of an Insurance Supervisor The insurance supervisor of a jurisdiction must be organized so that it is able to accomplish its primary task, i.e., to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. It should at any time be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the insurance supervisor should:</p> <ul style="list-style-type: none"> – be operationally independent and accountable in the exercising of its functions and powers; – have adequate powers, legal protection and financial resources to perform its functions and exercise its powers; – adopt a clear, transparent and consistent regulatory and supervisory process; – clearly define the responsibility for decision making; and – hire, train and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.
<p>Description</p>	<p>Insurance supervision in the Czech Republic is governed by Act No. 363/1999 proclaimed into force in April 2000 (Act on Insurance). The Office of Supervisor is part of the MoF. The Office has no separate budget and does not collect revenues from licensed institutions. The Office is not independent and any supervisory powers are those of the MoF. Decision-making authority is not clear. Recommendations are formulated by the Director but decisions are made by the Minister or Deputy Minister. Levels of compensation are subject to the limits applicable for public servants. The Office does not have the authority to outsource supervisory tasks to third parties. Accountability to Government, and hence to Parliament, lies with the MoF and not the Director of the Office. Within the year, the Office will begin to publish an annual report on its activities.</p>
<p>Assessment</p>	<p>Materially Non-observed. To be effective insurance supervision should be made independent of government and the supervisory system should be given increased financial resources.</p>

Comments	Staff of 35 persons engaged in insurance work is scheduled to grow to 50. This provides opportunity for increasing effectiveness of the Office. However, salary levels will continue to make it difficult to attract and retain skilled professionals.
Principle 2.	<p>Licensing</p> <p>Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor:</p> <ul style="list-style-type: none"> – in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan and projected solvency margins; and – in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.
Description	Companies must be licensed in order to underwrite insurance. License is granted under the authority of the MoF, although the processing of the application is handled by the office. There are no written guidelines that describe the licensing process, although section 8 of the Act on Insurance specifies the documents to be filed and the “fit and proper” rules for founders, directors and the person who is to be named responsible actuary. The criteria for the test appear in section 11 of the Act. The requirements look to determine whether persons are of good repute and have not been involved in bankruptcy. They do not question whether the owners have sufficient resources to meet the company’s financial requirements on an ongoing basis. While the legislation provides authority for exchange of information with supervisors in other jurisdictions, no MOUs have been executed.
Assessment	Largely Observed. The principle cannot be considered to be fully observed due to some remaining gaps in licensing criteria and supervisory procedures.
Comments	The legislation and the supervisory practices should ensure that owners have the necessary resources to support the capital needs of a new and potentially rapidly growing insurance company. Plans call for making a change in the next revision to the legislation such that the license can be denied when the supervisor determines that the manager will not manage the company in the proper fashion. A prerequisite for the assessment of the financial strength will be knowledge about the underlying ownership structure of major shareholders. A knowledge that does not seem to be present at the Office for existing insurance companies at the moment.
Principle 3.	<p>Changes in Control</p> <p>The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements which apply in granting a license. In particular, the insurance supervisor should:</p> <ul style="list-style-type: none"> – require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and – establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.
Description	Section 11 of the Act on Insurance requires that the ministry be notified in writing when a person proposes to acquire or increase a share in the company such that his voting rights will cross a 20 percent; 33 percent or 50 percent threshold. If the transaction is not approved, the acquirer will not be permitted to exercise voting rights. In practice, the Office of Insurance Supervision will review the request and advise the minister of what actino to take. The Office does not presently maintain complete records on the actual share ownership of all licensed companies. In at least one prominent recent case, the Office did not collect and was not provided with complete information regarding the new owners.
Assessment	Materially non-observed. The Act provides some safeguards but does not include explicit conditions on the capacity of the acquirer. The review should be no less exacting than the screening that is applied to an applicant for a new license.

Comments	The office should adopt the necessary procedure to establish and maintain a complete record of all holders of a significant interest in an insurance company, with information regarding the underlying ownership structure of any corporate shareholders.
Principle 4.	Corporate Governance It is desirable that standards be established in the jurisdictions which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the insurance supervisor should set requirements with respect to: <ul style="list-style-type: none"> – the roles and responsibilities of the board of directors; – reliance on other supervisors for companies licensed in another jurisdiction; and – the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.
Description	Standards of Corporate Governance for insurance companies prevailing in the Czech Republic are those specified for all corporations through the Commercial Code. The insurance supervisor has no specific authorities in this area. Changes to the corporate governance provisions in the Commercial Code have been announced to take effect in 2001. These changes will not meet the expectations for appropriate corporate governance requirements for insurance companies.
Assessment	Non-observed. There are no corporate governance provisions that are specific for insurance companies in either the Commercial Code or the Act on Insurance.
Comments	It would be appropriate for the Act on Insurance to contain provisions for corporate governance requirements that are necessary for financial institutions. Such provisions reflect a higher standard than that which applies to general purpose corporations. As matters now stand, neither the legislation nor the activities of the supervisor deal with the responsibilities nor the strategic objectives of Directors. The supervisory staff of the Office have asked for advice and guidance on the appropriate corporate governance measures they should adopt. Unfortunately, the observance of principles that depend on good corporate governance such as those related to internal controls, investment policies and the monitoring of transactions with related parties, will not improve unless there is a serious attempt to strengthen the legal requirements for good corporate governance among insurance companies
Principle 5.	Internal Controls The insurance supervisor should be able to: <ul style="list-style-type: none"> – review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and – require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.
Description	The legislation does not provide the supervisor with any specific authorities with respect to internal controls. The supervisor has no authority to require any particular actions of Boards of Directors. Likewise, the supervisor has no authority to require oversight by the Board of Directors nor to require strengthening of the internal controls system. Supervisory staff review a company's system of internal controls during on-site inspection. There are no specific rules for dealing with transactions with related parties. There is a Special Act No. 61/1996 whereby rules are set for the monitoring of any "suspicious transactions" such as money laundering
Assessment	Non-observed. Although there is a review of internal controls during on-site inspections, this process is rendered ineffective because on-site inspections are sporadic and infrequent.
Comments	At a very minimum the Act on Insurance should impose on the Board of Directors a responsibility for oversight of the Internal Controls system. While the report of the external auditor is available to the supervisor, it would be more useful if there was increased contact between the auditor and the supervisor such that, for example, the supervisor would have access to the management letters that the auditor provides to the company at the time of issuing a report. Supervisors should also have access to reports of internal audit.

Principle 6.	<p>Assets</p> <p>Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address:</p> <ul style="list-style-type: none"> – diversification by type; – any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables; – the basis for valuing assets which are included in the financial reports; – the safekeeping of assets; – appropriate matching of assets and liabilities; and – liquidity.
Description	<p>Section 21 of the Act on Insurance specifies the types of investments that an insurance company may make, and the quantitative limits are specified in part 4 of Decree 75/2000 that proclaimed the new insurance law into force. The rules for valuation of assets are contained in regulations on accounting issued by the MoF. However no rules have been established regarding safekeeping of assets, matching of assets and liabilities, and liquidity.</p>
Assessment	<p>Materially Non-Observed. Supervisory staff undertake a review of the company’s matching process as part of the on-site inspection. However since these inspections are sporadic and infrequent, this is not an effective system for the promotion of sound matching practices.</p>
Comments	<p>The supervisor lacks the authority to require the company to establish a strategic investment policy, nor are such policies examined as a matter of course during on-site inspections. Inspectors tend to focus on ensuring that companies comply with the specific quantitative rules on investment, and not on the extreme importance of matching assets with liabilities.</p>
Principle 7.	<p>Liabilities</p> <p>Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider:</p> <ul style="list-style-type: none"> – what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary; – the standards for establishing policy liabilities or technical provisions; and – the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.
Description	<p>The Act on Insurance specifies the types of liabilities that each company should post. The rules for computation of such provisions are given in the decree on financial reporting. The Ministry is authorized, by virtue of section 18 of the Act on Insurance and part 3 of Decree 75/2000 to fix a maximum ceiling on the valuation interest rate for certain kinds of life insurance policies. There is no authority to control the amount of credit that might be taken for amounts recoverable under reinsurance</p>
Assessment	<p>Largely observed. The principle cannot be considered to be fully observed due to the lack of a regime for reviewing reinsurance recoverables.</p>
Comments	<p>The supervisor should be able to challenge all assumptions used in the valuation of technical provisions that do not appear reasonable. A regime for reviewing reinsurance recoverables should be instituted.</p>

Principle 8.	Capital Adequacy and Solvency The requirements regarding the capital to be maintained by companies which are licensed, or seek a license, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.
Description	By virtue of section 22 of the Act on Insurance and parts 5 and 6 of the Decree 75/2000 the MoF has adopted for Czech companies the system of solvency measurement that prevails in the EU. The formulas determine the minimum amount of capital and surplus to be maintained by a company as a function of the size of operations, the volume of premiums, rate of claims, and the nature of assets available to support technical provisions.
Assessment	Observed.
Comments	While this approach is likely acceptable for the Czech insurance market given its present state of development, it will be desirable to move at a future time to a more dynamic approach to solvency monitoring that uses stochastic methods to forecast financial strength. The present system is a static test. There are two areas of potential weakness in the practices prevailing in the Czech Republic: at present, no attempt is made to eliminate the risk of double-gearing of investments in subsidiaries. Also the test of solvency is not subject to external audit.
Principle 9.	Derivatives and “off-balance sheet” items The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address: <ul style="list-style-type: none"> – restrictions in the use of derivatives and other off-balance sheet items; – disclosure requirements for derivatives and other off-balance sheet items; and – the establishment of adequate internal controls and monitoring of derivative positions.
Description	Subparagraph 21 (1) (r) of the Act restricts the use of derivatives to those which hedge the risk of other investments in the portfolio. By virtue of Decree 75/2000, derivative instruments may not exceed 5 percent of the assets used to cover technical provisions.
Assessment	Materially Non-observed. There are no requirements in place with respect to disclosure requirements nor to the establishment of internal controls and monitoring of derivative positions.
Comments	Disclosure requirements have not yet been specified by the authorities on the grounds that none are required. However, at least one company has made extensive use of derivatives and the companies will need guidance in accounting for these transactions. The Notes to the public financial statements of Ceska Pojistovna provide detail on their derivative transactions. This disclosure probably follows IAS.
Principle 10.	Reinsurance Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them. The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing: <ul style="list-style-type: none"> – the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverables and may take into account the supervisory control over the reinsurer; and – the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.
Description	The supervisor has no specific powers with respect to the review of reinsurance arrangements, although information on basic treaty reinsurance arrangements is to be supplied at the time of application for license. No requirements have been established with respect to credit that may

	be taken for reinsurance ceded nor to govern the amount of reliance on the insurance supervisors in other jurisdictions. Supervisory staff review reinsurance arrangements during on-site inspections.
Assessment	Materially Non-observed. Supervisory staff do not attempt to assess the ultimate collectability of amounts receivable under reinsurance agreements. Reviews conducted during on-site inspections are of limited effectiveness given the low frequency of such inspections.
Comments	It is encouraging to note that there is no requirement for mandatory cession of reinsurance to domestic reinsurers in the Czech Republic. Nevertheless, supervisors should maintain a constant watch on reinsurance programs. They should have the authority to challenge the terms of the reinsurance and the claims-paying ability of the reinsurer. Reinsurance activities are reviewed during inspections, but since these are so infrequent, a desk analysis system with regular reporting of reinsurance arrangements by the companies should perhaps be implemented. The failure of Morava Insurance Company was due at least in part to its inadequate reinsurance program, leaving the company unable to meet the claims from the floods in the Moravia district.
Principle 11.	<p>Market Conduct Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills and integrity in dealings with their customers. Insurers and intermediaries should:</p> <ul style="list-style-type: none"> – at all times act honestly and in a straightforward manner; – act with due skill, care and diligence in conducting their business activities; – conduct their business and organize their affairs with prudence; – pay due regard to the information needs of their customers and treat them fairly; – seek from their customers information which might reasonably be expected before giving advice or concluding a contract; – avoid conflicts of interest; – deal with their regulators in an open and co-operative way; – support a system of complaints handling where applicable; and – organize and control their affairs effectively.
Description	Section 26 of the Act on Insurance deals with the registration of intermediaries. They are expected to be of good repute and to discharge their duties with professional care. Both the association of brokers and the Czech Insurance Association have adopted Codes of Ethics for their members. They will expel a member for non-compliance. The Office of supervision has not adopted any formal procedures in respect of consumer protection. Complaints can be made to the President of the Republic, the Speaker of the Parliament or the MoF. There is no special ombudsman program for insurance consumers, and no obligations to provide clients of insurance companies with information about the authority of MoF in this area. Market conduct of companies is reviewed to some extent during on-site inspections, although as noted above, such reviews will be infrequent
Assessment	Materially Non-observed. The Act on Insurance provides some rules for consumer protection and the Office of supervision has made some progress at implementing these rules, but has not yet designed a comprehensive program of consumer protection.
Comments	The office of the supervisor receives frequent inquiries from customers. Staff provide information and attempt to reconcile the position of disgruntled policyholders with the position of the insurance company. Supervisory staff are currently reviewing practices of EU country supervisors to determine what measures should be implemented in the Czech Republic. There is no Alternate Dispute Resolution mechanism in the Czech Republic. It would perhaps be helpful to consumers if there were some method available that did not force the unhappy client to take court action

<p>Principle 12.</p>	<p>Financial Reporting</p> <p>It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections and communication with actuaries and external auditors.</p> <p>A process should be established for:</p> <ul style="list-style-type: none"> – setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports and other information; – setting the accounting requirements for the preparation of financial reports in the jurisdiction; – ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and – setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction. <p>In so doing a distinction may be made:</p> <ul style="list-style-type: none"> – between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and – between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.
<p>Description</p>	<p>The Accounting Act sets the basic framework for financial reporting. This is supplemented by decrees issued by the MoF pursuant to the authority specified in 26(3) of the Act on Insurance. Companies are to file their reports of technical provisions twice per year using the special forms specified by the Ministry. The solvency return is filed once per year. By virtue of section 24 of the Act on Insurance the company must supply an audited annual report to the MoF. The company is obliged to make these reports available to anyone upon request. There are no requirements for disclosure through the media or otherwise. Companies employ the same accounting and reporting rules when preparing their reports for shareholders as they use when preparing the statutory returns for the supervisory authorities. The supervisor receives annual reports from actuaries (section 23) and auditors (section 24).</p>
<p>Assessment</p>	<p>Observed.</p>
<p>Comments</p>	<p>According to paragraph 23(7) of the Act on Insurance, an actuary has special responsibilities when, in the course of the annual review, he or she identifies serious irregularities in the economic circumstances of the company, the actuary is obliged to propose remedial measures to the statutory board of the company. In the event that they are not implemented and the ability of the insurance company to meet its commitments is jeopardized, the actuary is obliged to inform the MoF. A similar provision for the role of the auditor will shortly be introduced through an amendment to the Law on Auditors. Authority to outsource independent reviews is limited. If it appears justified, the supervisor can ask a second auditor to review the work of the auditor in a given respect. If the supervisor's concern is justified by the findings of the second audit, the cost must be borne by the original auditor. It would be better if this power was broader and if it included actuaries.</p>

<p>Principle 13. On-site Inspection The insurance supervisor should be able to:</p> <ul style="list-style-type: none"> – carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and – request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies. 	
Description	By virtue of section 26 of the Act on Insurance, supervisory staff have broad authority to carry out on-site inspections and company Board members and staff are obliged to supply all information requested by the inspectors. These inspections can be conducted at any time, though no minimum frequency for inspections has been specified.
Assessment	Materially Non-observed. Many of the critical supervisory functions are to be performed during on-site inspections. However, the effectiveness of the system is impaired by the fact that inspections are conducted only once every 5 - 8 years. Some companies have never been inspected. Information about ultimate owners of insurance companies is not collected and applied in a consistent way to detect transactions between connected parties.
Comments	The legislation should stipulate that the supervisor must conduct an inspection of every company at least once every year, with discretion to defer for a year if necessary. Such frequency is essential since so much of the control work is said to be done as part of on-site inspections. There should also be a manual on inspections, which does not exist at present. It seems that the Office not presently collects information about the ultimate owners of insurance companies. Without such information inspecting and discovering transactions between connected parties is impossible. Supervisory staff explain that the principal impediment to upgrading of the inspection system is the lack of experienced staff within the Office. Considerable training will be required to prepare staff for risk-based inspection work.
<p>Principle 14. Sanctions Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include:</p> <ul style="list-style-type: none"> – the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions; – the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and – the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction. 	
Description	Sections 27 of the Act on Insurance provides that the Ministry, when it perceives that a company is in violation of the Act or is in a financial position that could jeopardize its ability to meet its obligations, it may (1) order changes in the management or Board of a company; (2) request a company to submit a plan of restoration; (3) impose a conservatorship; (4) suspend the sale of new policies in all or part of the company's operations; (5) order a transfer of policies to another company; (6) withdraw the authorization of the company. Sections 28 through 35 provide a broad specific details on how these sanctions will be applied.
Assessment	Observed.
Comments	The rating of Observed is assigned on the assumption that powers are exercised as needed. The Office of supervision should be encouraged to draw up a Ladder of Compliance that it would disclose to the supervised institutions, indicating the response or sanction it will invoke when faced with varying degrees of compliance problems among companies. The FSAP assessment team has been informed that supervisors communicate their findings to the Board

	of Directors as well as to management. This is a desirable practice.
Principle 15.	<p>Cross-border Business Operations</p> <p>Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that:</p> <ul style="list-style-type: none"> – no foreign insurance establishment escapes supervision; – all insurance establishments of international insurance groups and international insurers are subject to effective supervision; – the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and – foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.
Description	All companies doing business in Czech Republic must be licensed. There is no cross-border business in the style contemplated by the EU.
Assessment	Not applicable.
Comments	The plans for accession to the European Market and the ultimate adoption of the “single market” for insurance will mean changes for the Czech insurance market and for the work of supervision. As the Office reviews its activities and plans its reorganization, it should keep in mind the consequences of these important developments.
Principle 16.	<p>Coordination and Cooperation</p> <p>Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other’s concerns with respect to an insurance company that operates in more than one jurisdiction either directly or through a separate corporate entity.</p> <p>In order to share relevant information with other insurance supervisors, adequate and effective communications should be developed and maintained.</p> <p>In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:</p> <ul style="list-style-type: none"> – is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking or securities) to share information or otherwise work together; – is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential; – should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and – is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.
Description	Section 5 of the Act on Insurance authorizes the MoF to exchange information directly with supervisory authorities in other countries. Section 6 of the Act specifies that the MoF is to cooperate with international organizations and state supervisory authorities of other jurisdictions. The legislation contains no specific provision that authorizes the execution of formal agreements with other insurance supervisors, although there are references to “international agreements” without specifying what these agreements may be. No agreements have been negotiated as yet with supervisors in other jurisdictions. Paragraph 39(5) of the Act on Insurance refers to a “special legal provision” for exchange of information between the CSC, the CNB, and the MoF on behalf of the Office of insurance supervision.
Assessment	Observed.

Comments	Although the principle can be considered to be observed, contacts with supervisors in other jurisdictions have been informal and infrequent so far. They can be expected to be more common in future and formal agreements may be required. Exchange of information in key areas between domestic supervisors seem to lack in practice. As financial conglomerates increase in importance regular exchange of information and a clear division of labor also become vital in this area.
Principle 17.	Confidentiality All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections. The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorization for its release. Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.
Description	Section 39 of the Act on Insurance obliges all supervisory personnel to hold confidential all information they collect in the course of their duties relating to the insurance of legal or natural persons and on the activity of insurance or reinsurance companies and any matters relating thereto. The exchange of information with supervisory bodies in other countries shall not be considered an infringement of secrecy if the information relates to the business of foreign insurance companies who have their base of operations in those countries.
Assessment	Observed.
Comments	Nil.

Table 8. IAIS Core Principles: Observance of Individual Core Principles

Principle	Gradings					Comments and Corrective Actions
	O ^{1/}	LO ^{2/}	MNO ^{3/}	NO ^{4/}	NA ^{5/}	
1. Organization			X			The Supervision Office still lacks independence. There is also a need for additional resources and training
2. Licensing		X				Need to strengthen licensing procedures to include explicit reference to the financial soundness of owners. Information about ultimate owners need to be collected by the Office.
3. Changes in Control		X				There is a need for more explicit conditions on the acquirer.
4. Corporate Governance				X		Corporate governance rules need to be introduced in the Insurance Act.
5. Internal Controls				X		New provisions in the Insurance Act addressing internal controls need to be introduced. New inspection procedures need to be introduced to encompass risk management and internal controls.
6. Prudential—Assets			X			Supervisory procedures should be developed for dealing with issues not specified in legislation, such as matching
7. Prudential—Liabilities		X				A regime for reviewing reinsurance recoverables should be instituted.
8. Capital Adequacy and Solvency	X					

9. Derivatives and off balance sheet items			X			System of controls and disclosure requirements need to be prescribed.
10. Reinsurance			X			Office of supervision must develop procedures for review of reinsurance arrangements.
11. Market Conduct			X			Office of Supervision must establish a consumer protection program, Division of complaints, Ombudsman.
12. Financial reporting	X					
13. On site inspection - access to information			X			Minimum frequency of inspections is required. There is also a need to enhanced training program of on-site inspections, and to collect information about owners so to be able to inspect and uncover transactions among connected parties.
14. Sanctions	X					
15. Cross border business operations					X	This principle will become applicable as the country approaches EU membership.
16. Cooperation	X					
17. Confidentiality	X					

^{1/} O: Observed

^{2/} LO: Largely observed

^{3/} MNO: Materially non-observed

^{4/} NO: Non-observed

^{5/} NA: Not applicable.

Response to the assessment and recommended action plan

Response to the assessment

83. The Office of the State Supervision in Insurance and Pension Funds and the Secretariat of the Czech Insurance Association have provided the following observations concerning the assessment:

- The Office does not agree with the observation that insurance legislation should be strengthened in those areas that relate to licensing.
- The Office agrees that there has been a low frequency of on-site inspections in the past, but has pointed out that such inspections are becoming more frequent. In response to the assessment of Principle 13, the Office has observed that with its recent reorganization and the acquisition of new staff, there is scope for a gradual improvement of the frequency of controls.
- In respect of reinsurance (Principle 10), the Office has responded that increasing accent is being given to the importance of reinsurance programs, despite the fact that the Office does not have the legal authority to order or reject a specific reinsurance arrangement.

- The Office has also reported that “improvement of accounting rules for insurance companies” has been under its permanent consideration and attention for many years.

84. The Secretariat is of the opinion that the assessment should have emphasized the future changes in legislation expected from a new act on Insurance contracts (expected in 2002), a new Act on Insurance Intermediaries, Insurance Advisors and Independent Loss Adjusters (expected in 2003) and further amendments to the Act on Insurance harmonizing the act fully with the EEC directive on insurance (expected in 2003).

Recommended plan of action

85. The Czech authorities should focus their efforts in strengthening the system of insurance supervision. The Office of State Supervision of Insurance and Pensions should develop a strategic plan for restructuring its operations and adopting the techniques and procedures expected of those companies that adopt the EU directives. This strategic plan would have several steps:

- Identification of the special technical skills that the Office will require, including lawyers, actuaries, auditors, loss appraisers
- Redesign of the organization chart for the Office
- Plan for development of new procedures that will modernize the activities of the Office and bring them more into line with international practice
- Preparation of operational manuals and other work instruments that will be needed under the new style of operations
- Training program for staff
- Recruitment of additional personnel, where necessary professional skills are not presently available

86. The Office is fortunate to have the benefit of assistance from the German Office of Insurance Supervision supported by funding from the EU-Phare program. The resident expert has prepared a work program for the coming year that will help the office to make necessary changes in operation. This assistance should be incorporated into the strategic plan to be developed. The following specific features will be addressed by the German expert:

- Improvement of accounting rules for insurance companies
- Development of a manual for inspections
- Assistance with enhancement of a consumer protection program, including the introduction of an “ombudsman” role for the Office

87. These planned measures will help to remedy the concerns identified in the assessment of observance of IAIS Core Principles. However, there are some important measures that should be adopted immediately as standard procedures for the Office:

- On-site inspection must become a routine part of the supervisory process. Each company should be inspected each year, or at least every two years
- Inspection and analysis work should be directed according to risk assessment. Supervisory resources should be applied to those areas of a company's operations that represent the most serious threats to the long-term solvency of the company
- Supervisory staff must develop skills in assessing the appropriateness of matching of assets and liabilities as it is practiced by local companies
- A systematic program for review and assessment of reinsurance programs must be developed for the work of supervisory teams and techniques for the evaluation of reinsurance receivables developed

88. Technical assistance should be obtained to assist with the development of an effective program of consumer protection.

B. Transparency of Insurance Regulation

Information and methodology used for assessment

89. The assessment of transparency practices in insurance regulation in the Czech Republic was carried out by a three-member team³³ and was based on: (1) a pre-FSAP questionnaire response; (2) relevant laws;³⁴ and (3) discussions with MoF officials and Insurance Association and select insurance companies. The assessment was based on the *IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Transparency Code)*. No assessment methodology has been developed as yet, but the assessment has taken into account the implementation issues mentioned in the *Supporting Document* to the Code. The assessment also benefited from the discussions held with the authorities in the context of assessing MoF's observance with the *IAIS Core Principles* for effective supervision.

90. The Act on Insurance delegates the state insurance supervision in the Czech Republic to the MoF. Within the MoF, the Office of State Supervision of Insurance and Pension Funds (Office) is assigned the supervisory responsibilities over the insurance industry and the handling of consumer complaints. The Director of the Office reports to a Deputy Minister, who in turn reports to the Minister of Finance. The Minister of Finance acts upon

³³ Udaibir S. Das and Plamen Yossifov (IMF) and Donald McIsaac (World Bank).

³⁴ Insurance Act 363/1999 and the Decree No. 75/2000, Act on Accounting, Act on Auditing and the Commercial Code.

recommendations made by the Office in issuing regulations, issuing and revoking licenses, etc. Accountability to Parliament lies with the Minister and not the Director of the Office.

91. The Czech authorities cooperated fully with the assessment and provided all the necessary clarification and documents.

Practice-by-practice assessment

92. The detailed assessment has taken into account the fact that insurance systems and the legal and institutional arrangements differ across countries, as do domestic circumstances. It is further recognized that the new Insurance Act has become operational in April 2000 and a lot of steps are underway for improving the supervisory framework. A factor also kept in view has been the significant changes taking place in the Czech financial system, particularly in the banking sector, that influence the development of the insurance industry, specially those firms that are affiliates of bank holding companies. Competition in the insurance market is also growing and new foreign players are entering the industry.

93. The assessment of observance with each practice of the *MFP Transparency Code* is made on a qualitative basis based on existing laws and regulations, and practices. A five-part assessment system is used: observed; broadly observed; partly observed, not observed and not applicable: **observed**, implying full observance or with insignificant shortcomings; **broadly observed**, where minor weaknesses exist and these are not seen as being of a significant nature so as to raise serious doubts about the authority's ability to achieve the objective of that practice; **partly observed**, where shortcomings are sufficient to raise doubts about the authority's ability to achieve observance and which could affect the operational process and effectiveness of financial policies; **not observed**, where the practice is not being observed and no substantive progress has been recorded toward achieving the objectives of the practice; and **not applicable**, where, due to the country circumstances and the institutional and legal framework, the transparency practice is not applicable.

Table 9. Insurance Regulation Transparency: Practice-by-Practice Assessment

V. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES OF FINANCIAL AGENCIES RESPONSIBLE FOR FINANCIAL POLICIES	
5.1 The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.	
Description	The Act on Insurance delegates the state insurance supervision in the Czech Republic to the MoF. Within the MoF, the Office of State Supervision of Insurance and Pension Funds (Office) is assigned the supervisory responsibilities over the insurance industry and the handling of consumer complaints. The Director of the Office reports to a Deputy Minister, who in turn reports to the Minister of Finance. Accountability to Parliament lies with the Minister and not the Director of the Office. The Minister of Finance acts upon recommendations made by the Office in issuing regulations, issuing and revoking licenses, etc. The formal responsibility of the Office for settlement of disputes between consumers and insurance companies derives from a Government Decree from 1958 on the right of citizens to file consumer complaints with government bodies. References: Act on Insurance, ³⁵ Articles 1 and 6; Government Decree No. 150/1958.
Assessment	Observed
Comments	The internal distribution of responsibilities for the conduct of financial policies in the area of insurance within MoF is not clearly defined and publicly disclosed. The Government Decree from 1958, on which the formal responsibility of the Office for settlement of disputes between consumers and insurance companies is based, is outdated and the public is not informed about its provisions through other disclosure channels.
5.1.1 The broad objective(s) of financial agencies should be publicly disclosed and explained.	
Description	The Act on Insurance specifies that state insurance supervision shall be exercised in particular in the interest of consumer protection. References: Act on Insurance, Article 6(1).
Assessment	Partly observed
Comments	The broad objective of the MoF in the area of insurance supervision is not publicly disclosed and explained through other means than legislation.
5.1.2 The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.	
Description	The responsibilities and the authority of the MoF to conduct financial policies in the area of insurance are specified in the Act on Insurance. They are not publicly disclosed in any other manner. References: Act on Insurance, Articles 7, 26, 27, 37.
Assessment	Broadly observed
Comments	The responsibilities of the MoF in the area of insurance supervision, as defined in the Act on Insurance are to issue and revoke licenses of insurance and reinsurance companies and their intermediaries, ensure compliance with the license terms, monitor the economic performance of the insurance and reinsurance companies from the point of view of meeting their commitments, inspect the manner of application of administrative and accounting procedures and of internal control in the industry.
5.1.3 Where applicable, the broad modalities of accountability for financial agencies should be	

³⁵ Act No. 363/1999 Coll. of December 21, 1999 that entered in force in April 2000 (available in Czech on the MoF website www.mfcr.cz/scripts/hp/default.asp?Zakony). The Act was implemented by Decree No. 75/2000 Coll. of the Ministry of Finance dated 17 March 2000.

publicly disclosed.	
Description	The Minister of Finance reports to the government on issues related to insurance supervision on a need be basis. Under general rules of accountability of the executive branch of the state, the Minister can be summoned by Parliament to report on policies in the area of insurance and answer questions. Currently, the MoF does not publish reports on financial policies in the area of insurance. The Act on Insurance that entered in force in April 2000, however, requires the MoF to publish Annual Report on its insurance supervisory activities to ensure consumer protection, which will also contain an evaluation of the situation on the insurance market.
Assessment	Broadly observed
Comments	None of these modalities of accountability are defined specifically for the MoF insurance supervisory functions.
5.1.4	Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.
Description	The procedures for appointment, terms of office, and general criteria for removal of the Minister of Finance are specified in the Constitution. References: Constitution of the Czech Republic. ³⁶
Assessment	Observed
Comments	
5.2 The relationship between financial agencies should be publicly disclosed.	
Description	In compliance with Article 41 of the Act on the CSC, the CNB in cooperation with the MoF and the CSC has prepared a system of mutual cooperation in the area of capital markets. The resulting Memorandum of Understanding (MOU) also provides for cooperation in the other areas of financial supervision. This MOU is an internal document, which is not publicly disclosed. The agreement specifies the scope of information transmitted to other regulator without his request and by his request. In the same time the confidential character of shared information is protected and the objectives of using of this information limited. The MOU further details the cooperation in the area of on-site inspections. This co-operation does not include creation of common teams; it is limited to (ad hoc) on-site inspections made by the request of other regulator. The MOU provides for regular consultations between the heads of the three agencies at least yearly, on the lower level at least every half year and irregular consultations whenever it is necessary. The regulatory agencies decided not to publish this agreement without specifying the reasons behind this decision. By far, the Office has not received any requests for information or cooperation under this MOU. References: Act on the CSC, ³⁷ Article 41.
Assessment	Not observed
Comments	The procedures and scope of cooperation and information sharing between the MoF, the CSC and the CNB, specified in the 1998 Memorandum of Understanding, has not been explained to the public.
5.3 The role of oversight agencies with regard to payment systems should be publicly disclosed.	
Description	The MoF has no supervisory authority over the payment systems in the Czech Republic. This

³⁶ Constitutional Act of the Czech National Council of December 16, 1992.

³⁷ Act No. 15/1998 on the CSC and on amendments to other Acts.

	role is carried out by the CNB.
Assessment	Not applicable
Comments	The MoF has no supervisory authority over the payment systems in the Czech Republic.
5.3.1	The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.
Description	The MoF has no supervisory authority over the payment systems in the Czech Republic. This role is carried out by the CNB.
Assessment	Not applicable
Comments	See 5.3
5.4	Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.
Description	There are no self-regulatory organizations delegated with supervisory responsibilities in the area of insurance supervision.
Assessment	Not applicable
Comments	There are no self-regulatory organizations delegated with supervisory responsibilities in the area of insurance supervision.
5.5	Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.
Description	There are no self-regulatory organizations delegated with supervisory responsibilities in the area of insurance supervision.
Assessment	Not applicable
Comments	See 5.4
VI. OPEN PROCESS FOR FORMULATING AND REPORTING OF FINANCIAL POLICIES	
6.1	The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.
Description	The regulatory framework, governing the conduct of insurance supervision by the MoF, is readily available to the public in the Acts Collection ("Sbírka zákonů") and in the monthly publication of the MoF "Finanční zpravodaj." General operating procedures for the conduct of insurance supervision are specified in legislation. The fees charged for insurance supervisory activities are specified in the Act on Insurance and the Act on Administrative Fees. All changes in the regulatory framework of insurance supervision are consulted with the Czech Insurance Association. References: Act on Insurance; Administrative Code; Act on State Control; Act on Administrative Fees.
Assessment	Broadly observed
Comments	Specific operating procedures for the conduct of insurance supervision by the Office are not publicly disclosed. The procedures and scope of cooperation and information sharing between the MoF, the CSC and the CNB, specified in the 1998 Memorandum of Understanding, has not been explained to the public. Currently, neither the Office nor the MoF publish reports on financial policies in the area of insurance.
6.1.1	The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.
Description	The regulatory framework, governing the conduct of insurance supervision by the MoF, encompasses the Act on Insurance and the regulations issued by the MoF in this area. These regulations are published in the Acts Collection ("Sbírka zákonů") and in the monthly publication of the MoF "Finanční zpravodaj." The tables of contents of the issues of "Finanční zpravodaj" since 1998 are published on the website of MoF (www.mfcr.cz/scripts/hp/default.asp?FinZprav). In addition, the Act on Insurance, related

	<p>legislative acts and important decrees of the Minister of Finance are available in Czech on the MoF website (www.mfcr.cz/scripts/hp/default.asp?Zakony). General operating procedures for the conduct of insurance supervision are specified in the Act on Insurance, the Administrative Code and the Act on State Control.</p> <p>References: Act on Insurance, Articles 7, 8, 24, 38; Administrative Code; Act on State Control.</p>
Assessment	Broadly observed
Comments	Specific operating procedures for the conduct of insurance supervision by the Office are not publicly disclosed.
6.1.2	The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.
Description	<p>Some of the requirements for financial reporting by the companies subject to insurance supervision are published in the Act on Insurance and other related laws. Individual return forms are published in the monthly publication of MoF "Finanční zpravodaj."</p> <p>References: Act on Insurance.</p>
Assessment	Observed
Comments	
6.1.3	The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.
Description	The MoF has no supervisory authority over organized financial markets. This role is carried out by the CSC.
Assessment	Not applicable
Comments	The MoF has no supervisory authority over organized financial markets.
6.1.4	Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.
Description	<p>The fees charged for insurance supervisory activities are specified in the Act on Insurance and the Act on Administrative Fees.</p> <p>References: Act on Insurance, Article 46; Act on Administrative Fees.³⁸</p>
Assessment	Observed
Comments	
6.1.5	Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.
Description	<p>The Act on Insurance stipulates that the exchange of information between MoF, the CSC and the CNB, done according to the Memorandum of Understanding mentioned in the description of practice 5.2, shall not be considered an infringement of the obligation of MoF employees, under the Act of Insurance, to keep secrecy on matters relating to the insurance of natural and legal persons and the activity of the insurance or reinsurance companies. This MOU is an internal document, which is not publicly disclosed.</p> <p>The Act on Insurance governs information sharing with foreign supervisory authorities. In particular, the act specifies that upon issuing an authorization for insurance activity to a foreign insurance company MoF is entitled to request the necessary information directly from the state supervisory authority of the country, in which such company has its seat, and upon the request of such supervisory authority to provide information on the activities of the foreign insurance company on the territory of the Czech Republic through its organizational unit. In practice, even though the MoF has not signed any international agreements to this effect, the Office</p>

³⁸ Act No. 368/1992 Coll., on administrative fees, as amended through December 2000.

	frequently provides and obtains such information through informal arrangements. References: Act on Insurance, Articles 5, 6, 39.
Assessment	Not observed
Comments	The procedures and scope of cooperation and information sharing between the MoF, the CSC, and the CNB, specified in the 1998 Memorandum of Understanding, has not been explained to the public.
6.2	Significant changes in financial policies should be publicly announced and explained in a timely manner.
Description	Changes in regulations, governing the conduct of insurance supervision by the MoF, are published in the Acts Collection (“Sbírka zákonů”) and in the monthly publication of the MoF “Finanční zpravodaj.” The tables of contents of the issues of “Finanční zpravodaj” since 1998 are published on the website of MoF (www.mfcr.cz/scripts/hp/default.asp?FinZprav). In addition, the Act on Insurance, related legislative acts and important decrees of the Minister of Finance are available in Czech on the MoF website (www.mfcr.cz/scripts/hp/default.asp?Zakony).
Assessment	Observed
Comments	
6.3	Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.
Description	Currently, MoF does not publish reports on financial policies in the area of insurance. The Act on Insurance that entered in force in April 2000 requires the MoF to publish Annual Report on its insurance supervisory activities to ensure consumer protection, which should also contain an evaluation of the situation on the insurance market. The Annual Report will be published in the MoF publication “Finanční zpravodaj” not later than September 30 of each calendar year. References: Act on Insurance, Article 6.
Assessment	Not observed
Comments	Currently, MoF does not publish reports on financial policies in the area of insurance. The maximum delay between the end of the budget year and the publication of the Annual Report, specified in the latest amendments of the Act on Insurance, seems exceedingly long.
6.4	For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.
Description	All changes in the regulatory framework of insurance supervision are sent for comments from the Czech Insurance Association. There is no predetermined consultation period but in practice sufficient amount of time is given to the industry to submit their opinions.
Assessment	Observed
Comments	
VII. Public Availability of Information on Financial Policies	
7.1	Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.
Description	Currently, the MoF does not publish reports on financial policies in the area of insurance. The Act on Insurance that entered in force in April 2000, however, requires the MoF to publish Annual Report on its insurance supervisory activities to ensure consumer protection, which will also contain an evaluation of the situation on the insurance market. The Annual Report will be published in the MoF publication “Finanční zpravodaj” not later than on September 30 of each calendar year. References: Act on Insurance, Article 6.
Assessment	Not observed
Comments	Currently, the MoF does not publish reports on financial policies in the area of insurance. The maximum delay between the end of the budget year and the publication of the Annual Report,

	specified in the latest amendments of the Act on Insurance, seems exceedingly long.
7.2	Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.
Description	The MoF does not publish aggregate data on the insurance and reinsurance industry, with the exception of lists of licensed companies. It is expected that such information will be published in the Annual Report on insurance supervisory activities, the publication of which is required by the Act on Insurance that entered in force in April 2000.
Assessment	Not observed
Comments	This information vacuum is competently filled by the Czech Insurance Association (www.cap.cz), which provides detailed aggregate market information in its Annual Reports.
7.3	Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.
Description	The budget of the MoF and within it the one of the Office is part of the state budget.
Assessment	Not applicable
Comments	
7.3.1	Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.
Description	The MoF does not provide any emergency financial support to insurance and reinsurance firms.
Assessment	Not applicable
Comments	
7.4	Financial agencies should establish and maintain public information services.
Description	MoF maintains public information services that service all its policy functions. Individual requests for information under the Freedom of Information Act ³⁹ are handled by the Information Center of the MoF.
Assessment	Observed
Comments	
7.4.1	Financial agencies should have a publications program, including a periodic public report on their principal activities issued at least annually.
Description	As related to insurance supervision, the MoF publishes one monthly publication "Finanční zpravodaj," in which disseminates the text of regulations adopted by the Ministry. The Act on Insurance that entered in force in April 2000, however, requires the MoF to publish an Annual Report on its insurance supervisory activities to ensure consumer protection, which will also contain an evaluation of the situation on the insurance market. The Annual Report will be published in the MoF publication "Finanční zpravodaj" not later than September 30 of each calendar year.
Assessment	Partly observed
Comments	Currently, neither the Office nor the MoF publish reports on financial policies in the area of insurance. The maximum delay between the end of the budget year and the publication of the Annual Report, specified in the latest amendments of the Act on Insurance, seems exceedingly long. The website of the MoF (www.mfcr.cz/scripts/hp/default.asp?OrgStru) does not offer information on its insurance supervisory policies and does not even mention the Office by name.

³⁹ Act No. 106/1999 Coll., on Freedom of Information.

7.4.2	Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.
Description	The Minister of Finance reports to the government on issues related to insurance supervision on a need be basis. Under general rules of accountability of the executive branch of the state, the Minister can be summoned by Parliament to report on policies in the area of insurance and answer questions. MoF officials publish articles in the mass media and attend seminars and conferences on matters related to insurance. The Freedom of Information Act requires MoF to respond in writing to individual requests for information within fifteen days.
Assessment	Observed
Comments	None of these modalities of accountability are defined specifically for the MoF insurance supervisory functions.
7.5	Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.
Description	The text of regulations, governing the conduct of insurance supervision by the MoF, are published in the Acts Collection ("Sbírka zákonů") and in the monthly publication of the MoF "Finanční zpravodaj" (www.mfcr.cz/scripts/hp/default.asp?FinZprav). In addition, the Act on Insurance, related legislative acts and important decrees of the Minister of Finance are available in Czech on the MoF website (www.mfcr.cz/scripts/hp/default.asp?Zakony).
Assessment	Observed
Comments	
7.6	Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.
Description	There are no guarantee funds in the insurance industry.
Assessment	Not applicable
Comments	
7.7	Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.
Description	The Office has a formal responsibility for settlement of disputes between consumers and insurance companies, which derives from the Government Decree from 1958 on the right of citizens to file consumer complaints with government bodies. References: Government Decree No. 150/1958.
Assessment	Partly observed
Comments	Information on such arrangements is not publicly disclosed, as the staffing of the Office is inadequate to handle potential large amount of complaints. The Government Decree from 1958, on which the responsibility of the Office for settlement of disputes between consumers and insurance companies, is outdated and the public is not informed about its provisions through other disclosure channels.
VIII. Accountability and Assurances of Integrity by Financial Agencies	
8.1	Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.
Description	The Minister of Finance reports to the government on issues related to insurance supervision on a need be basis. Under general rules of accountability of the executive branch of the state, the Minister can be summoned by Parliament to report on policies in the area of insurance and answer questions.
Assessment	Observed
Comments	None of these modalities of accountability are defined specifically for the MoF insurance

	supervisory functions.
8.2	Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.
Description	The budget of the MoF and within it the one of the Office is part of the state budget
Assessment	Not applicable
Comments	
8.2.1	Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.
Description	See 8.2
Assessment	Not applicable
Comments	
8.2.2	Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.
Description	Internal governance procedures are not publicly disclosed and are exempt from the requirements for informing the public under the Freedom of Information Act.
Assessment	Not observed
Comments	
8.3	Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.
Description	The revenues and expenditures of the MoF and within it the one of the Office are determined by the state budget.
Assessment	Observed
Comments	
8.4	Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.
Description	General principles for the conduct of MoF officials and staff are defined in the Labor Act, whereas special provisions are described in Act on Insurance. The Act on Insurance obliges MoF employees to keep secrecy on matters relating to the insurance of natural and legal persons and the activity of the insurance or reinsurance companies. It furthermore prohibits staff and officials of the MoF from becoming members of a statutory or supervisory body or a proxy holder of an insurance or reinsurance companies. References: Act on Insurance, Articles 6, 12, 39; Labor Act.
Assessment	Observed
Comments	
8.4.1	Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.
Description	There is no legal protection of MoF staff and officials in carrying their official duties in insurance supervision.
Assessment	Not Applicable
Comments	

Table 10. Insurance Regulation Transparency: Observance of Individual Practices

Practice	Gradings					Comments
	O ⁴⁰	BO ⁴¹	PO ⁴²	NO ⁴³	NA ⁴⁴	
V. Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies						
5.1 The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.	X					The government decree, on which the formal responsibility of the Office for settlement of disputes between consumers and insurance companies is based, is very old (1958) and obsolete.
5.1.1 The broad objective(s) of financial agencies should be publicly disclosed and explained.			X			Besides the legislative formulation in the Act on Insurance, the broad objective of the MoF in the area of insurance supervision is not publicly disclosed and explained.
5.1.2 The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.		X				The responsibilities and the authority of the MoF to conduct financial policies in the area of insurance are specified in the Act on Insurance but are not publicly disclosed in any other manner.
5.1.3 Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.		X				The Minister of Finance reports to the government on issues related to insurance supervision on a need be basis. Under general rules of accountability of the executive branch of the state, the Minister of Finance can be summoned by Parliament to report on policies in the area of insurance and answer questions. None of these modalities of accountability are defined specifically for the MoF insurance supervisory functions. Currently, the MoF does not publish reports on financial policies in the area of insurance.
5.1.4 Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.	X					
5.2 The relationship between financial agencies should be publicly disclosed.				X		The procedures and scope of cooperation and information sharing between the MoF, the CSC and the CNB, specified in the 1998

⁴⁰ 1/ O: Observed.

⁴¹ BO: Broadly observed.

⁴² PO: Partly observed.

⁴³ NO: Nonobserved.

⁴⁴ NA: Not applicable.

Practice	Gradings					Comments
	O ⁴⁰	BO ⁴¹	PO ⁴²	NO ⁴³	NA ⁴⁴	
						Memorandum of Understanding, has not been explained to the public.
5.3 The role of oversight agencies with regard to payment systems should be publicly disclosed.					X	The MoF has no supervisory authority over the payment systems in the Czech Republic.
5.3.1 The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.					X	See 5.3
5.4 Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.					X	There are no self-regulatory organizations delegated with supervisory responsibilities in the area of insurance supervision.
5.5 Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.					X	See 5.4
VI. Open Process for Formulating and Reporting of Financial Policies						
6.1 The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.		X				See comments to practices in section VI.
6.1.1 The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.		X				Specific operating procedures for the conduct of insurance supervision by the Office are not publicly disclosed.
6.1.2 The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.	X					
6.1.3 The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.					X	The MoF has no supervisory authority over organized financial markets.

Practice	Gradings					Comments
	O ⁴⁰	BO ⁴¹	PO ⁴²	NO ⁴³	NA ⁴⁴	
6.1.4 Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.	X					
6.1.5 Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.				X		The procedures and scope of cooperation and information sharing between the MoF, the CSC and the CNB, specified in the 1998 Memorandum of Understanding, has not been explained to the public.
6.2 Significant changes in financial policies should be publicly announced and explained in a timely manner.	X					
6.3 Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.				X		Currently, the MoF does not publish reports on financial policies in the area of insurance.
6.4 For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.	X					
VII. Public Availability of Information on Financial Policies						
7.1 Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.				X		Currently, the MoF does not publish reports on financial policies in the area of insurance. The Act on Insurance that entered in force in April 2000, however, requires the MoF to publish an Annual Report on its insurance supervisory activities to ensure consumer protection the situation on the insurance market.
7.2 Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.				X		The MoF does not publish aggregate data on the insurance and reinsurance industry, with the exception of lists of licensed companies. It is expected that such information will be published in the Annual Report for 2000.
7.3 Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.					X	The budget of the MoF and within it the one of the Office is part of the state budget.
7.3.1 Consistent with confidentiality and privacy of information on					X	The MoF does not provide any emergency financial support to insurance and

Practice	Gradings					Comments
	O ⁴⁰	BO ⁴¹	PO ⁴²	NO ⁴³	NA ⁴⁴	
individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.						reinsurance firms.
7.4 Financial agencies should establish and maintain public information services.	X					
7.4.1 Financial agencies should have a publications program, including a periodic public report on their principal activities, issued at least annually.			X			The website of the MoF does not offer information on its insurance supervisory policies and does not even mention the Office by name. Currently, the MoF does not publish reports on financial policies in the area of insurance.
7.4.2 Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.	X					None of the venues for dissemination of information to the public by the MoF is defined specifically for the MoF insurance supervisory functions.
7.5 Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.	X					
7.6 Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.					X	There are no guarantee funds in the insurance industry.
7.7 Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.				X		Information on the Office's responsibility for settlement of disputes between consumers and insurance companies, which derives from a Government Decree from 1958, is not publicly disclosed, as the staffing of the Office is inadequate to handle potential large amount of complaints.
VIII. Accountability and Assurances of Integrity by Financial Agencies						
8.1 Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy	X					None of the venues of accountability by the MoF is defined specifically for the MoF insurance supervisory functions.

Practice	Gradings					Comments
	O ⁴⁰	BO ⁴¹	PO ⁴²	NO ⁴³	NA ⁴⁴	
objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.						
8.2 Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.					X	The budget of the MoF and within it the one of the Office is part of the state budget.
8.2.1 Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.					X	See 8.2
8.2.2 Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.				X		Internal governance procedures are not explained to the public and are exempt from the requirements for informing the public under the Freedom of Information Act.
8.3 Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.	X					
8.4 Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.	X					
8.4.1 Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.					X	There is no legal protection of MoF staff and officials in carrying their official duties in insurance supervision.

Response to the assessment and recommended action plan

Response to the assessment

94. In its response, the Office of State Supervision of Insurance and Pension Funds expressed the following reservations regarding the assessment:

- (Practices 5.1 and 7.7) While agreeing that the Government Decree No. 150/1958 is somewhat out-of-date, the Office felt that the decree satisfies the present needs.

- (Practice 5.1) The Office questioned the practicality of publishing the Internal Organization Rules of the MoF given their extensive coverage and frequent changes. In follow-up discussion, the assessors explained that the assessment does not ask for this but rather for disclosing the general distribution of responsibilities between the Office and the other departments in the MoF. As a result of the discussion this objection was dropped.
- (Practices 5.2 and 6.1.5) The Office objected to the recommended public disclosure of the procedures and scope of cooperation and information sharing between the MoF, the CSC and the CNB, specified in a 1998 MOU, further noting that this will require the consent of all parties involved.
- (Practices 6.3 and 7.1) The Office noted that as long as its staff receive the audited financial statements of supervised companies by June 30, the maximum delay between the end of the calendar year and the publication of its planned Annual Report (until September 30) is not so long.

95. The Office also provided some useful factual clarifications, which were incorporated in the final assessment.

Recommended action plan

Clarity of roles, responsibilities and objectives of financial agencies

96. The internal distribution of responsibilities for the conduct of financial policies in the area of insurance within the MoF should be publicly disclosed.

97. The Government Decree from 1958, on which the formal responsibility of the Office for settlement of disputes between consumers and insurance companies is based, is outdated. It should be brought up-to-date with the political and economic changes in the Czech Republic since then, and the general public should be actively informed about its implications for the insurance industry.

98. The broad objective of the MoF in the area of insurance supervision should be publicly disclosed and explained through other channels in addition to legislation.

99. The responsibilities and the authority of the MoF to conduct financial policies in the area of insurance should be publicly disclosed through other channels in addition to legislation and regulation.

Open process for formulating and reporting of financial policies

100. Specific operating procedures for the conduct of insurance supervision by the Office should be publicly disclosed.

101. The procedures and scope of cooperation and information sharing between the MoF, the CSC and the CNB, specified in the 1998 MOU, should be explained to the public.

Public availability of information on financial policies

102. The MoF should publish aggregate data on the insurance and reinsurance industry.

103. The website of the MoF should provide information on its insurance supervisory policies.

104. The maximum delay between the end of the budget year and the publication of the Annual Report, specified in the latest amendments of the Act on Insurance, should be significantly shortened.

105. Information on the Office's responsibility for settlement of disputes between consumers and insurance companies should be widely disclosed to the general public. The staffing of the Office should be increased to be capable of handling the potential large amount of complaints.

Accountability and assurances of integrity by financial agencies

106. Internal governance procedures in the MoF should be explained to the public.

**V. IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION AND
TRANSPARENCY OF SECURITIES REGULATION**

A. IOSCO Objectives and Principles of Securities Regulation

Information and methodology

107. In preparation for this assessment,⁴⁵ the CSC was asked to complete seven self-assessment questionnaires prepared by IOSCO for use by its members. Those questionnaires were completed diligently and, in many cases where the regulatory system was thought to fall short of the IOSCO standards, with a frank acknowledgement of that fact. It should be noted that the assessment takes into consideration revised legislation that reflects the ongoing effort by the CSC and the Czech Government to improve the regulatory framework for capital market activities. This legislation only came into effect on January 1, 2001, and it is therefore off course still too early to assess the practical impact of these positive measures.

⁴⁵ Prepared by Andrew Proctor (Hong Kong Securities and Futures Commission); and Jeppe Ladekarl (World Bank).

108. The information provided in the responses to the self-assessments was tested and supplemented in interviews conducted over several days with senior staff of the CSC. Three of the five members of the Presidium of the CSC participated in those interviews, including the Chairman. Presently one Presidium seat remains to be filled. The CSC staff were impressive in their preparedness to answer questions and to enter into discussion.

109. The assessment also benefited from face-to-face interviews with senior representatives of the operators of the key trading and settlement providers. These included senior staff of the PSE; the joint Chairman and Managing Director of RMS, as well as its senior staff; the Managing Director and senior staff of the SCP, and the General Director and senior staff of UNIVYC. Finally, the assessment included a series of meetings with industry participants, both in their personal capacity and in their capacity as members of representative bodies.

Supervisory framework and market structure

Supervisory framework

110. The primary regulator of the securities markets of the Czech Republic is the CSC. The CSC's functions and powers are to be found in the CSC Act and various pieces of legislation governing the capital markets. The CSC is an independent statutory body, with limited obligations to report to both the Minister of Finance and the Chamber of Deputies of the Parliament of the Czech Republic.

111. The CSC's responsibilities include: (1) the licensing and supervision of securities dealers; (2) the approval of offering documents (called "statutes" in the Czech Republic) for the public offering of securities, bonds and collective investments, and the approval of advertising in respect of those offerings; (3) the approval and supervision of Exchange operators and the providers of clearing and settlement systems; (4) the investment activities and portfolio composition of pension funds (the MoF is responsible for licensing and supervision of these funds); and (5) from January 2001, additional obligations arising under the Commercial Code, including with respect to takeover bids.

112. The CSC's responsibilities extend to the securities dealing of banks and to that extent, banks in the Czech Republic are subject to dual supervision by the CSC and the CNB.

113. Primary responsibility for policy formulation lies with the MoF. The Ministry also prepares secondary legislation. The PSE performs a limited supervisory role with respect to the monitoring of trading on the Exchange, and in the supervision of the conduct of its members. Starting in January 2001, the operator of the second securities trading system, the RMS, will be expected to monitor trading on its electronic exchange. It should be noted that there are no intermediaries on the RMS. The Chamber of Auditors also has self-regulatory powers under the Auditing Act.

114. The CSC, the CNB, the MoF, and the Chamber of Auditors have signed MOUs in recognition of the increasing overlapping in their areas of supervision. The CSC also has the legal authority to monitor the activities of the PSE and RMS.

115. Finally, there are other professional bodies whose members agree upon market conventions or conduct standards, and who have some limited capacity to take disciplinary action against their members, but they could not properly be described as SROs.⁴⁶

Market structure

116. The Czech Securities Market was created in the early 1990s, as part of a mass coupon privatization scheme that involved the introduction of around 1,800 publicly traded companies in the capital market, together with hundreds of newly created investment funds. The trading of the shares of companies and investment funds was conducted in two newly created exchanges, the PSE and the RMS.

117. Both the PSE and RMS are authorized by the CSC. The PSE is authorized as an exchange, whereas the RMS has a special authorization under the Securities Act not unlike that of a broker. However, from January 1, 2001, RMS will be regulated in the same manner as the PSE, and will assume responsibility for some regulatory matters, including surveillance of trading on the RMS.

118. The PSE is an intermediated stock exchange with 54 members. It is regulated according to the provisions of the Stock Exchange Act. Membership of the PSE may be granted to any legal entity licensed by the CSC as a dealer that meets the PSE's additional requirements, is a shareholder of the PSE, or is otherwise admitted to membership in accordance with the Exchange Membership Regulations. The CNB is a member of the PSE as a matter of law.

119. Securities are traded on the PSE in three markets: Main, Secondary, and Free. The Main and Secondary markets are differentiated by the higher listing requirements on the Main market. In the Free market, securities are not listed and there is no obligation to disclose material information on an ongoing basis. There is simply a required minimum value of the registered issue. The PSE also has provision for a New Market, which is described as an organic segment of the secondary market for young companies with high growth potential. The capital requirement is set very low, at a minimum of CZK 10 million, but there are still no companies in the New Market.

120. The PSE is an electronic exchange with an automated trading system. Its most important trading system is the SPAD system, which is used for the seven most active stocks and which accounts for more than 90 percent of all trades. Trading can also take place through two other channels: automatic trades at fixed or variable prices, or block trades

⁴⁶ For example, the Union of Investment Companies of the Czech Republic, and the Association of Fixed Income Traders.

effected off-market between PSE members and subsequently recorded on the PSE's trading system.

121. Clearing and settlement of trades on the PSE is effected through a system operated by a subsidiary of the PSE called UNIVYC. Pursuant to section 70c of the Securities Act, UNIVYC is approved by the CSC to provide settlement services. Members of the PSE automatically become members of UNIVYC. Any legal person authorized to trade in securities may become a member of UNIVYC.

122. The RMS is an electronic trading system accessible by the general public as well as by more sophisticated investors such as brokers or institutional investors. It has not been regulated under the Stock Exchange Act but rather, in a manner akin to a securities dealer, under the Securities Act. As of January 1, 2001, the RMS will be regulated in the same way as the PSE.

123. Approximately 2,100 publicly tradable securities can still be traded in the RMS, but many of these securities are rarely traded. The number of securities tradable in the RMS is expected to be significantly reduced in January 1, 2001, as a result of stricter requirements introduced by recent amendments to the Securities Act. Access to the RMS is via a number of "share shop" locations (more than 100) throughout the country. Professional and institutional clients may also access the RMS through on-line terminals installed at their premises.

124. Trading takes the form of an on-line auction. There is a pre-trade validation of orders as the principal guarantee of no failed trades. This involves a linkage to the Securities Center to ensure that a seller actually owns the securities offered for sale and, in the case of purchasers, to ensure the availability of cleared funds. Cash settlement is effected through one of the commercial banks commissioned by the RMS. Settlement is on a delivery versus payment basis.

125. The TKD system is used for the issuance, registration and settlement of trades in short-term instruments (maturity up to 1 year), including treasury bills and National Bank bills. The TDK System operates on a gross and continuous basis. It runs in real time and provides for delivery versus payment. Cash settlement is in the clearing and settlement system of the CNB.

126. The Securities Center ("SCP") is responsible for the registration of securities and debt instruments with maturity of longer than one year. The SCP was established under the Securities Act by the MoF and the Czech Republic is liable for the actions of the SCP. The SCP maintains registers of dematerialized and immobilized securities. Registration is presently to the level of the individual beneficial owner. Reforms to come into effect in 2001 will allow for registration in the name of a nominee.

General preconditions for effective securities regulation

127. The IOSCO *Objectives and Principles* describe a number of preconditions necessary for effective securities regulation.⁴⁷ These include an appropriate and effective legal, tax, and accounting framework. The preconditions listed in the IOSCO document appear to be broadly satisfied, including that there should be no unnecessary barriers to entry and exit from markets and products and an equal regulatory burden on all who make a particular financial commitment or promise. There are, however, some areas of concern, and they include the enforceability of legal obligations through the court system, and the adequacy of insolvency laws. These issues are covered in other parts of the FSAP report.

Table 11. IOSCO Core Principles: Principle-by-Principle Assessment

Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	The CSC Act provides for a general framework of the responsibilities of the CSC. Special provisions on its responsibilities can be found in the Securities Act, the Bonds Act, the Stock Exchange Act, the Investment Companies and Funds Act, and the Pension Funds Act. Starting on January 1, 2001, the CSC will have responsibilities in relation to takeover bids. These responsibilities are contained in the Commercial Code. As the Czech legal system is governed by the principle of the rule of law and legality, administrative powers of the CSC may not be exercised without an express provision in law. Clear rules of procedure are provided for in the legislation.
Assessment	Implemented.
Comments	The responsibilities of the CSC are clearly defined in the laws. Further improvements are expected from the new and modern rules of administrative procedure (Administrative Procedures Act) and the prepared reform of the system of administrative judicature (Civil Court Proceedings Act).
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.

⁴⁷ See, in particular section 5 of the *Objectives and Principles* and Annex 3.

Description	<p>The Presidium members of the CSC are appointed by the President upon the government's proposal and can be recalled only in limited circumstances clearly specified in the CSC Act (Section 23, ns 6-7). The government cannot exercise direct power over the Presidium or the decision making process within the CSC. The rules of appointment and the decision making process give the CSC a high degree of supervisory autonomy. However, the CSC does not have the right to promulgate secondary legislation (regulatory autonomy) and does not have its own funding sources (budgetary autonomy). Secondary legislation is drafted by the CSC, but the MoF must approve and issue such legislation. The CSC is entirely funded by the State budget.</p> <p>The lack of autonomy in these two areas does not necessarily result in loss of operational independence. It would be possible to construct cooperative arrangements in which the expertise of the regulator is utilized in the preparation of secondary legislation. However, the procedures between the CSC and the MoF seem to result frequently in lack of flexibility and delays.</p> <p>The lack of own funding sources (through fees levied on market participants) does not necessarily imply a loss of operational independence, provided there is proper transparency in the budgetary process, accountability, and a right to administer the resources day to day. The CSC does not seem to have lost operational independence due to its financial dependence on the State budget. However, some budgetary autonomy is generally believed to increase the degree of separation between the regulator and the government, and the supervisors of most EU countries finance at least part of their activities through fees and industry levies.</p> <p>Accountability has been provided for by way of regular reports to the Chamber of Deputies of the Parliament and to the government. Furthermore, decisions of the CSC can be challenged before an independent court. The court system is slow, however, raising questions about the practical utility of the right to challenge a decision of the CSC. The time a case spends in the system before it is finally settled is further lengthened by the fact that courts cannot substitute their own decision for that of the regulator, but rather refer cases back to the CSC.</p>
Assessment	<p>Partially implemented. The Principle cannot be considered to be fully implemented, due to the lack of efficient procedures for the CSC to provide input into the process of preparing secondary legislation, and the limited practical value of providing accountability measures through a slow court system.</p>
Comments	<p>The MoF has indicated that the CSC Act would be amended in 2001, empowering the CSC to issue secondary regulation. These enhanced powers should be accompanied by a build up of technical capacity within the CSC (see Principle 3). Further strengthening the accountability of the CSC is the reform of the system of administrative judicature intended to address the problems of the court system.</p>
Principle 3.	<p>The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.</p>
Description	<p>The laws and regulations of the Czech Republic as in effect on January 1, 2001 give sufficient functions and powers to the CSC to permit effective regulation of the securities markets within the given framework of laws. The difficulty lies in the CSC's limited capacity to exercise its powers due to staff shortages and limited experience.</p> <p>Staff of the CSC are civil servants and enjoy the benefits of that status but they are also tied to civil service pay scales. This makes it difficult for the CSC to hire and retain well qualified, specialized, and experienced staff.</p> <p>The lack of sufficient resources is well illustrated by the CSC's difficulty in staffing a</p>

	recently created Enforcement Division. Although the creation of such a division was a sensible step, it remains small, and its resources would be quickly exhausted by a few modest-sized investigations. Similarly, there are simply not enough staff to carry out an adequate program of routine inspections of brokers.
Assessment	Partially implemented. The CSC cannot properly perform its functions, due to its lack of capacity at the CSC in terms of qualifications of staff in areas such as risk management, auditing and accounting, experience of staff and overall resources available to the supervisor..
Comments	The single most important finding of this assessment is that in many areas in which the law appears adequate and the functions and powers available to the CSC appropriate, the CSC does not have the resources and in certain areas skills to effectively discharge its responsibilities. This problem of hiring and retaining skilled staff is a problem faced by securities regulators in many countries, but it appears to be particularly acute at the CSC and needs to be addressed.
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	The CSC has created and published a number of internal guidelines governing the use of its discretion in various matters (e.g., licensing, fit-and-proper tests, imposition of fines). It would appear that increasingly, comments from the market are sought as draft policy is formulated. Such a consultative practice is an important part of a modern transparent supervisory system. A system of internal checks and balances and independent internal audit has been introduced. The CSC publishes legal opinions on matters of general significance or upon request from the market. Selected decisions including their reasoning are also published. The CSC makes good use of technology to disseminate its views on regulatory issues and to publish the outcome of regulatory actions.
Assessment	Implemented.
Comments	Although the CSC is transparent in its regulatory processes, the lack of resources seems to result in some occasions in a lack of depth, and the adoption of a formal approach to some of the regulatory responsibilities. For example, in the area of licensing there does not appear to be a capacity to consider such matters as the adequacy of risk disclosure in offering documents. The focus on ensuring formal compliance with the regulation without proper regard for the substantive issues, seems to have hurt the credibility of the CSC. The CSC has correctly created a separate Enforcement Division to further safeguard the consistency of decision making in the use of administrative remedies, and increase the credibility of the CSC. However, this Division is still thinly staffed. Progress in these areas will depend on the build-up of supervisory capacity, as noted above.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	General provisions on professional standards for the staff of the CSC are provided for in the CSC Act. These include the obligation of strict confidentiality and duty to disclose all trades in securities. Detailed requirements have been included in an internal ethical code to be observed by each member of the staff. Internal guidance notes and codes govern the conduct of the employees in proceedings. The compliance with the codes is subject to supervision of the security and internal audit departments.
Assessment	Implemented.
Comments	The CSC is taking a number of steps to further improve these standards. A new code is to be presented in the course of 2001 to give detailed guidance to the employees of the CSC as to their intercourse with the outside world (e.g., telephone calls, invitations to lunch or dinner by market participants). Measures are to be taken to improve barriers impeding the misuse of information (e.g., limited access to internet from most PC-stations, limits to file copying both in printed or electronic form). A sophisticated file maintenance system on exclusively

	electronic bases is to be introduced by the end of 2001.
Principle 6	The regulatory regime should make appropriate use of self-regulatory organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	<p>The two exchanges (PSE and RMS) are required to function as SROs in relation to the monitoring of trading and the conduct of members (in the case of PSE). The Chamber of Auditors also has self regulatory obligations through the Act on Auditing.</p> <p>The PSE functions as an SRO. It receives monthly statements from members on liquid assets and balance sheets on a quarterly basis. It inspects members and conducts market surveillance. The PSE has the power to fine members for disciplinary breaches, although the fining power are limited (with a maximum fine of CZK 50,000). However, it can and has exercised a power to suspend membership.</p> <p>As RMS has been entrusted with self regulatory duties from January 2001 it is too early to assess whether the RMS has implemented systems enabling it to fully carry out the required SRO duties.</p>
Assessment	Implemented.
Comments	There are professional bodies, such as the Association of Fixed Income Traders and the Union of Investment Companies of the Czech Republic, who have the potential to perform a useful role in establishing market conventions and in setting standards of behavior. These professional bodies do not presently have the role and function of SROs, but should be encouraged, particularly in view of the resource constraints on the CSC.
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>The activities of the PSE are subject to supervision through the Stock Exchange Commissioner, who is acts on behalf of the CSC and is a CSC employee. The Commissioner attends meetings of the Listing, Members, and Trading Committees of the PSE. The Commissioner may participate in the discussions of those Committees but does not have voting rights.</p> <p>The Commissioner is authorized to suspend the powers of the Stock Exchange Chamber, if the Chamber has seriously violated statutory provisions, stock exchange rules or trading rules. How the oversight of the RMS is going to be conducted is not clear yet.</p> <p>The role and duties of the Commissioner seems to be largely effective in ensuring that the PSE performs its day to day self regulatory role appropriately. The CSC has also the power to conduct periodic inspections covering the operations of exchanges. However, the CSC has not done so. In fact, the PSE appears to be better resourced and more experienced to supervise its members than the CSC, and the CSC does seem to be in a position to undertake a thorough review of the PSE.</p>
Assessment	Partially implemented. The CSC does not conduct or have the capacity to conduct periodic inspections of the exchanges.
Comments	The CSC should conduct periodic reviews of the PSE and the RMS, and build its capacity to undertake such reviews.
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	The CSC is entitled to carry out inspections and administrative proceedings into breaches of obligations under its supervision when conducted by market participants. The CSC may carry out on site inspections at the premises of brokers whenever it thinks it appropriate. No advance warning is necessary. Inspections are both rotational and complaint driven. The statutory rules of procedure provide for sufficient instruments and authority to exercise the powers of the regulator, to conduct inspection, investigations and surveillance.

Assessment	Implemented.
Comments	The CSC advises that some minor refinements to the Administrative Proceedings Act are expected as a further aid to its work.
Principle 9	The regulator should have comprehensive enforcement powers.
Description	<p>The CSC is entitled to carry out inspections, conduct investigations and take administrative proceedings in respect of breaches by market participants. The statutory rules of procedure provide for sufficient instruments and authority to exercise its powers, impose effective sanctions and enforce its decisions. The regulator can impose effective sanctions for any breach of statutory obligation subject to its supervision and enforce its decisions either with judicial assistance or by its own means (administrative enforcement). Basically any breach of duties imposed under capital market law is considered an administrative offence and can be sanctioned by the CSC.</p> <p>The CSC may act upon complaint or on its own initiative. The Administrative Proceedings Act provides for its rights and obligations in the proceedings. Everyone must appear as a witness, any document must be presented when demanded. Failure to comply with these duties can be sanctioned.</p> <p>Whenever a suspicion arises that a criminal act has been conducted, the CSC may exercise a general right to file criminal announcement with the competent police authorities and initiate criminal proceedings. The CSC is limited to the field of public (administration) law.</p>
Assessment	Implemented.
Comments	The CSC appears to have sufficient powers to investigate a suspected breach of the law.
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>The CSC has a dedicated team in the IT and monitoring department conducting market surveillance, and inspection units in the Collective Investment Department and the Broker/dealer department. However, inspection staff are mostly inexperienced and with legal backgrounds. Ideally inspections should be conducted by more experienced staff, with a broader set of skills, including auditing skills. The CSC does also rely to some extent upon the PSE to carry out contract based inspections of its 54 members.</p> <p>Inspections are at present not risk based for securities dealers but to some extent for collective investment schemes and pension funds. The CSC conducts inspections of very limited duration (typically 2 days in the field). Although short inspections may be effective when there is adequate information available to make a good risk assessment and staff are skilled and focused, these pre-conditions do not seem to be met by the CSC.</p> <p>The CSC relies to some extent upon the PSE to carry out contract based inspections of its 54 members. It is common and perfectly reasonable to rely upon an SRO in that way, provided the SRO is doing a good job and there are adequate information sharing arrangements to allow the statutory regulator to take on the most serious cases. The PSE appears to be better resourced than the CSC and to have staff of greater experience with more relevant qualifications. The PSE receives a monthly report on liquid assets from its members and balance sheets on a quarterly basis so it is better placed than the CSC to undertake risk based assessments. However, these inspections typically take a month and seem to lack a clear risk focus. It also suggests that the inspection cycle for routine visits to members is probably too long.</p> <p>Under the new internal structure of the CSC, all suspected breaches are to be investigated by the Enforcement Division. Although the recent establishment of an Enforcement Division is to be welcomed, this Division remains small and its resources would quickly be exhausted by</p>

	a few modest sized investigations. That poses a particular problem for the CSC. It is obliged under Czech law to follow the principle of legality and therefore to investigate any complaint or breach that comes to its attention. However, the CSC is not be sufficiently resourced to investigate all matters, or even a majority of matters. It will need to make choices about how it applies its resources. The CSC has proposed an amendment to the CSC Act allowing it to make risk based judgments in the investigation of suspected breaches.
Assessment	Not implemented. There are doubts as to the capacity of the CSC to apply adequate resources to the exercise of available powers of inspection, investigation and enforcement. The CSC also lacks the resources to collect information required for risk based inspections on an ongoing basis.
Comments	The CSC has recently conducted an extensive re-licensing program which has seen the departure of many weak intermediaries, and the CSC deserves a great deal of credit for this outcome. The lack of an effective inspection program has been somewhat ameliorated by the reduction in the number of intermediaries. The situation will improve further to the extent that newly established Enforcement Division becomes operational.
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	Exchange of information of non-public character with other domestic regulators is guaranteed under law. The CNB and the MoF enjoy special status for reasons of shared supervision of the financial market. Authorities acting in criminal proceedings can also be provided with any requested information. International exchange of information is enabled under CSC Act upon condition of mutuality. The provision of assistance to foreign regulators is limited to the provisions on the exchange of information and consultations. Informal assistance is, nonetheless, provided when needed.
Assessment	Implemented.
Comments	The amendment to the CSC Act due to enter into force on January 1st 2002 is expected to provide an obligation to provide for assistance to EU member states' regulators. The amendment is also expected to give wider powers to provide assistance to other foreign regulators upon a condition of mutuality.
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	The CSC has concluded memoranda of understanding domestically with the CNB, the MoF, and the Chamber of Auditors. MOUs based on the IOSCO template have been concluded with a number of international regulators in France, Germany, Austria, the Slovak Republic, Hungary, and Poland. In some cases close cooperation exists without a memorandum of understanding ever being concluded. The CSC is, furthermore, implementing a new security system that should protect passed information from any kind of misuse.
Assessment	Implemented.
Comments	The CSC has made good progress in a short time frame, but recognizes the need to, in particular, to upgrade the MOUs to include special provisions on home country supervision for institutions using the European passport to operate in the Czech Republic.
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	The provision of assistance to foreign regulators is limited to the provisions on the exchange of information and consultations. Under the current law more active assistance could be

	provided on an informal basis—the regulator can act (i.e., carry out inspection, etc.) on its own initiative and provided it is a matter within power, regardless of the source and nature of the information.
Assessment	Implemented.
Comments	The CSC can and occasionally provide active assistance to foreign regulators. An obligation to provide for assistance to EU member states regulators is proposed to be implemented in the amendment to the CSC Act due to enter into force on January 1, 2002. The general power to provide such assistance to other foreign regulators is also expected to be provided for in the amended Act upon a condition of mutuality.
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>The principle of full and fair disclosure to investors is set out in the Securities Act. The relevant provisions cover the information to be given in a prospectus, the provision of recurrent information in the form of annual and semi-annual financial statements and the provision, without delay, of information on material changes that may affect price or the issuer's ability to meet obligations. The formal powers of the CSC to ensure compliance with disclosure requirements appear adequate. The main concern is in relation to the CSC's ability to enforce the rules.</p> <p>Prospectuses for public offering must be filed with and approved by the CSC. The CSC has the power to delay or stop an offering. The CSC can do this if the prospectus does not contain the prescribed information, or if the proposed public trading in a security would conflict with protection of the interests of investors. The issuer is responsible for the whole prospectus. In the area of public offerings the CSC diligently checks compliance with the formal requirements in the law. There does not, however, appear to be a capacity to check beyond compliance with the formal statutory requirements to consider such matters as the adequacy of risk disclosure in offering documents, nor to check on how funds are applied.</p> <p>The annual and semi-annual reports are only considered published after they have been sent to the CSC and the Securities Center, and have been made available at the registered office of the issuer. The CSC has the power to request a correction of deficiencies. If not satisfied, it can commence an administrative proceeding, impose a corrective action or impose a fine up to CZK 20 million as of January 1, 2001. There is some concern, however, about the CSC's capacity to do more than ensure apparent completeness of the information. For PSE main and secondary market-listed companies, quarterly reports are required. These reports are sent to PSE and are available to public electronically via the internet and through press agencies that have a distribution agreement with the PSE. There is also a requirement, under the Listing Rules of the PSE, for issuers to make timely disclosure of material information.</p> <p>The CSC is behind in its enforcement of continuous disclosure obligations. The CSC is aware of this situation and is preparing guidelines on the content and timeliness of continuous disclosure obligations. The draft guidelines have not been reviewed for this assessment.</p>
Assessment	Partially implemented. There are doubts as to the CSC's capacity to check beyond compliance with formal statutory requirements.
Comments	The CSC has over the last year made a monumental effort to ensure compliance with the recurrent disclosure requirement. Over 90 percent of the companies now comply with the recurrent disclosure requirements of annual and semi-annual reports. This is an impressive record given the many small companies that are covered by the law. The main challenge is now to ensure that the accounts fulfill the pre-requisites for full, accurate and timely disclosure of financial statements in terms of accounting and auditing standards of a high and internationally acceptable standard, and the publication of material information that might affect price or issuer's ability to meet obligations

Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	Listed companies may issue only two types of shares: common and preferred. Common shares typically carry one vote per share, though by-laws may permit a higher number of votes for a class of shares of identical nominal value. The by-laws may allow a cap on voting rights, but without discriminating between shareholders. Basic shareholder rights, including the right to transfer share, to obtain relevant information, to participate and vote in general meetings, to elect members of the board, and to share in the profits of the company are provided for under the Commercial Code and the Securities Act. A comprehensive takeover code has, furthermore, been created by the recent changes to the Commercial Code. The CSC has already used its increased powers to require a change in the price offered in connection with a take over.
Assessment	Partially implemented. There is a continuing uncertainty as to implementation by companies and effective oversight by the CSC.
Comments	The recent changes to the Commercial Code and the Securities Act have reinforced the clarity of basic rights of shareholders. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. There are continuing areas of uncertainty as to the interpretation and implementation of these rights, particularly in regard to the control and quality of disclosures, and shareholder participation in general meetings. Further steps are required to specify the content of disclosure to shareholders, and for increased monitoring by the CSC. Action is also required to ensure that boards are aware of and comply with their responsibility for ensuring proper participation by shareholders in general meetings. For further analysis and recommendations see the OCG principles assessment.
Principle 16	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>The new auditing and accounting standards appear adequate to ensure an acceptable quality of financial statements. However, it is not clear how thoroughly the standards are applied.</p> <p>The accounting standards are prescribed according to the Accounting Law and through regulations issued by the MoF. The accounting standards are broadly in line with the EU directives and with International Accounting Standards (IAS). Financial statements for purposes of capital raising and financial reporting are based on the requirements set out in the Accounting Law. There are accounting and bookkeeping principles and procedures published by the MoF on prescribed formats for a balance sheet, P/L statement and cash flow analysis, as well as on prescribed procedures for accounting consolidation. It is being discussed if listed companies on the PSE should be required by the PSE listing rules to complete their financial statements in accordance with IAS. The Union of Accountants does not have licensing powers and membership is voluntary. As a result, the quality of accounting work varies widely and cannot be relied upon outside the largest companies and those affiliated with the major Czech and foreign accounting firms.</p> <p>Auditing standards are broadly in line with International Auditing Standards. The Chamber of Auditors has statutory licensing powers and a disciplinary function, but has not been proactive in monitoring its members. Auditors can be sued by the company or by shareholders if the auditors do not properly conduct the audit, with a resultant loss to the company or the shareholder, but there are no concluded cases of law suits against auditors. The independence of auditors is potentially compromised by the absence of protective rules for the appointment and removal of auditors. Even though the Act on Auditing provides that the auditor shall be independent and only obliged to respect the laws in force, the content of independence is potentially eroded by the common practice of leaving the appointment and removal of external auditors to company management.</p>
Assessment	Partially implemented. Despite the improvements in the accounting and auditing areas, the quality of accounting seems to vary significantly, external auditors are not sufficiently independent, and the Chamber has not been proactive in exercising its supervisory powers.

Comments	The Chamber of Auditors has failed to exercise pro-actively its self-regulatory powers, but should become increasingly active in investigating misconduct or serious quality problems involving external auditors. A further positive development is the training of PSE staff in IAS so that they may review financial statements of main board companies for apparent compliance.
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	A license from the CSC is a prerequisite for establishing either an investment company or an investment fund. In simple terms, in the Czech Republic, an investment company is a corporate vehicle that manages collective investments and an investment fund is a corporate vehicle that makes its shares available to the public as a form of collective investment. The Investment Companies and Investment Funds Act sets out the formalities and minimum requirements for establishing an investment company or an investment fund. In addition, the CSC's detailed organizational, personnel, and material prerequisites are set out in CSC's Bulletin. The primary aim with regulation of investment companies and investment funds is the protection of investors. The Investment Companies and Investment Funds Act, provides specific provisions for this purpose.
Assessment	Implemented.
Comments	The legal requirements appear in place to ensure sound standards for the operators of new collective investment schemes in the Czech Republic. The CSC does not, however, appear to undertake a risk based assessment of the content of statutes governing collective investment schemes.
Principle 18	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	The legal form and structure of collective investment schemes and for the protection and segregation and protection of client assets is provided for in the Investment Companies and Investment Funds Act. The act requires separation of investors' assets from the investment company's assets and the funds under management. As matter of law, the activities of investment companies and investment funds are also under the scrutiny of their depositories. The Investment Companies and Investment Funds Act prohibits, as an additional safeguard, investment companies and investment funds from undertaking other types of business. The legal requirements for segregation and protection of client assets appear to be in place.
Assessment	Implemented.
Comments	The assessment is that the principle is implemented. However, it is of concern in relation to this principle that it appears that the scrutiny required by depositories is not an effective safeguard, and depositories do little to protect the interests of those who hold an interest in an investment fund.
Principle 19	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	The Investment Companies and Investment Funds Act sets out detailed requirements for disclosure by investment companies and investment funds. Statutes (Articles of Association) must be prepared for each and any investment fund or unit trust and must include, among other things, the information on the following: <ul style="list-style-type: none"> • fund investment strategy; • manner of utilization of the income resulting from the fund assets • rules for publishing the reports of business results and significant information; • rules for the frequency of appraisal of the assets in the fund (minimum once a week) • value of the entry or departure fees; and • management fees (maximum 2 percent of the annual value of the fund capital, or 20 percent of the fund accounting profits). <p>Annual and half-yearly reports of the business results must be submitted to the CSC on</p>

	<p>behalf of each investment fund, unit trust and investment company. There are detailed requirements for the content of the annual and half-yearly reports. The reports must be available to investors at the registered office of the company, or another publicly accessible place referred to in the Statutes (Articles of Association) of the fund, and at the SCP.</p> <p>The Investment Companies and Investment Funds Act makes it an offence to disseminate false or misleading information, or to withhold material information, while advertising the sale of shares or participation certificates. This obligation is the foundation for a requirement to inform potential investors of possible risks connected with the investment. Failure to comply with these obligations and duties is subject to a sanction imposed by the CSC.</p>
Assessment	Implemented.
Comments	Although the Principle is assessed as implemented the position in practice is not entirely satisfactory. The requirements are in place as the CSC will check for apparent compliance with the formal requirements, but it does not look in detail at issues of risk disclosure. The CSC does not appear either to assess the periodic disclosure required to be made. The legal role of depositories does not appear to fill the regulatory gap (see above).
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Information on the value of the participation certificate and on the value of the equity in the fund must be published for each and any open-end unit trust in the manner mentioned by the Statutes (Articles of Association) of the fund at least once a week. The assets of unit trusts may consist under the law of bank deposits or securities only. The uniform rules for assessment of securities owned by the funds are provided through a separate Decree, and are binding for the funds. The assets of investment funds may further include movables and immovables, to be assessed by independent experts. The bank which acts as a depository for the fund should supervise proper assessment of the assets and determines the values of a participation certificate or a share. Information on the value of the participation certificate and on the value of the equity in the fund must be published for every open-end unit trust in the manner mentioned by the Statutes (Articles of Association) of the fund at least once a week.</p> <p>The shares and participation certificates of the investment funds and closed-end unit trusts are publicly negotiable under the law and must be accepted for trading at the PSE or the RMS.</p>
Assessment	Implemented.
Comments	<p>Historic pricing has been used for the valuation of funds in the Czech Republic in the past. Forward pricing of funds is, however, now being practiced by some funds. This method is very much to be preferred, and the CSC should mandate and require the use of this pricing principle.</p> <p>The role of depositories in supervising proper assessment of the assets and determining the values of a participation certificate, or a share, does not, according to industry representatives, occur in practice (see above).</p>
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	The Securities Act provides that only a person who has a proper license from the CSC may trade in securities. Licenses are granted on the basis of a submitted application that must include the obligatory information required under the Securities Act. Assessment is essentially against a requirement that an applicant is fit and proper, and in possession of the minimum required capital. The minimum required capital of securities dealers is set at CZK 27 million for dealers permitted to hold client assets and engage in underwriting of securities. For dealers with more limited authorization to provide investment service the capital requirement can be either CZK 5 or CZK 2 million, depending on whether the dealer is authorized to receive funds or investment instruments for clients. The number of

	<p>investment firms in the Czech Republic has declined from approximately 400 firms at the start of 1999 to approximately 120 today. The focus in recent years has been on “re-licensing” existing license holders. The CSC deserves great credit for this re-licensing exercise. However, even 120 firms appears to be a large number relative to the size of the market, and the CSC expects further consolidation.</p> <p>Individual brokers must pass an examination to obtain a license. There have in recent years been no examinations of brokers, but nonetheless a number of new entrants to the market, many of which have foreign broker licenses. The CSC should consider introducing a limited examination (on local regulations) for licensed brokers from pre-approved jurisdictions.</p>
Assessment	Implemented.
Comments	The CSC must consider the need to issue investment service company licenses with different endorsements depending on the activities of the company (in equity, fixed income, and/or derivatives), in order that the “fit-and-proper” requirements can be adjusted accordingly. The law now allows for such differentiation as well as issuing different licenses for individual brokers dependent on the specialization of the broker (securities dealers, fixed income dealers and derivatives dealers). The CSC should expeditiously implement these possibilities.
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	The minimum registered capital of a market intermediary is set at either CZK 27, 5, or 2 million, according to the nature of the business, as noted above. Although the present regulatory framework provides for initial and ongoing capital requirements, the absence of continuing risk based requirements to hold liquid assets is a source of fragility.
Assessment	Partially implemented. The assessment is due to the lack of risk based liquid asset requirements.
Comments	<p>There is a need for an ongoing requirement to hold liquid assets against risk. The requirement to hold liquid assets against risk should be supplemented by a regular (probably monthly) reporting requirement to ensure that the obligation is complied with. This reporting requirement should involve some provision of information about the risk of the enterprise. With an appropriate information sharing arrangements, or complementary rules at the PSE this should aid both the conduct of risk based inspections of intermediaries and risk management in the clearing and settlement system.</p> <p>Understanding risk is a key requirement for proper supervision. Although securities brokers (other than banks) are not permitted to carry on other types of business, their risks will vary according to whether and to what extent they hold client assets, provide margin finance, undertake proprietary trading, assume credit risk or underwrite offerings. The CSC has recognized the need for risk based liquid asset requirements and established a working group to consider the issue. The Working Group includes the CNB, and these liquid asset requirements will need to be reconciled with bank capital adequacy requirements for banks that provide dealing services.</p>
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
Description	Licensed intermediaries must remain fit and proper and are subject to inspection. The formal requirements are in place, but there are concerns about the CSC’s capacity to inspect intermediaries and to ensure that intermediaries have and adhere to proper systems of risk management and internal control.
Assessment	Partially Implemented. The requirements are in place but there are concerns expressed about the CSC’s capacity to inspect intermediaries and ensure that intermediaries have and adhere to proper systems of risk management and internal control.

Comments	The assessment will be reviewed to the extent that the CSC demonstrates capacity to ensure compliance in this area of regulation.
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>There are no special provisions relating to the failure of an intermediary. The absence of a requirement to hold liquid assets against risk increases the risk of failure.</p> <p>The bankruptcy and insolvency provisions of the Czech Republic are the subject of detailed assessment as part of the FSAP, and it is clear that reform in this area is necessary and desirable.</p> <p>A Guarantee Fund will be established, to comply with the EU investor protection directive, out of which the clients of a failed brokerage would receive some compensatory payment. Amendments to the Securities Act are in preparation. Obviously the establishment of such a fund raises difficult policy questions as to funding sources and the basis for and level of payment.</p>
Assessment	Partially implemented. The lack of requirements to hold liquid assets against risk increases the risk of failure. General bankruptcy and insolvency procedures are also inadequate.
Comments	See also principle 23 and the assessment of compliance with ICR principles.
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	There are two systems for trading in the Czech Republic: the PSE and RMS. Both the PSE and RMS are authorized by the CSC. The PSE is authorized as an exchange. RMS has been, in effect, authorized as a broker. RMS is, however, from January 1, 2001 regulated in the same manner as the PSE and assumes responsibility for some regulatory matters, including surveillance of trading on the RMS. Both the PSE and RMS are subject to licensing, inspection and oversight and to disciplinary action or even loss of authorization if they fail to comply with the terms of their authorization. The Stock Exchange Commissioner does provide oversight of PSE; a system needs to be implemented in practice on RMS to ensure full regulation as an exchange for this trading platform.
Assessment	Implemented.
Comments	There is a gap in Czech law in the area of on exchange derivatives trading. According to the CSC, that is, amongst others, a reason why no derivative trading is being carried out in the Czech capital market. Amendments to Securities Act No. 591/1992 Coll. and other Acts concerning the capital market in the Czech republic which have come into effect January 1, 2001 will provide a new legal framework that the CSC believes will make it possible for a functioning derivative market to be established.
Principle 26.	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	Both the PSE and RMS are subject to inspection and oversight and to disciplinary action or loss of authorization if they fail to comply with the terms of their authorization. PSE activities are subject to state supervision through the Stock Exchange Commissioner who acts on behalf of the CSC.
Assessment	Implemented.
Comments	The role of the Commissioner appears to be effective but some closer periodic inspection of the work of operating divisions of the PSE and the RMS is advisable also to ensure integrity of trading is maintained, cf. also Principle 7 above.
Principle 27.	Regulation should promote transparency of trading.
Description	There is a continuous quoting of prices and a requirement for reporting and transparency of settled trades. The obligation to provide prices / quotations is defined by the Czech Securities Act in relation to RM-System and by the Stock Exchange Act in relation to the PSE.

	<p>Provision of pre-trade information (i.e., bids and offers) and post-trade information (i.e., last trade price, volume) is required under the market rules, trading rules and market conventions of both secondary markets. The objective is a fast (preferably in real time) release of all the relevant information about trading. An obligation of both market organizers to provide average prices has been set forth in the recent Securities Act amendment. While transparency is good for the major stocks the market is much more opaque for stocks traded on the secondary and free markets. While strictly enforced reporting requirements and expeditious publication of trades will help promote transparency, lax definitions of what constitutes a “block trade” can contribute to a less transparent market (minimum size of “block trades” is set at CZK 1 for stocks and CZK 10,000 for bonds). This increases the risk that off market trades will not be reported in a timely fashion or at all.</p>
Assessment	Implemented.
Comments	There should be a review of the work of the CSC’s surveillance department to ensure that there is proper integration of its work with that of the surveillance unit of the PSE and the new surveillance function of RMS. To promote transparency focus needs to be on compliance with reporting requirements.
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	Market manipulation and other unfair trading practices are generally prohibited and are subject to supervision by the CSC. Monitoring and surveillance of the stock exchange trading are ensured by the Surveillance Department of the CSC and by the surveillance department of the PSE, overseen by the Stock Exchange Commissioner. The large number of very small tradable stocks and the low free float in many of the large value companies heightens the risk of market manipulation and unfair trading practices. The most important initiative to ensure market integrity is therefore the ongoing effort to reduce the number of tradable securities.
Assessment	Partially implemented. Proper integration of the surveillance functions of the PSE, RMS, and CSC still needs to be ensured, and the reduction in tradable securities needs to be further reduced.
Comments	There should be a review of the work of the CSC’s surveillance department to ensure that there is proper integration of its work with that of the surveillance unit of the PSE and the new surveillance function of RMS. It is particularly important for the detection of market manipulation that there be close coordination between these three market surveillance departments.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>Management of large exposures with regard to securities trading is addressed in the PSE rules and the SCP membership rules. The rules address daily limits for trading volumes and the maximum allowable limit for the obligation or risk exposures which a UNIVYC member is allowed to assume within the scope of activities resulting from membership.</p> <p>There are procedures in place to avoid market disruption. The PSE has the power to suspend trading with a specific security under specific conditions. The CSC has the right to suspend specific trade or trading with a specific security if proposed by the stock exchange commissioner. The RMS also has the right to suspend the provision of services in specific conditions. The CSC also has the right to issue a preliminary decision to suspend trading with a specific security on public markets as well as outside public markets if there is no other way to prevent economic damages.</p> <p>At the PSE, there are circuit breakers and price limits are applied in a different form for different trading segments in order to limit trading volatility (± 20 percent for the most liquid trading segment). On the RMS there are circuit breakers and price limits are applied in order to limit trading volatility.</p>
Assessment	Implemented.

Comments	The procedures for management of large exposures, default risk and market disruption seem adequate.
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	<p>The settlement of trades in securities and other investment instruments may be performed only by a person with a license from the CSC and further by the CNB. They are also subject to ongoing oversight. Before the CSC grants the license, it has to consider compliance with material, personnel and organizational prerequisites for the performance of settlement of trades in securities. The CSC may vary or withdraw the license. Pursuant to the Securities Act, the RMS does not need a special license from CSC to settle its trades. It provides the settlement of trades in securities made on the OTC market through a bank.</p> <p>Settlement on the PSE is provided by UNIVYC, which is approved by the CSC to provide settlement services. Univyc carries out its activity as a settlement agent and does not hold any risk. There are exchange trades for which settlement is guaranteed by the Guarantee Fund (GF). Off-exchange trades are not guaranteed by the GF. All the exchange trades are settled as near to DVP (reconciliation will take place within the same day, although there remains a small timing differential). Off-exchange trades are settled either as near DVP or DFP. For automatic exchange trades, UNIVYC compares a participant's position with its deposit to the GFB. If any inadequacy is disclosed, UNIVYC issues the order to the CNB for transfer of an extraordinary contribution from the participant's account to GFB. At the end of each working week UNIVYC makes adjustments to the deposits made to GFB by participants. For SPAD trades, each day UNIVYC compares a participant's position with its deposit made to GFB. The next day UNIVYC issues orders to the CNB to transfer either contribution or refund to or from GFB.</p>
Assessment	Implemented.
Comments	Clearing and settlement is the subject of separate treatment in the FSAP. UNIVYC's risk management, however, for the purpose of this assessment appears adequate and its processes fair and transparent.

Table 12. IOSCO Core Principles: Observance of Individual Principles

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
1. The responsibilities of the regulator should be clear and objectively stated.	X				The problems lie not in the statement of responsibilities but in the CSC's capacity to exercise its functions and powers.
2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.		X			There are concerns about whether review of CSC decisions before the courts provide a real and practical means for ensuring that the CSC is held accountable for its decisions. There are also potential problems arising from a lack of CSC involvement in the preparation of secondary legislation. There should be a review of these arrangements.
3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.		X			The major problem in this area is a lack of capacity. There should be a review of the resources available to the CSC including an evaluation of staffing and salary policies
4. The regulator should adopt clear and consistent regulatory processes.	X				There is some concern that in certain areas, the lack of resources means the CSC only exercises its powers to a limited extent, and loses credibility in its operations by applying strict interpretations of the law. Effort should be made to ensure a move away from reliance on a formal approach to supervision.

Note: This assessment reflects both the current weak effectiveness of enforcement and the sound new legal framework that applies to the securities market since the beginning of 2001. When implementation and enforcement of the new regulation are strengthened, the Czech Republic will observe most of the IOSCO principles.

⁴⁸ I: Implemented.

⁴⁹ PI: Partially Implemented

⁵⁰ NI: Not Implemented.

⁵¹ NA: Not applicable

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
5. The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.	X				The CSC advises that further improvements are proposed. A new code is to be presented in the course of 2001 to give detailed guidance to the employees of the CSC as to their intercourse with the outside world . Measures are to be taken to improve barriers impeding the misuse of information A sophisticated file maintenance system on exclusively electronic bases is to be introduced by the end of 2001
6. The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.	X				This Principle applies in respect of the PSE and the RMS. There are other bodies who have the potential to perform a useful role in establishing market conventions and in setting standards of behavior. The do not presently have the role and function of SROs but, particularly given the resource constraints on the CSC, this type of organization appears worth encouraging.
7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.		X			In some jurisdictions the securities regulator will from time to time undertake a detailed review of the performance of an SRO. So far as the PSE acts as an SRO in the supervision of its members, it would appear to be better resourced and more experienced than the CSC and the CSC is not in a position to undertake such a review. The CSC should, however, consider the need for periodic reviews of the PSE and the RMS through inspections.
8. The regulator should have comprehensive inspection, investigation and surveillance powers.	X				The CSC advises that some minor refinements to the Administrative Proceedings Act are expected as a further aid to its work. The difficulty would appear to lie in the CSC's capacity to exercise some of its powers, as to which see comments under Principle 10.

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
9. The regulator should have comprehensive enforcement powers.	X				The recent establishment of an Enforcement Division is to be welcomed. At the time of the assessment the new Division was still recruiting staff and had not really begun to operate. It appears to have quite limited resources and those resources will quickly be consumed by a few investigations of modest size.
10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.			X		Sufficient doubt exists as to the capacity of the CSC to apply adequate resources to the exercise of the available powers of inspection, investigation and enforcement. The CSC should carefully prioritize the use of its scarce resources until the acute resource issues have been addressed.
11. The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	X				The amendment to the CSC Act due to enter into force on January 1, 2002 is expected to provide an obligation to provide for assistance to EU Member States regulators. The amendment is also expected to give wider powers to provide assistance to other foreign regulators upon a condition of mutuality.
12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	X				The CSC has made good progress in a short time frame. Second generation MOUs are needed, however, to allow for efficient home country supervision of companies using the European passport to provide services from or to the Czech Republic.

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	X				An obligation to provide for assistance to EU member states regulators is proposed to be implemented in the amendment to the CSC Act due to enter into force on January 1, 2002. The general power of provide such assistance to other foreign regulators is also expected be provided for in the amended Act upon a condition of mutuality.
14. There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.		X			A requirement for full, accurate and timely disclosure cannot be separated from the prerequisite need for accounting and auditing standards of a high and internationally acceptable standard. The pre-requisite is not satisfied—see Principle 16.
15. Holders of securities in a company should be treated in a fair and equitable manner.		X			The recent changes to the Commercial Code and the Securities Act have reinforced the clarity of basic rights of shareholders. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Steps are required to specify the content of disclosure to shareholders, and for increased monitoring by CSC of compliance with rules. Action is also required to ensure that boards are aware of and comply with their responsibility for ensuring proper participation by shareholders in general meetings.
16. Accounting and auditing standards should be of a high and internationally acceptable quality.		X			The new auditing and accounting standards appear adequate to ensure an acceptable quality of financial statements. It is, however, not clear how thoroughly the standards are applied. Furthermore, the independence of auditors is potentially compromised by the absence of protective rules for the appointment and removal of auditors.

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.	X				The legal requirements appear in place to ensure sound standards for the operators of new collective investment schemes in the Czech Republic. The CSC does not, however, appear to undertake a detailed assessment of the content of statutes governing collective investment schemes. Such assessments should be undertaken.
18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	X				The requirements are in place but the CSC does not appear to undertake a detailed assessment of the content of statutes governing collective investment schemes. Proper risk disclosure by issuers should be emphasized in review of offering documents.
19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	X				Although the Principle is assessed as implemented the position in practice is not entirely satisfactory. The requirements are in place but the CSC does not appear to undertake a detailed assessment of the content of statutes governing CIS nor does it assess the periodic disclosure required to be made. The legal role of depositories does not appear to fill the regulatory gap. The role of the depository should be reviewed and their responsibilities should be better enforced.
20. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	X				The CSC should mandate and require use the forward pricing principle. Depositories do not in fact appear generally to perform the role of checking on pricing issues, cf. Principle 19.
21. Regulation should provide for minimum entry standards for market intermediaries.	X				The CSC should consider to issue licenses to brokers with different endorsements depending on company activities. The CSC should also consider issuing different securities dealers licenses to differentiate between brokers active in different markets.

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.		X			There is a need for an ongoing requirement to hold liquid assets against risk. The requirement to hold liquid assets against risk should be supplemented by a regular reporting requirement to ensure that the obligation is complied with. This reporting requirement should involve some provision of information about the risk of the enterprise.
23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.		X			The formal requirements for full implementation are in place but the concerns expressed about the CSC's capacity to inspect intermediaries affect its ability to ensure that intermediaries have and adhere to proper systems of risk management and internal control.
24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.		X			The absence of a requirement to hold liquid assets against risk increases the risk of failure. Law reform in the area of bankruptcy and insolvency provisions is necessary and desirable.
25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	X				The role of the Stock Exchange Commissioner appears to be effective (for PSE), but periodic inspection of the work of operating divisions of the PSE and RMS is advisable.
26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	X				The role of the Stock Exchange Commissioner appears also to be effective in the ongoing regulatory supervision (of PSE), but again some closer periodic inspection of the work of operating divisions of the PSE and RMS would be advisable.

Principle	Gradings				Comments and Corrective Actions
	I ⁴⁸	P ⁴⁹	NI ⁵⁰	NA ⁵¹	
27. Regulation should promote transparency of trading.	X				There should be a review of the work of the CSC's surveillance department to ensure that it is properly integrated with the surveillance unit of the PSE and the new surveillance function at RMS. To promote transparency focus needs to be put on compliance with reporting requirements in market surveillance and broker dealer inspections.
28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.		X			It is essential to prevent market manipulation that stocks with tight shareholder spread and limited market capitalization are not quoted for trading. Detection capabilities should be strengthened through a review of the work of the CSC's surveillance department to ensure that there is proper integration of its work with that of the surveillance unit of the PSE and the new surveillance function of RMS
29. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	X				The procedures for management of large exposures, default risk and market disruption seems adequate.
30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	X				UNIVYC's risk management appears adequate and its processes fair and transparent.

Note: This assessments reflect both the current weak effectiveness of enforcement and the sound new legal framework that applies to the securities market since the beginning of 2001. When implementation and enforcement of the new regulation are strengthened, the Czech Republic will observe most of the IOSCO principles.

Response to the assessment and recommended action plan

Response to the assessment

128. The CSC has welcomed most of the findings and recommendations of the assessment. The CSC stresses that the current staff though young is competent and quickly developing

the skills needed for efficient supervision of the securities markets. The CSC has also provided useful factual clarifications, which were incorporated in the final assessment.

Recommended action plan

129. The CSC cannot address the underlying problem of lack of capacity alone. The first best solution requires recruitment of new staff at entry level, salary reviews to retain existing staff and targeted recruitment of seasoned professionals with, e.g., accounting, audit experience, risk management and market knowledge. Such solutions hinge on general budgetary reforms the CSC does not control. The CSC can, however, implement a number of initiatives to minimize the impact of the lack of capacity until its resources are strengthened.

130. Clear prioritization concentrating resources where the highest concentration of risk is to be found is one way to minimize the consequences of lack of capacity. Identifying these areas would, however, require a change in the approach to supervision and regulation. The new approach would involve more focus on material issues and increased reporting requirements for intermediaries, enabling the CSC to conduct risk based inspections. It might also entail a certain degree of concentration in terms of areas covered by the CSC. Taking on new responsibilities without adequate additional resources should be avoided.

131. Upgrade of existing resources could be another area of priority. A training needs assessment should be conducted. On the job training could be provided through cooperation with foreign supervisors on an ad hoc basis, or a twinning arrangement could be sought established for a more formal longer-term relationship. On the job training could, however, also be provided domestically through cooperation with the Chamber of Auditors or the CNB. Having staff participate in an audit of a financial institution (with the consent of the institution) could provide valuable insight, as could active participation in inspections led by experienced banking supervisors. Experienced and trained staff should train other staff rather than conduct day to day business so as to fully exploit and spread new knowledge obtained through out of house experiences. There is, however, a limit to what can be achieved through training because staff in some areas are not trained in disciplines such as accounting and risk management well suited to their responsibilities.

132. A staff exchange program with the banking supervisors could also provide valuable knowledge transfer for both institutions. Interest from CNB staff in secondment to the CSC could also be explored. A number of secondments for one or two years of seasoned staff from the CNB to the CSC could contribute to a fast creation of a critical mass of experience and supervisory knowledge at the CSC.

B. Transparency of Securities Regulation

Information and methodology

133. The assessment of the CSC's observance with transparency practices relating to securities regulation was undertaken by a two-member staff team⁵² and was based on: (1) a pre-FSAP questionnaire response; (2) relevant laws; (3) self-assessment of the IOSCO Core Principles; and (4) discussions with CSC officials and select securities brokers. The assessment was based on the *IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Transparency Code)*. No assessment methodology has been developed as yet, but the assessment has taken into account the implementation issues mentioned in the *Supporting Document* to the Code. The assessment also benefited from the discussions held with the authorities in the context of assessing CSC's observance with the IOSCO Core Principles for effective regulation, and with the CNB's observance with the Basel Core Principles for effective banking supervision.

134. The Czech authorities cooperated fully with the assessment and provided all the necessary clarification and documents.

Practice-by-practice assessment

135. The detailed assessment has taken into account the fact that securities market systems and the legal and institutional arrangements differ from one country to another, as do the domestic circumstances. It is also recognized that a lot of steps, including further reform of the legal framework, are underway at improving the supervisory framework. A factor also kept in view has been the significant changes taking place in the Czech financial system, particularly in the banking sector, that have an influence on the securities operations carried out by banks. Competition in the insurance market is also growing and a new set of foreign players are entering the industry.

136. The assessment of observance with each practice of the *MFP Transparency Code* is made on a qualitative basis based on existing laws and regulations and practices. A five-part assessment system is used: observed; broadly observed; partly observed; not observed; and not applicable. **Observed**, implying full observance or with insignificant shortcomings; **broadly observed**, where minor weaknesses exist and these are not seen as being of a significant nature so as to raise serious doubts about the authority's ability to achieve the objective of that practice; **partly observed**, where shortcomings are sufficient to raise doubts about the authority's ability to achieve observance and which could affect the operational process and effectiveness of financial policies; **not observed**, where the practice is not being observed and no substantive progress has been recorded toward achieving the objectives of the practice; and **not applicable**, where, due to the country circumstances and the institutional and legal framework, the transparency practice is not applicable.

⁵² Udaibir S. Das and Plamen Yossifov (IMF).

Table 13. Securities Regulation Transparency: Practice-by-Practice Assessment

V. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF FINANCIAL AGENCIES RESPONSIBLE FOR FINANCIAL POLICIES	
5.1	The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.
Description	In 1998, the Act on the CSC and on Amendments to Other Acts (CSC Act) established the CSC as the primary supervisor of securities markets in the Czech Republic. Under the Stock Exchange Act, the PSE performs limited supervisory role with respect to the monitoring of trading on its floor and the conduct of its members. According to Article 32 of the Stock Exchange Act, the CSC has supervisory responsibilities over the PSE. Under the CSC Act and the Securities Act, the regulatory power to issue secondary legislation, governing the securities markets and the exercise of state supervision over them, rests with the MoF. References: CSC Act, ⁵³ Articles 1, 2; Securities Act, ⁵⁴ Articles 82, 85; Stock Exchange Act. ⁵⁵
Assessment	Observed
Comments	
5.1.1	The broad objective(s) of financial agencies should be publicly disclosed and explained.
Description	As specified in the CSC Act, the broad objective of the CSC is to contribute to the development and protection of the capital market. The broad objective of the CSC is disclosed on its website (www.sec.cz/cz/informace/informacecz.htm) and explained by professionals from the CSC through lectures carried out at universities and seminars organized by SROs. References: CSC Act, Article 2.
Assessment	Observed
Comments	The broad objective of the CSC is quite narrow, given the wide range of supervisory responsibilities that it carries. One of the main objectives of the CSC—to protect investors rights—is not specified in legislation.
5.1.2	The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.
Description	The scope of the supervisory responsibilities of the CSC are defined in relevant legislation, disclosed in the CSC’s Annual Report (www.sec.cz/en/zpravyOcinnosti/zpobsahen.htm) and on its website (www.sec.cz/cz/informace/informacecz.htm). References: CSC Act, Articles 3, 7, 12; Securities Act, Articles 45, 50, 70b, 72, 83; Stock Exchange Act; Bonds Act; ⁵⁶ Investment Companies and Investment Funds Act. ⁵⁷
Assessment	Observed
Comments	

⁵³ Act No. 15/1998 Coll. on the CSC and on Amendments to Other Acts.

⁵⁴ Securities Act No. 591/1992 Coll. as amended under Acts No.89/1993 Coll., No.331/1993 Coll., No. 259/1994 Coll., No. 61/1996 Coll., No. 152/1996 Coll. and No. 151/1998 Coll.

⁵⁵ Act No. 214/1992 Coll. on the Stock Exchange as amended.

⁵⁶ Act No. 530/1990 Coll. on Bonds as amended.

⁵⁷ Act No. 248/1992 Coll. on Investment Companies and Investment Funds as amended.

5.1.3	Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.
Description	Under the CSC Act, the CSC prepares and submits to the government and Chamber of Deputies an Annual Report on the situation in the Czech capital market (www.sec.cz/en/zpravyOcinnosti/zpobsahen.htm) and prepares and submits semi-annual reports to the budget committee of the Chamber of Deputies on its activities and economic management. Furthermore, the Chairman of the CSC can be summoned to attend the sessions of the government, the Chamber of Deputies, and the Senate (CSC Act). In addition, the CSC prepares quarterly reports to the MoF on its activities. Even though these quarterly reports are not public documents, the CSC publishes them on its own initiative on the CSC's website. References: CSC Act, Articles 4, 22.
Assessment	Observed
Comments	
5.1.4	Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.
Description	The procedures for appointment, terms of office, and general criteria for removal of the CSC Chairman and the other members of the CSC Presidium are publicly disclosed in the CSC Act. References: CSC Act, Articles 21, 22, 23, 24, 25.
Assessment	Observed
Comments	In particular, the CSC Chairman and the other four members of the CSC Presidium are appointed and recalled by the President of the Czech Republic at the proposal of the government. The Chairman and Presidium members must be citizens of the Czech Republic who have full legal capacity, have not been convicted of property-related crime or any intentional crime, and have knowledge, experience and moral attributes which guarantee the good holding of office. The term of office of the Chairman and Presidium members is five years and they can be appointed for up to two consecutive terms of office. Among other criteria for removal, the Chairman and Presidium members can be recalled by the President if they violate a provision of the CSC Act or with their acts cast doubt upon their independence.
5.2	The relationship between financial agencies should be publicly disclosed.
Description	The CSC Act delineates these shared supervisory responsibilities by stating that in exercising its authority over banks, pension funds and insurance companies the CSC shall proceed in such a manner so as not to interfere with the authority of banking supervision bodies and the MoF, respectively. The CSC Act contains special provisions establishing the principles of cooperation and information sharing between the CSC, the CNB, the MoF, and the Chamber of Auditors. It also obliges these agencies to enter into formal agreement that establishes the procedures for cooperation and information sharing. In compliance with Article 41 of the CSC Act, the CNB in cooperation with the MoF and the CSC has prepared a system of mutual cooperation in the area of capital markets. The resulting MOU also provides for cooperation in the other areas of financial supervision. This MOU, however, is an internal document, which is not publicly disclosed. References: CSC Act, Articles 12, 16, 17, 18, 19, 41.
Assessment	Not observed
Comments	Despite the existence of the 1998 MOU, it remains unclear as to how the cooperation works in practice and what specific types of information is being shared among the regulators.
5.3	The role of oversight agencies with regard to payment systems should be publicly disclosed.
Description	The CSC has no supervisory authority over the payment systems in the Czech Republic.
Assessment	Not applicable

Comments	
5.3.1	The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.
Description	The CSC has no supervisory authority over the payment systems in the Czech Republic.
Assessment	Not applicable
Comments	
5.4	Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.
Description	The CSC has oversight responsibilities over the PSE. Mutual relationship between these two institutions is set out by the law and thus publicly disclosed. The CSC also informs of the relationship in its regular reports (annual, semiannual and quarterly) that are submitted to the MoF, the Chamber of Deputies and also available on the CSC's web site. The PSE also informs of the relationship with the regulator through its regular reports which are available on its web site. References: Stock Exchange Act, Article 32.
Assessment	Observed
Comments	In particular, the Chairman of the CSC appoints and recalls the Exchange Commissioner and his deputy. The Exchange Commissioner is an employee of the CSC, who oversees PSE's supervisory role over the trading activities on its floor and the conduct of its members to ensure full compliance with relevant legislation. The Exchange Commissioner collects information, suspends trading and imposes forced administration of the PSE.
5.5	Where SROs are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.
Description	Transparency practices of the PSE are similar to those of the CSC. They are governed by the provisions of the Stock Exchange Act, the Articles of Association of the PSE (available on the PSE's website (www.pse.cz), and PSE's trading rules.
Assessment	Observed
Comments	
VI. OPEN PROCESS FOR FORMULATING AND REPORTING OF FINANCIAL POLICIES	
6.1	The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.
Description	The regulatory framework and general operating procedures, governing the conduct of capital market supervision by the CSC, is publicly disclosed through legislation and regulations. Specific operating procedures for the conduct of capital market supervision by the CSC are not publicly disclosed.
Assessment	Broadly observed
Comments	The CSC has published only select guidelines on how it addresses issues such as fit and proper tests, licensing. There remains a fair degree of ambiguity on the market as to how exactly does the CSC carry out its supervisory and oversight functions. The CSC's operating practices thus need to be better explained.
6.1.1	The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.
Description	The regulatory framework, governing the conduct of capital market supervision by the CSC, encompasses the CSC Act, Securities Act, Stock Exchange Act, Bonds Act, Investment Companies and Investment Funds Act and the regulations issued by the MoF in this area. These regulations are published in the Acts Collection ("Sbírka zákonů") and in the monthly publication of the MoF "Finanční zpravodaj." Policies are explained in the CSC's legal opinions, which are published on regular basis in a bi-monthly Bulletin

	<p>(www.sec.cz/cz/vestnik/veobsah.htm) and on the web site (www.sec.cz/scripts/cz/stanoviska/stanoviskacz.asp). General operating procedures for the conduct of capital market supervision are specified in the CSC Act, Securities Act, the Administrative Code and the Act on State Control. Specific operating procedures for the conduct of capital market supervision by the CSC are not publicly disclosed.</p> <p>References: CSC Act, Articles 8, 9, 10, 11; Securities Act; Stock Exchange Act; Bonds Act; Investment Companies and Investment Funds Act; Administrative Code; Act on State Control.</p>
Assessment	Broadly observed
Comments	Specific operating procedures for the conduct of capital market supervision by the CSC are not explained to the public.
6.1.2	The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.
Description	<p>The reporting duty of financial institutions for the purposes of capital market supervision is prescribed and defined in legislation. In 2000, the CSC sent a diskette to companies and organizations under its supervision with a list of information required by the CSC for regular annual and semiannual reporting. The CSC also organized special seminars on financial reporting for the industry and informs the public through the CSC's press releases (http://www.sec.cz/scripts/en/tiskzprav/tiskzpraven.ASP).</p> <p>References: CSC Act; Securities Act; Stock Exchange Act; Bonds Act; Investment Companies and Investment Funds Act; Commercial Code.</p>
Assessment	Observed
Comments	
6.1.3	The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.
Description	The CSC has not yet licensed operators of futures, options or derivatives exchanges.
Assessment	Not applicable
Comments	No derivatives market exist as yet.
6.1.4	Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.
Description	<p>The fees charged for capital market supervisory activities are specified in the Act on Administrative Fees.</p> <p>References: Act on Administrative Fees.⁵⁸</p>
Assessment	Observed
Comments	
6.1.5	Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.
Description	<p>The CSC shares supervisory responsibilities over banks with the CNB and with the MoF over pension funds and insurance companies. The CSC supervises only those activities of banks, pension funds and insurance companies related to their investment and trading on the capital market. The CSC Act clearly delineates these shared supervisory responsibilities by stating that in exercising its authority over banks, pension funds and insurance companies the CSC shall proceed in such a manner so as not to interfere with the authority of banking supervision bodies and the MoF, respectively. The CSC Act contains special provisions establishing the principles of cooperation and information sharing between the CSC, the CNB, the MoF, and the Chamber of Auditors. It also obliges these agencies to enter into formal agreement that establishes the</p>

⁵⁸ Act No. 368/1992 Coll., on administrative fees, as amended through Act No. 363/1999 Coll.

	<p>procedures for cooperation and information sharing. In compliance with Article 41 of the CSC Act, the CNB in cooperation with the MoF and the CSC has prepared a system of mutual cooperation in the area of capital markets. The resulting MOU also provides for cooperation in the other areas of financial supervision. This MOU is an internal document, which is not publicly disclosed.</p> <p>The CSC Act stipulates the principles for international cooperation in the area of capital market supervision. The CSC is authorized to provide relevant administrative offices and institutions of other states with information on capital market participants for the purpose of instituting administrative or judicial proceedings on the condition of reciprocity. The CSC has signed numerous MOUs with foreign regulators and actively cooperates with IOSCO members. The texts of these MOUs are not publicly disclosed, but their presence is announced through press-releases (http://www.sec.cz/scripts/en/tiskzprav/tiskzpraven.ASP).</p> <p>References: CSC Act, Articles 12, 16, 17, 18, 19, 20, 41.</p>
Assessment	Not observed
Comments	In practice, a fair degree of ambiguity exists regarding the scope and regularity of dialogue and information sharing among domestic regulators, as the MOU between them is not a public document.
6.2	Significant changes in financial policies should be publicly announced and explained in a timely manner.
Description	<p>Changes in capital market supervisory policies are defined in regulations issued by the MoF. These regulations are published in the Acts Collection ("Sbírka zákonů") and in the monthly publication of the MoF "Finanční zpravodaj." Changes in supervisory policies are publicly announced and explained in CSC's press releases (http://www.sec.cz/scripts/en/tiskzprav/tiskzpraven.ASP), discussed at press conferences and are also available on the CSC's web site. New (changed) policies come into force after a period necessary for the protection of investors' rights defined in the old regime.</p>
Assessment	Observed
Comments	
6.3	Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.
Description	<p>Under the CSC Act, the CSC prepares and submits to the government and Chamber of Deputies an annual report on the situation in the Czech capital market and prepares and submits semi-annual reports to the budget committee of the Chamber of Deputies on its activities and economic management. These reports are available on the CSC's website (www.sec.cz/en/zpravyOcinnosti/zpobsahen.htm). In addition, the CSC prepares quarterly reports to the MoF on its activities within one month after the end of the reference period. Even though these quarterly reports are not public documents, the CSC publishes them on its own initiative on the CSC's website.</p> <p>In practice, in the first year of its existence the CSC mistakenly produced its semi-annual and annual reports in cycle (April, September) commencing from the month of its establishment (April 1998) as opposed to the start of the calendar year (June, December). Furthermore, the annual report for 1999 was submitted to the government only in September 2000.</p> <p>References: CSC Act, Article 4.</p>
Assessment	Broadly observed
Comments	Even though the CSC maintains a publication program the latter is erratic and in practice the delay in the issuance of the semi-annual and annual reports after the end of the reference period is too long.

6.4	For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.
Description	The CSC issues for public consideration most such technical changes (public is informed of it through a press release (http://www.sec.cz/scripts/en/tiskzprav/tiskzpraven.ASP), the Bulletin and the website). There is no standard consultation period, however minimum of one month is usually given.
Assessment	Observed
Comments	
VII. PUBLIC AVAILABILITY OF INFORMATION ON FINANCIAL POLICIES	
7.1	Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.
Description	Besides listings of newly licensed capital market intermediaries and of those which licenses were suspended, the annual, semi-annual, quarterly, and monthly reports of the CSC do not provide information on capital market developments.
Assessment	Not observed
Comments	The CSC has indicated that a publication program is planned from next year that will include its assessment of the capital market operations. Part of the reason for non observance relates to the lack of budgetary and technical staff that can undertake such reviews and analysis on an on-going basis.
7.2	Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.
Description	The annual, semi-annual, quarterly and monthly reports of the CSC do not provide aggregate data on capital market developments (www.sec.cz/en/zpravyOcinosti/zpobsahen.htm).
Assessment	Not observed
Comments	The data being released consists mainly of licenses issued and revocations. No publication is available from the CSC that presents the capital market data and information on activities and operations of the capital market intermediaries.
7.3	Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.
Description	The CSC is a budgetary organization, which annual budget is approved as part of the state budget. The CSC does not perform any market transactions. References: CSC Act, Article 28.
Assessment	Not applicable
Comments	
7.3.1	Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.
Description	The CSC does not provide any emergency financial support to capital market intermediaries.
Assessment	Not applicable
Comments	
7.4	Financial agencies should establish and maintain public information services.
Description	The spokesperson of the CSC and the Department of International and Public Relations are responsible for providing information services to public. The CSC maintains a website (www.sec.cz). The Freedom of Information Act requires CNB to respond in writing to individual requests for information within fifteen days. A charge free telephone line for answering individual questions was introduced in March 2000.
Assessment	Observed
Comments	

7.4.1	Financial agencies should have a publications program, including a periodic public report on their principal activities issued at least annually.
Description	<p>Under the CSC Act, the CSC prepares and submits to the government and Chamber of Deputies an annual report on the situation in the Czech capital market and prepares and submits semi-annual reports to the budget committee of the Chamber of Deputies on its activities and economic management. These reports are available on the CSC's website (www.sec.cz/en/zpravyOcinnosti/zpobsahen.htm). In addition, the CSC prepares quarterly reports to the MoF on its activities within one month after the end of the reference period. Even though these quarterly reports are not public documents, the CSC publishes them on its own initiative on the CSC's website. The CSC also published a bi-monthly Bulletin (www.sec.cz/cz/vestnik/veobsah.htm).</p> <p>In practice, in the first year of its existence the CSC mistakenly produced its semi-annual and annual reports in cycle (April, September) commencing from the month of its establishment (April 1998) as opposed to the start of the calendar year (June, December). Furthermore, the annual report for 1999 was submitted to the government only in September 2000.</p> <p>References: CSC Act, Articles 3, 4.</p>
Assessment	Broadly observed
Comments	Even though the CSC maintains a publication program the latter is erratic and in practice the delay in the issuance of the semi-annual and annual reports after the end of the reference period is too long.
7.4.2	Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.
Description	The CSC organizes regular press-conferences and meetings with reporters and journalists attended by members of the Presidium. Senior officials explain CSC's objectives and attitudes toward current issues in media (TV, radio broadcasting or newspapers). Members of the staff and officials also publish articles in specialized magazines and newspapers and give lectures at specialized trainings, conferences and seminars. The Freedom of Information Act requires CNB to respond in writing to individual requests for information within 15 days.
Assessment	Observed
Comments	
7.5	Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.
Description	The regulatory framework, governing the conduct of capital market supervision by the CSC, encompasses the CSC Act, Securities Act, Stock Exchange Act; Bonds Act, Investment Companies and Investment Funds Act and the regulations issued by the MoF in this area. These regulations are published in the Acts Collection ("Sbirka zákonů") and in the monthly publication of the MoF "Finanční zpravodaj." Legal opinions of the CSC are published in its monthly bulletin, which is also available at the CSC's website.
Assessment	Observed
Comments	
7.6	Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.
Description	Under the Agreement on Association Guarantee Fund of the Exchange, concluded on 2 April 1993, the members of the PSE have established a guarantee fund that would secure obligations and cover risks implying from trades executed at the PSE. The CSC exercises supervisory functions over the Guarantee Fund through a provision that entitles it to appoint one of the members of the governing board. The participation in the Fund is voluntary. The form of protection, operating procedures, financing of the Fund are publicly disclosed in the

	Agreement, which is available at the PSE website (www.pse.cz)
Assessment	Observed
Comments	
7.7	Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.
Description	One of the main objectives of the CSC is investor rights protection, which includes investigating capital market participants complaints and resolution of disputes. This objective, however, is not specified in relevant legislation, is not explicitly referred to in the CSC's reports. It is, however, explained on the website of the CSC (www.sec.cz/cz/radceinvestora/raobsahcz.htm).
Assessment	Partly observed
Comments	One of the main objectives of the CSC—investor rights protection—is not specified in relevant legislation and is not explicitly referred to in the CSC's reports.
VIII. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY FINANCIAL AGENCIES	
8.1	Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.
Description	Under the CSC Act, the Chairman of the CSC can be summoned to attend the sessions of the government, the Chamber of Deputies, and the Senate (SC Act). In practice, discussions of the Annual Report on situation of the Czech Capital market and discussions on the CSC's budget are always attended by the Chairman. References: CSC Act, Article 22.
Assessment	Observed
Comments	
8.2	Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.
Description	The CSC is a budgetary organization, which annual budget is approved as part of the state budget. References: CSC Act, Article 28.
Assessment	Not applicable
Comments	
8.2.1	Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.
Description	Not applicable
Assessment	Not applicable
Comments	
8.2.2	Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.
Description	The CSC has established its internal governance procedures. The CSC considers the internal audit arrangements confidential and does not disclose them to the public.
Assessment	Not observed
Comments	The internal audit procedures of the CSC are not explained to the public.
8.3	Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.
Description	The CSC is a budgetary organization, which revenues and expenditures are disclosed as part of the state budget. Summary information on the expenditures of the CSC is published in the Annual Report. It is, however, very aggregated and not very informative.
Assessment	Observed

Comments	The summary information on the expenditures of the CSC published in its Annual Report is very aggregated and not very informative.
8.4	Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.
Description	The CSC Act clearly defines rules for personal conduct of financial affairs by officials and staff of the CSC, including provisions preventing exploitation of conflicts of interest. The Labor Code specifies general rules in these matters for employees of the CSC. In particular, the CSC Chairman and members of the CSC Presidium may not hold any other paid office or conduct any other gainful activity with the exception of literary, artistic, or teaching activities and the administration of such persons' own property. The CSC Chairman and members of the CSC Presidium may not hold any office, even if unpaid, in a statutory or other body of any business company, state enterprise, state organization, or cooperative. They also may not participate during their term of office directly or indirectly in a business which is subject to the state supervision of the CSC. They must entrust to the administration of a third person any investment instruments which they acquired prior to their appointment in the CSC or which they acquired during their stay in office and they may not provide such third person with instructions as to the disposal of such investment instruments. The CSC Chairman, members of the CSC Presidium, and employees of the CSC may not use information which they obtained while in office or while employed to their own or to another's benefit. Similar rules apply for employees of the agency with the exception of the restrictions of acquiring and disposing of investment instruments while serving in the CSC. References: CSC Act, Articles 23, 24, 27; Labor Code
Assessment	Observed
Comments	
8.4.1	Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.
Description	There are no specific provisions for legal protection of the staff and officials of the CSC.
Assessment	Not applicable
Comments	

Table 14. Securities Regulation Transparency: Observance of Individual Practices

Practice	Gradings					Comments
	O ⁵⁹	BO ⁶⁰	PO ⁶¹	NO ⁶²	NA ⁶³	
V. Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies						
5.1 The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or	X					

⁵⁹ O: Observed.

⁶⁰ BO: Broadly observed

⁶¹ PO: Partly observed.

⁶² NO: Nonobserved.

⁶³ NA: Not applicable.

Practice	Gradings					Comments
	O ⁵⁹	BO ⁶⁰	PO ⁶¹	NO ⁶²	NA ⁶³	
regulation.						
5.1.1 The broad objective(s) of financial agencies should be publicly disclosed and explained.	X					
5.1.2 The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.	X					
5.1.3 Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.	X					
5.1.4 Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.	X					
5.2 The relationship between financial agencies should be publicly disclosed.				X		The MOU between the CNB, the MoF, and the CSC on cooperation and information sharing in the area of capital markets is an internal document, which is not publicly disclosed.
5.3 The role of oversight agencies with regard to payment systems should be publicly disclosed.					X	The CSC has no supervisory authority over the payment systems in the Czech Republic.
5.3.1 The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.					X	See 5.3.
5.4 Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.	X					
5.5 Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.	X					

Practice	Gradings					Comments
	O ⁵⁹	BO ⁶⁰	PO ⁶¹	NO ⁶²	NA ⁶³	
VI. Open Process for Formulating and Reporting of Financial Policies						
6.1 The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.		X				See comments below.
6.1.1 The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.		X				Specific operating procedures for the conduct of capital market supervision by the CSC are not publicly disclosed.
6.1.2 The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.	X					
6.1.3 The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.					X	The CSC has not yet licensed operators of futures, options or derivatives exchanges.
6.1.4 Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.	X					
6.1.5 Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.				X		The scope and procedures for cooperation and information sharing between the CNB, the MoF, and the CSC on in the area of capital market supervision is not publicly disclosed and explained.
6.2 Significant changes in financial policies should be publicly announced and explained in a timely manner.	X					
6.3 Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.			X			Even though the CSC maintains a publication program the latter is erratic and in practice the delay in the issuance of the semi-annual and annual reports after the end of the reference period is too long.
6.4 For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.	X					

Practice	Gradings					Comments
	O ⁵⁹	BO ⁶⁰	PO ⁶¹	NO ⁶²	NA ⁶³	
VII. Public Availability of Information on Financial Policies						
7.1 Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.				X		Besides listings of newly licensed capital market intermediaries and of those which licenses were suspended, the annual, semi-annual, quarterly and monthly reports of the CSC do not provide information on capital market developments.
7.2 Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.				X		The annual, semi-annual, quarterly, and monthly reports of the CSC do not provide aggregate data on capital market developments.
7.3 Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.					X	The CSC is a budgetary organization, which annual budget is approved as part of the state budget. The CSC does not perform any market transactions.
7.3.1 Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.					X	The CSC does not provide any emergency financial support to capital market intermediaries.
7.4 Financial agencies should establish and maintain public information services.	X					
7.4.1 Financial agencies should have a publications program, including a periodic public report on their principal activities, issued at least annually.		X				Even though the CSC maintains a publication program the latter is erratic and in practice the delay in the issuance of the semi-annual and annual reports after the end of the reference period is too long.
7.4.2 Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.	X					
7.5 Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.	X					
7.6 Where there are deposit insurance guarantees, policy-holder guarantees,	X					

Practice	Gradings					Comments
	O ⁵⁹	BO ⁶⁰	PO ⁶¹	NO ⁶²	NA ⁶³	
and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.						
7.7 Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.			X			One of the main objectives of the CSC— investor rights protection—is not specified in relevant legislation and is not explicitly referred to in the CSC’s reports.
VIII. Accountability and Assurances of Integrity by Financial Agencies						
8.1 Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.	X					
8.2 Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.					X	The CSC is a budgetary organization, which annual budget is approved as part of the state budget.
8.2.1 Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.					X	See 8.2.
8.2.2 Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.				X		The CSC considers the internal audit arrangements confidential and does not explain them to the public.
8.3 Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.	X					
8.4 Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be	X					

Practice	Gradings					Comments
	O ⁵⁹	BO ⁶⁰	PO ⁶¹	NO ⁶²	NA ⁶³	
publicly disclosed.						
8.4.1 Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.					X	There are no specific provisions for legal protection of the staff and officials of the CSC.

Response to the assessment and recommended action plan

Response to the assessment

137. The CSC agreed with the findings of the assessment. In its response, the CSC provided some useful factual clarifications, which were incorporated in the assessment.

Recommended action plan

Clarity of roles, responsibilities and objectives of financial agencies

138. The scope and nature of the MOU between the CNB, the MoF, and the CSC on cooperation and information sharing in the area of capital markets should be publicly disclosed.

Open process for formulating and reporting of financial policies

139. Specific operating procedures for the conduct of capital market supervision by the CSC should be publicly disclosed.

140. The CSC should ensure the timeliness of its published reports.

Public availability of information on financial policies

141. The CSC should publish information and aggregate data on capital market developments in its annual, semi-annual and quarterly reports.

142. One of the main objectives of the CSC—investor rights protection—should be explicitly specified in relevant legislation and more actively disclosed through the CSC’s publications.

Accountability and assurances of integrity by financial agencies

143. The internal audit procedures of the CSC should be explained to the public.

VI. OECD CORPORATE GOVERNANCE PRINCIPLES

General

144. The assessment of the quality of corporate governance in the Czech Republic was performed as part of a Financial Sector Assessment (FSAP) for the Czech Republic, conducted between November 27 and December 12, 2000 in Prague.⁶⁴ The assessment was conducted by determining the levels of observance with the OECD Principles of Effective Corporate Governance (the “OECD Principles”). The assessment also identifies areas where further development may be appropriate.

145. The assessment drew upon the World Bank *Capital Market Review, the Czech Republic (1999)*, and was based on a review of several pieces of legislation and extensive discussions with Government officials, financial supervisors, and numerous segments of the private sector. In particular, the assessment reflects extensive technical discussions with the Ministries of Finance and Justice, the CSC, the PSE, the Chamber of Auditors, the Union of Accountants, the Institute of Directors, the Union of Investment Companies, major listed companies, and professional services firms. The review also is based upon self-assessment questionnaires completed by the CSC for the purposes of an assessment of IOSCO’s *Objectives and Principles of Securities Regulation*, and in particular on a questionnaire on corporate governance.

The legal framework affecting corporate governance

146. For the purposes of the OECD Principles, corporate governance is “that structure of relationships and corresponding responsibilities among a core group consisting of shareholders, board members and managers designed to best foster the competitive performance required to achieve the corporation’s primary objective.” (*A Report to the OECD by the Business Sector Advisory Group on Corporate Governance*, April 1998, page 13).

147. During 2000, a major package of legislation affecting corporate governance was approved by the Parliament to come into force on January 1, 2001. Amongst the more important elements of this package are extensive changes to the Commercial Code, the Securities Act, the Bond act, the Stock Exchange Act, and the Auditing Act. Additional legislative changes are under consideration or are already under discussion in Parliament, including amendments to the CSC Act and the Law on Investment Companies and Investment Funds. A number of the changes brought about by the package are novel to Czech law or substantially alter the responsibilities and rights of companies, board members, shareholders, and auditors. Because of the timing of this package, companies, investors and regulators are still attempting to understand how these provisions will operate in practice. For

⁶⁴ Prepared by Douglas Webb (World Bank).

the same reason, complete English translations of the package were not available during the review phase. This assessment should therefore be read with caution, pending possible modifications in the light of a review of complete translations of the legislation. Definitive interpretations by the courts of some key provisions will also be required before there can be a reasonable level of predictability as to how those provisions are to be applied.

148. It must be pointed out that in most countries banks and insurance companies are typically subject to specific and stricter governance rules, relative to those applied to all other financial and non-financial companies. This includes, for example, the duty of boards to implement and monitor systems of risk management and internal controls. This difference is justified due to the nature of the business and the critical importance of minimum capital requirements in these industries. The assessment of corporate governance does not comprise an analysis of specific governance rules for banks and insurance companies. This analysis is done in the specific assessments for banks and insurance companies.

149. The courts are a key component of an effective corporate governance system. The courts play three important roles. First, court decisions interpreting the relevant laws provide guidance to regulators, companies, board members, managers, auditors, and investors on the manner in which the laws should be applied in similar situations. Second, the courts are responsible for deciding appeals from regulatory decisions, and therefore are an important check-and-balance to broad regulatory powers. Finally, the courts have the authority to award damages in civil suits for breach of corporate governance obligations where the law provides for such damages claims, and to impose criminal penalties for serious misconduct. Though this assessment does not represent an evaluation of the capacity and effectiveness of the court system, conclusions are drawn as to the impact on corporate governance of weaknesses in the court system.

Information and methodology

150. The OECD Principles are concerned primarily with publicly traded corporations listed on a stock exchange, though many of the issues addressed by the OECD Principles are also of relevance to large non-traded corporations and state-owned companies. The assessment which follows is based upon the laws, regulations and institutional infrastructure concerned with the governance of joint stock companies listed on the PSE. Limited liability companies, typically companies wholly owned by a strategic investor or entrepreneur, which do not raise external capital from the public should also adopt sound corporate governance practices, though some of the OECD Principles concerned with protection of minority shareholders will have limited application to this group of companies.

151. The focus of the OECD Principles is on mechanisms of governance internal to the corporation. But for the purposes of this assessment, the evaluation of the Czech Republic has been extended to include the roles and responsibilities of regulatory authorities and of voluntary practices. The OECD principles do not deal extensively with the role of the credit system as an external influence on shareholders, board members and managers. However, reference will be made to the responsibilities of corporate boards to consider the interests of

creditors as stakeholders in the corporation, and to the important role that creditors play in exerting financial discipline on borrowers.

152. Reference will also be made to two draft codes of corporate governance now under public discussion. One code was issued by the Institute of Directors in August this year. The other was issued by the CSC in November. Both codes are influenced by the OECD Principles. The CSC code once finalized is expected to be adopted by the PSE and the RM-System (RMS). The PSE is in its listing committee discussing whether to recommend compliance with the code by all companies listed on its main market from January 1, 2003 and to require those companies to include a statement in their annual report for that year as to whether or not the company has adopted the code. Companies listed on the second market will be encouraged to disclose compliance. The RMS will identify in its records those companies that have adopted the code.

153. These voluntary statements of sound corporate governance practices are in line with similar codes adopted in a number of major capital markets. They complement in a flexible and non-prescriptive manner the corporate governance structure defined in primary and secondary corporate and capital markets legislation. By announcing their compliance with such codes, companies demonstrate to their employees and to the market their commitment to transparency, integrity in business operations, and accountability to shareholders and stakeholders. Companies are also able to benchmark themselves against international best practices.

154. The methodology applied in the ratings of compliance with the OECD Principles is as follows. A Principle will be considered **observed** whenever all essential criteria are generally met without any significant deficiencies. A Principle will be considered **largely observed** whenever only minor shortcomings are observed, which do not raise any concerns about the authority's ability and intent to achieve full observance with the principle within a prescribed period of time. A Principle will be considered **materially non-observed** whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance. A Principle will be considered **non-observed** whenever no substantive progress toward observance has been achieved.

Institutional setting and enforcement

155. Sound corporate governance requires a convergence of market practices, laws, and regulatory oversight. An effective court system is also required, to resolve the meaning and application of key legal requirements, to provide enforceable remedies in civil litigation and to penalize those who breach the criminal law.

156. Each element is complementary to the others, and weaknesses in one will reduce the effectiveness of the overall environment for corporate governance. In the case of the Czech Republic, the voucher privatization program created stress on all elements of the corporate governance system, at a time when commercial morality was under-developed, laws were incomplete, regulatory agencies were nascent, and the courts poorly equipped to handle

complex civil litigation. The *Czech Capital Market Review* prepared by the World Bank details the challenges and consequences for the credibility and integrity of the capital markets in the aftermath of a period of widespread misdealing and misappropriation and destruction of shareholder value in banks, investment companies and funds, and companies.

157. This assessment reviews the progress that has been made in improving corporate governance and the unfinished agenda. Progress has been substantial, particularly in the completion of core laws, the expansion of regulatory oversight, and the development of awareness on the part of companies, managers and shareholders of the practical importance of good corporate governance, both as a responsibility and as a means of building shareholder value and encouraging new external investment. Nonetheless, significant weaknesses remain, primarily in the areas of disclosure, regulatory capacity, and the court system.

Table 15. OECD Principles of Corporate Governance: Principle-by-Principle Assessment

Principle 1.	<p>The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to: (i) secure methods of ownership registration; (ii) convey or transfer shares; (iii) obtain relevant information on the corporation on a timely and regular basis; (iv) participate and vote in general shareholder meetings; (v) elect members of the board; and (vi) share in the profits of the corporation.</p>
Description	<p>(i) <i>Ownership Registration.</i> The Securities Center maintains registers of shareholdings in listed companies. The Center appears to maintain adequate security systems to prevent unauthorized access to or changes in the register. Registers are not open for public inspection. Shareholders are unable to obtain shareholding details from the register except in respect of their own holdings. Holdings in excess of 5 percent of the issued shares are required by Section 183d of the Commercial Code to be disclosed to the company, the CSC, and the Securities Center, and are searchable at the offices of the Center or on-line.</p> <p>(ii) <i>Transfer of Shares.</i> Shareholders may freely transfer their shares either on the PSE or the RMS. Bilateral trades may be completed by the parties at the Securities Center. Registration of transfers is suspended for seven days prior to a general meeting to allow for the production of an accurate shareholders' list for the company. Share transfers do not require the prior approval of the company.</p> <p>(iii) <i>Access to Information.</i> Sections 80a and 80b of the Securities Act require the company to publish six monthly and annual financial statements of the company and an annual report of the board of directors as to the operations and trading results. The documents are provided to the CSC and the Securities Center, and are available on-line from these sources. The framework and overall content is established in the Securities Act. The company is obliged also under Section 80c of the Securities Act to promptly publish material price-sensitive information, except when the CSC has granted an exemption where publication would be contrary to the public interest or may significantly damage the company.</p> <p>(iv) <i>Participation and Voting.</i> There are no formal restrictions on the ability of shareholders to attend and vote at general meetings of the company. The meeting must be held during working hours on a working day, and the location of the meeting should not unnecessarily inconvenience shareholders. Nevertheless, there continue to be reported instances of difficulties encountered by shareholders in gaining access to meetings or</p>

	<p>establishing their right to vote. The control of the shareholders meeting is the responsibility of the management board. The Board is collectively responsible for ensuring that shareholders are able to exercise their rights, either directly or through a representative.</p> <p>Shareholders are entitled under Section 184 of the Commercial Code to appoint a proxy to vote their shares at a meeting. Directors and members of management may not be appointed as proxies. Proxy voting has given rise to some problems with proxies having difficulty in gaining access to meetings.</p> <p><i>(v) Election of members of the Board.</i> Joint stock companies have both a supervisory board and a management board. Board members must meet the general requirements under the Trades Licensing Act, though these requirements are not directly related to professional competence.</p> <p>The supervisory board comprises a minimum of three members, and thereafter in multiples of three. For companies with more than 50 employees, one third of the members of the supervisory board are elected by the employees. The by-laws of a company with 50 or less employees may allow employees to elect members of the supervisory board. The remaining two thirds are elected by the shareholders in general meeting. The function of the supervisory board is to oversee the management board and the operations of the company.</p> <p>The management board is responsible for the day-to-day management of the company. Members of the board are elected each year by the shareholders in general meeting. The maximum term of a director is five years. There is no periodic rotation, though the CSC code recommends rotation at regular intervals and at least every five years.</p> <p>Cumulative voting for board elections is not authorized by law, though it may be open to a company to adopt such a system through its by-laws</p> <p><i>(vi) Sharing the Corporation's Profits.</i> The shareholders in general meeting approve payment of dividends or other profit distributions based on a recommendation from the management board.</p>
Assessment	<p>Largely observed. The principle is considered to be largely observed, due basically to the recent extensive amendments to the Commercial Code. However, the application of the recent amendments in practice remains to be tested, particularly ensuring shareholder participation in general meetings, and ability of shareholders to obtain comprehensive relevant information.</p>
Comments	<p>The recent changes to the Commercial Code and Securities Act have reinforced the clarity of the basic rights of shareholders of joint stock companies. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.</p> <p>The MoF should issue regulation specifying actions to ensure that boards are aware of and comply with their responsibility for ensuring open access by shareholders and their representatives to shareholder meetings.</p> <p>The CSC should consider seeking powers under the proposed amendments to the CSC Act to require that a meeting be reconvened where shareholders have been improperly prevented from attending or voting, either themselves or through their representatives.</p> <p>The PSE should consider amending its listing rules to allow for the suspension of trading in a stock in response to legitimate complaints of this kind.</p>

Principle 2. Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes, such as : (i) amendments to the governing documents of the company; (ii) the authorization of additional shares; and (iii) extraordinary transactions that in effect result in the sale of the company.	
Description	<p>The Commercial Code contains adequate protection for minority shareholder rights in respect of fundamental corporate changes, such as changes in share capital, changes to the by-laws, material transactions, mergers, the sale of a substantial part of the business, or the liquidation of the company. These requirements are within best practice norms.</p> <p>Section 186 of the Commercial Code requires that amendments to the by-laws of the company be approved by a two-thirds majority of the votes of attending shareholders at a general meeting. A similar majority is required for the issuance of new capital. Shareholders are entitled to pre-emptive rights in respect of any share issue, though these rights can be waived at a general meeting with the approval of a 75 percent majority.</p>
Assessment	Largely observed. The principle cannot be considered to be fully observed, because of the need to verify whether the recent substantive changes to the Commercial Code will be adequately implemented.
Comments	The recent changes to the Commercial Code have reinforced the rights of shareholders to participate in fundamental corporate changes. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.
Principle 3. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern shareholder meetings.	
Description	<p>Companies are required under Section 184 of the Commercial Code to convene a general meeting at least once each year. Special general meetings may be convened by the company, or, by virtue of Section 181 of the Commercial Code, at the request of the holders of 5 percent of the issued shares for companies, or 3 percent for companies with a capital in excess of CZK 100 million. Section 185 of the Commercial Code fixes the quorum for a valid meeting as the attendance of the holders of 30 percent of the issued shares.</p> <p>The agenda for general meetings is set by the company. However, the holders of 5 percent (3 percent for companies with a capital in excess of CZK 100 million) of the shares may require under Section 182 of the Commercial Code that additional items be added to the agenda for consideration by the meeting. Any shareholder may deliver to the company at least five days before the general meeting a response to any management proposals.</p> <p>The general meeting will elect two scrutineers for any shareholder vote. The scrutineers are required to sign the minutes of the meeting. A notarized record is made of the resolutions adopted.</p> <p>Shareholders have a right of action against the company for any failure to comply with the procedural requirements for shareholder meetings. There have however been reported instances where this right may have been misused and Section 56a of the Commercial Code now contains a prohibition on the abusive exercise of voting rights both by and against the majority and the minority.</p>
Assessment	Observed.
Comments	

Principle 4.	Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
Description	<p>The acquisition of 5 percent or more of the issued shares must be disclosed within three days to the company, the CSC and the Securities Center for listed securities. The Securities Center publishes these disclosures on its web site. Further disclosures are required at each additional five percent threshold and at the one-third and two-thirds levels.</p> <p>Under Sections 66, 190a and 190b of the Commercial Code, the concept of a controlling interest is used in order to clarify the responsibilities of shareholders who, acting individually or in concert, exercise effective control over the company. Control is presumed at the level of 40 percent of the issued shares, though the presumption can be overcome if another unrelated shareholder has an equal or larger holding. Control can also exist below the 40 percent level, but the claimant will have the responsibility to demonstrate it.</p> <p>Where a controlling interest exists, any action by the controlling party that causes loss to the company will trigger a right of compensation, either for the company or the minority shareholders. The controlling party must enter into a contract with the controlled company to define the operating relationship between them, and the arrangements for participation by the controlling party in distributions by the company. A report from an independent expert on the fairness of these arrangements must be provided to the shareholders, and the contract approved by a super-majority of shareholders at a general meeting.</p>
Assessment	Largely observed. The principle cannot be considered to be fully observed, because of the need to verify whether recent substantive changes to the Commercial Code will be adequately implemented.
Comments	The recent changes to the Commercial Code have reinforced the disclosure requirements for material shareholdings and substantially strengthened the obligations of controlling persons to avoid any abuse of that position. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.
Principle 5.	Markets for corporate control should be allowed to function in an efficient and transparent manner. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class. Anti-takeover devices should not be used to shield management from accountability.
Description	<p>Takeovers are governed by the provisions of section 183 of the Commercial Code, which is closely modeled on the Rules of the Takeover Panel of the London Stock Exchange. The offeror must notify the target company of the offer and supply full information to the target and to the CSC. The management board of the target is required to review the offer and notify the offeror and the market of its views within five days. The offer must be open to all shareholders and on equal terms. The target is not permitted to use anti-takeover devices to prevent the offer from being considered by the shareholders.</p> <p>“Creeping” takeovers are in effect precluded by the requirement of the Commercial Code that once a shareholder, or several acting together, have acquired 50 percent of the issued shares, an offer must be made to all shareholders at a fair price based on average prices paid for the shares over the prior six month period.</p> <p>The acquisition of five percent or more of the issued shares must be disclosed within three days to the company, the CSC and the Securities Center. The Securities Center includes</p>

	<p>these disclosures on its web site. Further disclosures are required at each additional five percent threshold and at the one-third and two-thirds levels.</p> <p>Related party transactions between a company and insiders are required to be disclosed in notes to the financial statements. In addition, the company must obtain shareholder approval of material transactions, and provide an independent expert assessment of the adequacy of the exchange of values. Any shareholder may file suit to invalidate the transaction on the grounds that the transaction is detrimental to the company.</p> <p>Once a 95 percent stake in the company is held by a shareholder, or persons acting in concert, the CSC on the request of a minority shareholder may under Section 183h of the Commercial Code require the controlling shareholders to make a purchase offer for the minority shares. This is not, however, a compulsory acquisition power capable of being exercised by the company at its own initiative, with the result that companies may be required to incur the expense of servicing a very small pool of residual shareholdings.</p>
Assessment	Largely observed. The principle cannot be considered to be fully observed, because of the need to verify whether the recent substantive changes to the Commercial Code will be adequately implemented.
Comments	<p>The recent changes to the Commercial Code have created a comprehensive takeover regime, including oversight powers for the CSC. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.</p> <p>The new oversight powers granted to the CSC may require additional staff should takeovers grow in importance.</p>
Principle 6.	<p>The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.</p> <p>All shareholders of the same class should be treated equally. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.</p>
Description	<p>Joint stock companies may issue only two types of shares: common and preferred. Common shares typically carry one vote per share, though the by-laws may stipulate a higher number of votes for shares of the identical nominal value. The by-laws of the company may allow a cap on voting rights, but without discriminating between shareholders. Preferred shares may be issued, carrying a fixed dividend payable in priority to dividends on common shares or distribution of liquidation proceeds. Preferred shares do not carry voting rights except if the company is in default.</p> <p>Section 186 of the Commercial Code requires that changes in the voting rights attached to shares be approved by a 75 percent majority of the shareholders of that class attending the general meeting.</p> <p>The beneficial owner of shares may direct a custodian as to the exercise of the voting rights for the shares.</p>
Assessment	Observed.
Comments	

Principle 7.	Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.
Description	<p>The company is required under Section 184 of the Commercial Code to give at least 30 days notice of general meetings, and to appoint a day and time for the meeting that will not unreasonably inconvenience shareholders. Meeting procedures are set by the by-laws of the company.</p> <p>Shareholders do have the right to file a civil law suit against the company if there are breaches of the procedures for the conduct of meetings. There are several instances of such law suits, which have on occasions resulted in shareholders' meetings being reconvened to overcome the irregularity. However, law suits are a costly and difficult remedy, especially for minority shareholders.</p> <p>General shareholder meetings are required to be called by reasonable notice and to be held at times and in a location that is not unreasonably difficult for shareholders to attend.</p> <p>Shareholders are entitled to vote by proxy, provided the proxy holds a power of attorney. Electronic voting is not currently available. Voting agreements where a shareholder commits in advance to vote in a particular manner are prohibited by Section 186d of the Commercial Code.</p>
Assessment	Observed
Comments	
Principle 8	Insider trading and abusive self-dealing should be prohibited.
Description	<p>Delay in disclosure of material information exacerbates the risk of insider trading or self-dealing. In this respect the Securities Act requires the company to inform the PSE, though without specifying a period within which to do so, of all information required to protect the interests of shareholders or required to ensure the normal functioning of the public market. The PSE may require the company to publish that information, or may do so itself if the company fails to do so. The listing rules of the PSE also require companies to make timely disclosure of material information.</p> <p>The company is required to notify the PSE promptly of any price-sensitive information. The CSC has the power to exempt for the requirements under special circumstances. The Securities Act lists the classes of information required to be disclosed, including changes in business conditions, commencement of bankruptcy or composition proceedings, a decline in the value of the assets of the company of more than 10 percent, disputes where the sum at issue is more than 5 percent of the value of the assets of the company, and changes in the supervisory or management boards. There is no guidance in the Act as to the basis on which the company is to make such a determination of a fall in asset values. Since Czech accounting principles require that fixed assets are reported at historic cost, companies may ignore value fluctuations above book value.</p> <p>The CSC through its monitoring unit watches for indications of abnormal trading activities and investigates potential insider dealing on non-public information. The CSC has the power to impose administrative penalties, though there is as yet little evidence of vigorous enforcement.</p> <p>The external auditor of a listed company now has an obligation under Section 15(3) of the Law on Auditing to notify the CSC if he becomes aware during the course of the audit of any breach of law, which would include insider trading. The sanctions on external auditors for failure to perform this critical duty are not clear, while there are no concluded cases of lawsuits against external auditors.</p>

Assessment	Materially non-observed. The rating is primarily due to the insufficient integration of surveillance functions of PSE, the RM System, and the CSC. The new obligations of external auditors to report breaching of legislation remain to be tested.
Comments	Rapid progress with improvements in detection and enforcement is a critical test for the credibility of the regulatory regime and the capital markets. In this respect, the CSC monitoring and enforcement units should be strengthened.
Principle 9.	Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.
Description	<p>The Law requires Board members and managers to disclose to shareholders the purchase of substantial assets from the company. Moreover, the company is required to seek an independent evaluation of the fairness of the transaction, and to obtain the prior approval of a shareholder resolution. Shareholders may claim damages if the procedures for approval are not complied with. If the transaction is detrimental to the company, the directors may be liable in a civil action for the loss suffered by the company. Shareholders with 5 percent or more of the shares (3 percent for companies with issued share capital of CZK 100 million) may require the supervisory board to launch the civil action on behalf of the company. If the board fails to do so, the shareholders may sue directly.</p> <p>The Law does not require Board members and managers to disclose to the company material interests in transactions to be entered in by the company. A material interest would include a personal financial interest in the transaction, or a relationship (as an employee, manager, director, shareholder or otherwise) with the other party to the transaction.</p>
Assessment	Materially non-observed. The law fails to provide an obligation on corporate insiders to disclose to the company a material interest and to abstain from the decision-making process. There are also doubts concerning the breadth of the rules regarding transactions with insiders.
Comments	The Commercial Code should be changed to include an express obligation on board members and managers to disclose any material interests in transactions to be entered into by the company. They should not thereafter be involved in the decision-making process. The provisions of the Commercial Code regarding material transactions with insiders should also be strengthened to ensure their application to a broad range of such transactions.
Principle 10.	The corporate governance framework should recognize the rights of the stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
Description	<p>Employees have the opportunity to elect members of the supervisory boards of large companies. Joint stock companies with more than fifty employees are required under Section 200 of the Commercial Code to provide one-third of the seats on the supervisory board for representatives elected by the employees. Companies with fewer employees may also choose to set aside supervisory board seats for employees. Companies do not have a specific duty to consider the interests of employees in their operations, though there is no indication that companies are failing to do so.</p> <p>Companies may create employee share-purchase plans, though there are no tax incentives for companies to do so.</p> <p>Stakeholders such as employees, local and tax authorities are well protected by the Commercial Code. However, creditors as another major stakeholder group are not well protected by the Bankruptcy Act or the general legal framework and reforms are required in the areas of collateral and insolvency to improve the balance of interests between companies and their creditors.</p>

Assessment	Materially non-observed. Creditors are important stakeholders, and continue to be deprived of essential rights to enforce claims, to obtain adequate collateral, and to participate effectively in bankruptcy and composition proceedings.
Comments	Creditors are an important source of pressure for improved corporate governance and for the efficient operation of companies. While their rights to enforce debt claims are weak, their role as external monitors of management remains under-developed.
Principle 11.	<p>The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.</p> <p>Disclosure should include, but not be limited to, material information on: (i) the financial and operating results of the company; (ii) company objectives; (iii) major share ownership and voting rights; (iv) members of the board and key executives, and their remuneration; (v) material foreseeable risk factors; (vi) material issues regarding employees and other stakeholders; (vii) governance structures and policies.</p>
Description	<p>Listed companies are required under Section 80a of the Securities Act to prepare, file with the CSC and the Securities Center, and publish an annual report within four months after the end of each financial year. The information contained in the report must provide a true and fair picture of the financial situation, business activities and economic results of the company as well as future prospects. The information contained in the report must provide a true and fair picture of the financial situation, business activities, and economic results of the company as well as future prospects. The report must disclose aggregate directors' remuneration (though not that of executives), identify revenues derived from controlled persons, and the shareholdings of board members and executives. Semi-annual audited statements must be issued by listed companies.</p> <p>Periodic disclosure requirements also exist for material and related-party transactions requiring shareholder approval. Price-sensitive information is required to be promptly disclosed to the PSE, as noted above. In the case of investment funds and investment companies, the Investment Companies and Investment Funds Act makes it an offence to disseminate false or misleading information or to withhold material information, while advertising the sale of shares or participation certificates.</p> <p>Disclosure of major share ownership is achieved through a requirement to inform the CSC and the Securities Center of the acquisition of a 5 percent shareholding and subsequent 5 percent increments, along with blocking stakes of one-third and two-thirds.</p> <p>Disclosure of corporate governance structures and policies is not currently required, but the PSE has indicated that once the SEC-inspired corporate governance code has been finalized, the PSE will progressively require listed companies to disclose their compliance.</p>
Assessment	Largely observed. The principle cannot be considered to be fully observed, because of the need to verify whether recent substantive changes to the Securities Act will be adequately implemented.
Comments	The recent changes to the Securities Act have created a comprehensive disclosure regime, and improved the oversight powers for the CSC. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.

Principle 12	Information should be prepared, audited and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.
Description	<p><i>Accounting.</i> Financial reporting is based upon Czech accounting principles as defined in the Accounting Law and regulations issued by the MoF. Czech Accounting Standards are broadly in line with the EU's Fourth and Seventh Directives and with International Accounting Standards (IAS). However, there is still a separation between tax and accounting profit and loss, and an emphasis upon tax compliance over full and accurate reporting for the benefit of shareholders, employees and creditors.</p> <p>There is a need for greater flexibility in the adoption of new accounting principles. At present, the MoF controls the preparation of changes, which must also be approved by Parliament. Changes are therefore slow, and still influenced by fiscal rather than business considerations. Amendments to the Accounting law under consideration would allow the MoF to authorize the creation of an independent standard-setting body.</p> <p>Listed companies on the main market of the PSE will be required by the PSE listing rules from January 1, 2001 to complete their financial statements in accordance with IAS. Currently, they are permitted to report under either or both of Czech accounting principles and IAS. IAS accounts are common amongst the larger companies and particularly those raising capital outside the Czech Republic.</p> <p>The Union of Accountants does not have licensing powers and membership is voluntary. As a result, the quality of accounting work varies widely and cannot be relied upon outside the largest companies and those affiliated with the major Czech and foreign accounting firms.</p> <p><i>Auditing.</i> Czech Auditing Standards are in compliance with International Auditing Standards, although consistency of application is not assured. The Chamber of Auditors has statutory licensing powers and a disciplinary function. The Chamber has not been proactive in monitoring the activities of its members, but should be expected to become increasingly active in investigating misconduct or serious quality problems involving external auditors.</p> <p>The Act on Auditing provides that the auditor shall be independent, being only obliged to respect laws in force. However, the content of independence is potentially eroded by the common practice of leaving the appointment and removal of external auditors to company management. The removal of the auditor during the course of the year is often a strong signal of significant disagreement as to the audit function or the completeness of reporting.</p> <p>Starting on January 1, 2001, the auditors of banks, pension and mutual funds, and insurance companies, will have an obligation to inform the regulator immediately of a breach of law, the existence of a tangible threat to the viability of the company, or if there are circumstances that may lead to the issue of a qualified audit opinion. This new obligation represents a positive step toward early involvement of the regulator in circumstances where prompt regulatory intervention may reduce the costs to investors and the financial system. However, it is still premature to assess how it will be applied.</p> <p>Auditors can be sued by the company or by shareholders if the auditors do not properly conduct the audit, with a resultant loss to the company or the shareholder. Auditors are required to insure against liability claims.</p>

	Internal auditors can play an important role in complementing the external audit function by monitoring internal controls and governance standards. Efforts are underway through the Union of Internal Auditors to increase awareness of the internal auditor role, and to encourage international best practices in the selection and functioning of internal auditors.
Assessments	Materially non-observed. The rating is a consequence of the continuing lack of independence of external auditors, the failure of the external auditing function to perform its expected role in a number of important cases, and the failure of the Chamber of Auditors to exercise pro-actively its self-regulatory powers. The fact that the MoF retains the power to set accounting standards tends to impair the development of appropriate accounting charts for different sectors, and to subject it to tax considerations.
Comments	<p>The government should proceed with amendments to the Accounting Law to provide for the creation of an independent body representative both of the accounting profession and the business community with responsibility for setting accounting standards.</p> <p>The independence of auditors is potentially compromised by the absence of protective rules for the appointment and removal of auditors. Audit committees, preferably with independent members, should nominate and deal with the external auditors. Any proposal by management to remove the auditor during the year should be notified to the relevant supervisor with a statement of reasons. The supervisor should be empowered to discuss with the auditors the reasons for their dismissal. Finally, the removal of the auditor should require the approval of the shareholders in general meeting. The auditor should be entitled to attend the meeting and to speak before the resolution is voted on.</p>
Principle 13.	<p>The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.</p> <p>Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interests of the company and the shareholders. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders equally. The board should ensure compliance with applicable law and take into account the interests of stakeholders. The board should be able to exercise objective judgment on corporate affairs independent, in particular, from management. In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.</p>
Description	<p>A slow evolution is taking place in regard to the roles of members of supervisory and management boards, partly under the pressure of strategic shareholders, and partly through clearer legal responsibilities and liabilities. In a two tier board system, the supervisory board should represent all the shareholders and should be made up of individuals who are not connected with management. The supervisory board function is to oversee the management board and supervisory board members should therefore have relevant professional and technical skills. The management board is drawn from the senior executives of the company, though it may also include non-executives who are familiar with the business of the company.</p> <p>The by-laws of the company may grant the supervisory board the power to remove members of the management board. The ability of the supervisory board to effectively oversee the management board is limited by the absence of a general power for the supervisory board to remove management board members for poor performance. Though individual company by-laws may grant this power, generally the power of removal of management board members rests with the shareholders in general meeting.</p> <p>Supervisory and management board members are elected by the shareholders’ meeting. Minority shareholders have little influence over the appointment or removal of board</p>

	<p>members, which is dominated by the majority shareholders acting in their own interests. There is no right of cumulative voting. However, board members owe a duty to act in the best interests of the company. The duty is enforceable by a minority shareholder if the company fails to do so.</p> <p>There is no requirement under Czech law or the listing rules of the PSE for any of the members of either the supervisory or management board to be independent of management or of any business or other relationship with the company or its major shareholders. The CSC draft code of corporate governance recommends that not less than 25 percent of the members of the supervisory board should be independent. The Institute of Directors draft code recommends that one third of the supervisory board be independent. The OECD Principles suggest that Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest, especially in financial reporting, nomination of board members, and executive and board remuneration.</p> <p>The responsibilities of board members are set out in the Commercial Code and are expanded in laws concerned with investment funds and investment companies, pension funds and banks. Directors are required to act in the interests of the company. If they fail to do so, they may be sued by the company. Minority shareholders representing at least 5 percent of the issued capital, or 3 percent for companies with a capital of CZK 100 million or more, are able to demand that the supervisory board take action and, if the board does not do so, the shareholders are entitled to launch an action themselves.</p> <p>From January 1, 2001, persons who are able to substantially influence the actions of the company will also bear the same liability as directors. This expansion of the scope of director liability is a useful step to create accountability for persons exercising effective day-by-day control over the operations of the company while otherwise remaining an employee.</p> <p>The effectiveness of these private legal remedies will ultimately depend upon the ability of companies and shareholders to obtain an enforceable judgment against the director through the court system. In this respect, there is little confidence amongst market participants or regulators that the court system can be relied upon. Court proceedings are slow, commonly last three or more years, expensive (with court costs of 4 percent of the amount of the claim and further fees payable for enforcement of judgments) and unreliable. Judges have limited awareness of economic and commercial matters, particularly those which raise questions of business judgment. Because of the strong tendency to interpret laws literally rather than to seek to give them a reasonable interpretation, cases of this kind are often difficult to bring within the exacting requirements of the written law.</p>
Assessment	<p>Not observed. The principle has been considered to be non-observed, because of the dominance of supervisory boards by majority shareholders, the lack of independent directors and, especially, by serious doubts as to the ability of the courts to provide effective support for enforcement of directors' duties to act in the best interests of all shareholders.</p>
Comments	<p>The introduction of cumulative voting, along with power for the supervisory board to remove a member of the management board, would enhance minority shareholder protection, as would progress toward the introduction of a critical mass of independent directors on company boards.</p> <p>International best practice is for committees of the supervisory board to be created to deal with the audit function (oversight of the internal auditor, nomination of the external auditor, review of financial statements and audit report), nomination of board members and</p>

	remuneration of the board. Remuneration is in the Czech Republic decided by the general assembly. Though some of the largest Czech companies have established one or more supervisory board committees, the benefits are diluted in the absence of independent members of the board to be appointed to the committees. Reform of the court system will remain a major requirement to enhance the accountability of board members.
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Table 16. OECD Principles of Corporate Governance: Observance of Individual Principles

Principle	O ⁶⁵	LO ⁶⁶	MNO ⁶⁷	NO ⁶⁸	NA ⁶⁹	Comments
1. Basic shareholder rights		X				<p>The recent changes to the Commercial Code and Securities Act have reinforced the clarity of the basic rights of shareholders of joint stock companies. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.</p> <p>Other actions required are the issue by the MoF of a regulation specifying the content of annual reports, and actions to ensure that boards are aware of and comply with their responsibility for ensuring open access by shareholders and their representatives to shareholder meetings.</p>
2. Fundamental corporate changes		X				<p>The recent changes to the Commercial Code have reinforced the rights of shareholders to participate in fundamental corporate changes. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.</p>
3. Shareholder meetings	X					
4. Proportionate control		X				<p>The recent changes to the Commercial Code have reinforced the disclosure requirements for material shareholdings and substantially strengthened the obligations of controlling persons to avoid any abuse of that position. Nonetheless, it is too early to say with</p>

⁶⁵ O: Observed.

⁶⁶ BO: Broadly observed.

⁶⁷ PO: Partly observed.

⁶⁸ NO: Nonobserved.

⁶⁹ NA: Not Applicable.

Principle	O ⁶⁵	LO ⁶⁶	MNO ⁶⁷	NO ⁶⁸	NA ⁶⁹	Comments
						confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.
5. Markets for control		X				The recent changes to the Commercial Code have created a comprehensive takeover regime, including oversight powers for the CSC. Nonetheless, it is too early to say with confidence how these changes will be interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating. The new oversight powers granted to the CSC may require additional staff should takeovers grow in importance.
6. Equal treatment of shareholders	X					
7. Procedures for shareholder meetings	X					
8. Insider trading			X			Insider trading and self-dealing have been widely reported and rapid progress with improvements in detection and enforcement is a critical test for the credibility of the regulatory regime and the capital markets. In this respect, the CSC monitoring and enforcement units should be better resourced.
9. Insider disclosure			X			The Commercial Code should be changed to include an express obligation on board members and managers to disclose any material interests in transactions to be entered into by the company. They should not thereafter be involved in the decision-making process. The provisions of the Commercial Code regarding material transactions with insiders should also be strengthened to ensure their application to a broad range of such transactions.
10. Rights of stakeholders			X			Creditors are an important source of pressure for improved corporate governance and for the efficient operation of companies. While their rights to enforce debt claims are weak, their role as external monitors of management remains under-developed.
11. Corporate disclosure		X				The recent changes to the Securities Act have created a comprehensive disclosure regime, including oversight powers for the CSC. Nonetheless, it is too early to say with confidence how these changes will be

Principle	O ⁶⁵	LO ⁶⁶	MNO ⁶⁷	NO ⁶⁸	NA ⁶⁹	Comments
						<p>interpreted and applied. Accordingly, demonstrated progress in implementation will be required to achieve a higher rating.</p> <p>Remaining areas for full disclosure are remuneration of senior managers and governance policies. These matters could be included in a regulation on disclosure now under preparation by the MoF in consultation with the CSC.</p>
12. Accounting and auditing			X			<p>Progress should be made toward a shift of responsibility for accounting principles to an independent body representative both of the accounting profession and the business community. This process could be launched by requiring the MoF to issue principles after consultation with affected groups.</p> <p>The independence of auditors is potentially compromised by the absence of protective rules for the appointment and removal of auditors. Audit committees, preferably with independent members, should nominate and deal with the external auditors. Any proposal by management to remove the auditor during the year should be notified to the supervisor with a statement of reasons. The supervisor should be empowered to discuss with the auditors the reasons for their dismissal. Finally, the removal of the auditor should require the approval of the shareholders in general meeting. The auditor should be entitled to attend the meeting and to speak before the resolution is voted on. The chamber of auditors must adopt a more pro-active approach in exercising its self-regulatory powers.</p>
13. Board responsibilities				X		<p>The introduction of cumulative voting, along with power for the supervisory board to remove a member of the management board, would enhance minority shareholder protections, as would progress toward the introduction of a critical mass of independent directors on company boards.</p> <p>The court system remains a major impediment to accountability of board members.</p>

Response to the assessment and recommended plan of action

Response to the assessment

158. While agreeing with the assessment, the authorities provided the following clarification with respect to Principle 12: Amendments to the Accounting Law are under discussion and should be in effect from January 1, 2002. A priority of the amendments is to harmonize the Czech accounting legislation with EU accounting practices. New accounting procedures for financial institutions (banks, investment companies, investment funds, and insurance companies) have also been discussed with relevant supervisory agencies.

Recommended plan of action

159. To strengthen further the quality of corporate governance, the regulatory authorities should consider the following measures:

- Strengthen the capacity of the CSC to monitor insider trading and self-dealing by directors and managers.
- Strengthen requirements for the disclosure by insiders of interests in transactions and for shareholder approval.
- Establish a consultation process for the continuing revision of accounting principles to approximate international best practices in conjunction with the business community and accounting and auditing representatives.
- Clarify the disclosure requirements for regular and periodic reporting by listed companies, and actively monitor compliance through the CSC.
- Strengthen the independence of external auditors.
- Encourage the completion of a voluntary corporate governance code in consultation with the business community, regulators, the Institute of Directors and the PSE.
- Introduce cumulative voting for supervisory boards, require that the supervisory boards of listed companies have the power to remove members of the management board for cause, and encourage the appointment of independent directors to supervisory boards.
- Strengthen the capacity of the CSC to monitor compliance by listed companies concerning shareholder participation in general meetings and to impose sanctions where appropriate.
- Strengthen the capacity of the courts to provide effective and prompt resolution of civil and criminal litigation concerning the responsibilities of companies, directors, managers and auditors.

VII. CPSS CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS AND TRANSPARENCY OF PAYMENT SYSTEM OVERSIGHT

A. The CPSS Core Principles

Information and methodology

160. This assessment pertains specifically to the interbank payment mechanism known as the Clearing and Settlement Center of the CNB, often referred to as the Clearing Center (or the CC for short). This real-time, gross-settlement (RTGS) system is owned and operated by the central bank, and it is the only payment clearing mechanism in the Czech Republic, handling both large and small value transactions. The direct participation in the CC is compulsory for all licensed banks. The system processes transactions that are initiated either directly by banks, or indirectly as a result of their customers' credit transfer orders, cheques, payment card or stock exchange purchases. In sum, the CC is the heart of the Czech payment system. It is systemically important, and thus the subject of assessment according to the CPSS Core Principles for such systems.

161. The assessment⁷⁰ was based on information provided by the CNB in the form of the BIS Red Book titled Payment Systems in the Czech Republic; the Czech chapter in the ECB Blue Book on payment systems in countries that have applied for membership in the European Union; answers to the IMF questionnaire with regard to payment and securities clearing and settlement issues; the 1992 Regulation of the State Bank of Czechoslovakia; the 1993 CNB Act; and the text of the revised National Bank Act which was adopted by Parliament during the mission's stay in Prague, together with a principles document for an Act on Payment Systems. These sources were supplemented by discussions held with officials of the CNB, the Czech Bankers Association, and officials of UNIVYC, the clearing subsidiary of the PSE. The individuals involved were both knowledgeable and cooperative. A fuller assessment of the payments system broadly defined was limited by the fact that time did not permit an examination of many of other relevant laws such as the Czech Republic's commercial code and its bankruptcy law.

Institutional and market structure

162. The CNB and the licensed banks form the backbone of the Czech payment system. While the banks provide most of the payment services to the general public, the CNB plays the principal role in establishing and operating the interbank clearing system, the CC. The CNB provides operating accounts for the Government, and the deposit accounts that banks must open at the CNB are used for the settlement of all payment transactions between these entities. The rules governing the use of these accounts are found in the 1992 Regulation promulgated by the CNB.

⁷⁰ Conducted by James Dingle (Bank of Canada).

163. As in other countries, there are close links in the Czech Republic between the securities markets, the foreign exchange market, and the payments system. There are three securities clearing mechanisms, each of which uses the CC system in order to effect the necessary settlements each day. The koruna leg of foreign exchange transactions involves payments moving between pairs of banks, via the CC system, two business days after the purchase and sale contracts are negotiated.

164. The CNB has explicit legal responsibility for the Czech payment system. Section 2 of the recently enacted National Bank Act states that the primary objective of the Czech central bank shall be to maintain price stability. In accordance with this objective, the CNB shall “administer payments and clearing between banks, promote their smooth and efficient operation, and contribute to ensuring sound and efficient payment systems and to their development.” This citation indicates that such smooth and efficient operations are viewed as necessary conditions for the effective conduct of monetary policy. The CNB’s basic approach to payment system policy is that it should develop and run the Clearing Center at the heart of the system, marshalling as necessary the cooperation of the private banks.

General preconditions for payment system oversight

165. There is not as yet a specific law regulating the payment system in the Czech Republic. Payments involving private individuals and legal entities are considered to occur in a civil law relationship and hence they are subject to the Civil Code (1964) and the Commercial Code (1992). These codes also contain the basic principles on which banking contracts are based. Interbank payment and settlement arrangements are shaped by the 1992 regulation that is binding on all banks in the republic. In the same year, the State Bank of Czechoslovakia issued the General Terms and Conditions (amended in 1994 and 1997 by the CNB) that serve, on the basis of a “gentleman’s agreement” with the banks, as the model for these institutions when they create their own terms and conditions for opening accounts and providing payment services to customers. The principles of a uniform interbank payment system, as well as the rules for handling misdirected payments, are stipulated in the 1998 amendment of the 1992 Banking Act. A law providing the rules on bankruptcy was passed in 1992 and amended in 1998. At the moment, a bank ceases to function legally only when the appropriate statements are physically posted by officials of the relevant court. The CNB would immediately thereafter block all further CC transactions involving that institution; it would not unwind earlier transactions.

166. The CNB has drafted and submitted the principles for a Payment System Act that could be enacted by the Czech Parliament in 2001. Upon its passage, this act should achieve full compliance with the relevant EU Directives, including those concerned with cross-border payments and finality, as well as with the EU Recommendation concerning transactions made using electronic payment instruments.

Principle-by-principle assessment

167. The following assessment of the Clearing and Settlement Center of the CNB (the CC) is based on the guidance provided in the BIS document titled “Core Principles for Systemically Important Payment Systems,” specifically the text on the CPSIPS published by that institution early in 2001 (the final draft version being available for use in the conversations with the relevant officers of the CNB late in 2000).

Table 17. CPSIPS: Principle-by-Principle Assessment

Principle 1. The system should have a well-founded legal basis under all relevant jurisdictions.	
Description	The legal basis for the CC lies in the 1992 Regulation promulgated by the CNB, and the 1998 amendments to the Banking Act. The CNB has signed a standard agreement with each licensed bank, governing the operation of their settlement accounts held at the central bank. There have been occasional revisions to these agreements caused by technical or legal considerations. Such revisions are discussed with the banks in draft form. The changes are made simultaneously in the agreements with every bank.
Assessment	Largely observed.
Comments	The new Payments System Act, which should be passed in 2001, will incorporate some of the provisions of the 1992 Regulation regarding settlement accounts, and will provide for the licensing and oversight by the CNB of any private-sector initiated interbank payment mechanism. While this is not anticipated, the new law would ensure that the competition from an alternative structure to the CC would at least be legally possible. This in turn would satisfy an EU Directive. The new law will state that payments made in the CC are irrevocable, and will establish their treatment in a bankruptcy situation.
Principle 2. The system’s rules and procedures should enable participants to have a clear understanding of the system’s impact on each of the financial risks they incur through participation in it.	
Description	The CC system is designed in such a way that the task of credit-risk management with respect to any bilateral clearing gain from another bank is effectively taken over by the CNB. Specifically, no bank can move into a daylight overdraft position in the RTGS process. All funds transfers are irrevocable. Individual transactions held in a sending bank’s queue are not at present revealed to the receiving bank, hence reducing the risk of overly prompt crediting by the latter institution of the ultimate beneficiary’s account. (An amendment to the Regulation governing the operation of settlements accounts is being prepared; this will permit the CC system to provide a listing of the amounts of each payment held in a receiving bank’s queue.)
Assessment	Fully observed.
Comments	The CC system was designed according to contemporary payment system architecture specifically to minimize systemic risk, and it achieves this result. The fact that every transfer is simultaneously covered either by deposits held at the CNB or by high quality securities pledged to the CNB effectively protects each bank from any risk associated with an incoming transfer —regardless of the legal or financial status of the sending bank at that moment.
Principle 3. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.	
Description	The descriptive details provided for Principle 2 imply that there is no credit risk attached to any incoming transfer which has passed through the CC. Liquidity risk does not exist in the CC system because all processed transfers are final and irrevocable. (Liquidity risk outside the payment system remains a normal banking consideration, of course, because a sending bank that is expected to fulfill a contracted obligation to pay may, in the event, not do so. The usual protection against this type of risk is the establishment of trading limits, interbank deposit

	“lines,” etc., with respect to a questionable institution.)
Assessment	Fully observed.
Comments	
Principle 4.	The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.
Description	The RTGS design of the CC system by definition means each incoming transfer causes a simultaneous credit to the settlement account of the receiving bank. Since that credit is irreversible, the bank can immediately make a corresponding credit to the beneficiary’s account, if this is not the bank itself, without exposing itself to any risk associated with the beneficiary’s subsequent dispersal of the funds.
Assessment	Fully observed.
Comments	
Principle 5.	A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.
Description	The CC system does not involve netting.
Assessment	Not applicable.
Comments	
Principle 6.	Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk.
Description	The assets used for settlement are claims on the central bank.
Assessment	Fully observed.
Comments	
Principle 7.	The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.
Description	The CC system has a high degree of security. For example, access to a particular terminal requires the use of a unique integrated circuit “token” which provides the corresponding authorized user with a PIN which varies almost continually over time. Security procedures are reviewed regularly. Operational reliability of the CC is enhanced by a hot back-up system. Full recovery should occur within one hour, including the time to relocate staff to the alternative operating site should this be necessary. Contingency plans are regularly reviewed and they are tested with all banks annually, pursuant to a clause in the agreements with the CNB.
Assessment	Fully observed.
Comments	
Principle 8.	The system should provide a means of making payments, which is practical for its users and efficient for the economy.
Description	The CC system provides a sophisticated, low risk payment facility for banks and indirectly for all users of the payment system broadly defined. The charges to the banks are low, less than CZK 2 on average per transfer. These fees are intended to recover the development and operating costs borne by the CNB in providing the interbank service. The relevant officers at the CNB reported no complaints from banks. The individuals and institutions of the economy can use any one of a fairly wide range of payment media, all of which are supported, as far as clearing is required, by the CC system. They pay between CZK 4 and CZK 6 on average per transfer.
Assessment	Observed.
Comments	The fees charged to banks using the CC system are low – about CZK 2 on average per transfer. The banks do not view the necessary pledging of collateral as a significant cost.
Principle 9.	The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
Description	Direct and full access to the CC system is compulsory by law for every licensed bank. All banks, whether domestic or foreign, are participants. Credit unions must rely indirectly on banks for clearing services. Direct access is permitted to some seven “third-party” participants such as securities clearing entities and card-payment processing companies which effect credit

	transfers electronically from one bank to another bank for their settlement purposes.
Assessment	Fully observed.
Comments	There would appear to be no type of institution in the Czech Republic that desires direct access to the CC and yet is unable to participate in this manner.
Principle 10.	The system's governance arrangements should be effective, accountable and transparent.
Description	Relevant information on the CC system is readily available in the ECB Blue Book on payment systems in countries that have applied for membership in the European Union, pages 88-92, dated August 1999. Major CNB decisions relating to governance, such as changes in the 1992 Regulation, are made following the provision of draft text for comments to a standing committee of the Czech Bankers Association. High-level decisions have been communicated to the relevant users of the system in the publication of the initial (principles) version of the new Payment System Act. The system is charging transaction fees that are fully recovering the costs associated with it. Finally, as indicated in this assessment, the CC system stands up well against the other nine Core Principles, and is judged to satisfy most of the requirements of the Code of Good Practices on Transparency in Monetary and Financial Policy.
Assessment	Largely observed.
Comments	The officers in charge of this relatively new, central-bank owned system consult with, and report decisions to, the user banks (and their clients) in a low-keyed practical manner. In addition, the Executive Director of the CNB Payment Systems Department is a member of the Board of the UNIVYC securities clearing mechanism. The CNB should publish aggregate information on its emergency support to troubled banks, and should provide adequate legal protection for its officials while they are performing payment-related duties.
Addendum.	Responsibilities of the Central bank in Applying the Core Principles A: The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems. B: The central bank should ensure that the systems it operates comply with the core principles. C: The central bank should oversee compliance with the core principles by systems it does not operate and it should have the ability to carry out this oversight. D: The central bank, in promoting payment system safety and efficiency through the core principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.
Description	A. The monetary and payment system objectives of the central bank are set done in Section 2 of the National Bank Act, as quoted above in the Institutional and Market Structure Overview. The current example of a policy statement is the initial version of the new Payment System Act. B. The CC system which is operated by the CNB observes, or largely observes, all relevant Core Principles. C. There are no other systemically important payment systems in the Czech Republic. D. The CNB is in close contact with the officials in the ECB who are concerned with the payment system conditions for accession to the EU. There is also a good working relationship with the senior officer of CHIPS in New York, partly because the CC system and CHIPS use the same UNISYS operating environment.
Assessment	Largely observed.
Comments	There would be a broad social benefit from a well-designed booklet on the CC system. This should be written for a wide audience in the Czech Republic and abroad.

Table 18. CPSIPS: Observance of Individual Principles

Principle	Gradings					Comments and Corrective Actions
	O ^{1/}	LO ^{2/}	MN ^{3/}	NO ^{4/}	NA ^{5/}	
1. Payment systems' legal basis		x				The draft Payments System Act needs to be enacted prior to accession to the EU.
2. Payment systems' rules and procedures should enable participants to understand financial risks of participation	x					
3. Clearly defined procedures for management of credit and liquidity risks	x					
4. Prompt final settlement on the day of value	x					
5. Timely completion of daily settlements under multilateral netting in the event of inability to settle by the participant with the largest single settlement obligation					x	
6. Assets for settlement	x					
7. Security and operational reliability, and contingency arrangements	x					
8. Practical for the markets and efficient for the economy	x					

9. Objective and publicly disclosed criteria for participation	x				
10. Governance of the system should be effective, transparent and accountable		x			The CNB should publish aggregate information on its emergency support to troubled banks, and should provide adequate legal protection for its officials while they are performing payment-related duties. There would be a broad social benefit from a well-designed booklet on the CC system. This should be written for a wide audience in the Czech Republic and abroad.
Responsibilities of the Central Bank in Applying the Core Principles		x			

^{1/} O: Observed.

^{2/} LO: Largely observed.

^{3/} MNO: Materially non-observed.

^{4/} NO: Non-observed.

^{5/} NA: Not applicable.

Response to assessment and recommended action plan

Response to the assessment

168. The CNB is in agreement with the assessment. Minor corrections in matters of fact were made which have been incorporated in the assessment.

Recommended action plan

169. It is widely recognized that the draft Payments System Act needs to be guided through the bureaucratic processes and enacted by Parliament prior to the accession of the Czech Republic to the EU.

170. The CNB should publish, after an appropriate time lag, aggregate information on its emergency support to troubled banks. It should in due course seek changes to the National Bank Act in order to provide adequate legal protection for its officials while they are performing payment-related duties.

171. The CNB should prepare a well-designed booklet describing the CC system in both Czech and English. This should be written for a wide audience in the Czech Republic and abroad.

B. Transparency of Payment Systems Oversight

Information and methodology

172. The assessment of transparency practices in payment systems oversight in the Czech Republic was undertaken by a two-member team⁷¹ and was based on: (1) a pre-FSAP questionnaire response; (2) relevant laws and regulations;⁷² and (3) discussions with officials from the Payment Systems Department of the CNB. The assessment was based on the *IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Transparency Code)*. No assessment methodology has been developed as yet, but the assessment has taken into account the implementation issues mentioned in the *Supporting Document* to the Code.

173. The Czech authorities cooperated fully with the assessment and provided all the necessary clarification and documents.

Institutional and market structure

174. The CNB is the sole supervisor of payment systems in the Czech Republic. Under the current provisions of the Banks Act, CNB also has a monopoly over the establishment and management of the interbank payment systems. This is expected to change in the near future, even though amendments in the Banks Act to that effect were recently rejected by Parliament. Currently, there is only one interbank payment system, namely the Clearing and Settlement Center, which is operated by CNB since 1992.

175. Within the CNB, the Payment Systems Department is responsible for managing the non-cash payment system, for developing and running the automated accounting and payment system at the CNB and the interbank settlement system (the Clearing and Settlement Center). A member of the CNB's supreme managing body (the Bank Board) oversees the activities of this department and submits for approval by the Bank Board proposals for changes in secondary legislation on payment systems' operation and oversight. In carrying out its supervisory responsibilities over the payment systems in the Czech Republic, the CNB is guided by the objective, stated in the CNB Act, to promote the smooth and efficient operation of the payments and clearing between banks, and contribute to ensuring sound and efficient payment systems and to their development. For a complete description of the institutional and macro prudential setting, and of the interbank payment system, see the Assessment of Observance of CPSS Core Principles for Payment Systems in the Czech Republic.

⁷¹ Udaibir S. Das and Plamen Yossifov (IMF) and James Dingle (Bank of Canada).

⁷² Act No 6/1993 on the CNB (CNB Act), as amended through December 2000, Act 21/1992 Coll. on Banks (Banks Act), as amended through December 2000, and CNB Regulation on Interbank Relations and Settlement of 1992 as amended.

Practice-by-practice assessment

176. The assessment of observance with each practice of the *MFP Transparency Code* is made on a qualitative basis based on existing laws and regulations, and practices. A five-part assessment system is used: observed; broadly observed; partly observed, not observed; and not applicable: **observed**, implying full observance or with insignificant shortcomings; **broadly observed**, where minor weaknesses exist and these are not seen as being of a significant nature so as to raise serious doubts about the authority’s ability to achieve the objective of that practice; **partly observed**, where shortcomings are sufficient to raise doubts about the authority’s ability to achieve observance and which could affect the operational process and effectiveness of financial policies; **not observed**, where the practice is not being observed and no substantive progress has been recorded toward achieving the objectives of the practice; and **not applicable**, where, due to the country circumstances and the institutional and legal framework, the transparency practice is not applicable.

Table 19. Payment Systems Transparency: Practice-by-Practice Assessment

V. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF FINANCIAL AGENCIES RESPONSIBLE FOR FINANCIAL POLICIES	
5.1	The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.
Description	<p>The primary objective of the CNB, as defined in the CNB Act, is to maintain price stability. In accordance with its primary objective, CNB is entrusted to administer payments and clearing between banks, promote their smooth and efficient operation, and contribute to ensuring sound and efficient payment systems and to their development.</p> <p>Within the CNB, the Payment Systems Department is responsible for managing the non-cash payment system, for developing and running the automated accounting and payment system at the CNB (ABO2) and the interbank settlement system (clearing), and for the conception, methodology and operation of the short-term bond market system (TKD). A member of the Bank Board oversees and the activities of this department. She submits for deliberation and approval proposals for changes in secondary legislation on payment systems oversight to the Bank Board.</p> <p>References: CNB Act,⁷³ Article 2.</p>
Assessment	Observed
Comments	
5.1.1	The broad objective(s) of financial agencies should be publicly disclosed and explained.
Description	<p>The primary objective of the CNB, as defined in the CNB Act, is to maintain price stability. In accordance with its primary objective, the CNB is entrusted to administer payments and clearing between banks, promote their smooth and efficient operation, and contribute to ensuring sound and efficient payment systems and to their development.</p>

⁷³ Act No 6/1993 on the CNB, as amended through December 2000.

	References: CNB Act, Article 2.
Assessment	Observed
Comments	
5.1.2	The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.
Description	<p>According to the recently amended CNB Act, the CNB is entitled to operate systems for interbank payments. In order to ensure uniform payment and clearing in the Czech Republic, the CNB is given the power to issue secondary legislation on the manner of execution of payments between banks and account clearing at banks, and of use of payment instruments by banks within the payments system.</p> <p>References: CNB Act, Article 38.</p>
Assessment	Observed
Comments	
5.1.3	Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.
Description	<p>The recently amended CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of the Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed and testify. In addition, upon a resolution of the Chamber of Deputies, the CNB must submit within 30 days an extraordinary report on monetary development. The resolution of the Chamber of Deputies must state what the extraordinary report should contain. The Chamber of Deputies can either acknowledge the report on monetary development or ask for a more accurate and complete report, which must be submitted within six weeks and should be in compliance with the requirements of the Chamber of Deputies. The reports mentioned above can contain a section on the developments in the payment systems.</p> <p>The recently amended CNB Act stipulates that CNB's operating budget must be approved by the Chamber of Deputies. The funding of the Payment Systems Department is determined as part of this operating budget.</p> <p>The CNB Act also obliges the central bank to publish Annual Reports. In each Annual Report, there is a separate chapter on the payment system (www.cnb.cz/en/o_cnb/vz.htm).</p> <p>References: CNB Act, Articles 3, 5, 47, 48.</p>
Assessment	Observed
Comments	
5.1.4	Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.
Description	<p>The procedures for appointment, terms of office, and the general criteria for removal of the heads and members of the governing body of CNB are specified in the CNB Act.</p> <p>References: Constitution, Article 62; CNB Act, Articles 5 and 6.</p>
Assessment	Observed
Comments	
5.2	The relationship between financial agencies should be publicly disclosed.
Description	CNB is the sole supervisor of payment systems in the Czech Republic.
Assessment	Not applicable
Comments	

5.3	The role of oversight agencies with regard to payment systems should be publicly disclosed.
Description	According to the recently amended CNB Act, the CNB is entitled to operate systems for interbank payments. In order to ensure uniform payment and clearing in the Czech Republic, the CNB is given the power to administer payments and clearing between banks and issue secondary legislation on the manner of execution of payments between banks and account clearing at banks, and of use of payment instruments by banks within the payments system. References: CNB Act, Articles 2, 38; Banks Act, ⁷⁴ Article 20b.
Assessment	Observed
Comments	
5.3.1	The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.
Description	The 1992 Regulation on Interbank Relations and Settlement is revised from time to time as necessary to reflect the evolution of general policy principles. Any change in detail, such as risk management policies, information provision, etc., is discussed in a timely manner with the Committee on Payments and Payment Instruments of the Czech Bankers Association. (The consultation period was described as lasting six months.) Substantive changes lead to additional or revised clauses in the settlement account agreements between the CNB and each bank.
Assessment	Observed
Comments	
5.4	Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.
Description	Not applicable
Assessment	Not applicable
Comments	
5.5	Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they should be guided by the same good transparency practices specified for financial agencies.
Description	Not applicable
Assessment	Not applicable
Comments	
VI. OPEN PROCESS FOR FORMULATING AND REPORTING OF FINANCIAL POLICIES	
6.1	The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.
Description	The general policy principles of the operation of the payment system are specified in CNB regulation, which is readily available to system's participants and the general public. The operating procedures of the payment system and fees charged are distributed in the form of a bilateral agreement between the CNB and individual participants. The CNB publishes Annual Reports, in which there is a separate chapter on the payment system.
Assessment	Broadly observed
Comments	It would be advisable to broaden the coverage of the chapter on payment system to include a more detailed description of its operation, explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.).

⁷⁴ Act 21/1992 Coll. on Banks, as amended through December 2000.

6.1.1	The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.
Description	The general policy principles of the operation of the payment system are laid down in the 1992 Regulation on Interbank Relations and Settlement, which is revised as necessary to reflect the evolution of general policy principles. It is published in the Collection of Laws, issued as a circular, and published in the non-periodic publication "Vestník." The operating procedures of the payment system are distributed in the form of a bilateral agreement between the CNB and individual participants.
Assessment	Observed
Comments	
6.1.2	The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.
Description	In the case of payment systems oversight, there is no need for financial reporting as all the data necessary for the running of the payment systems operated by CNB is readily available to CNB staff (settlement accounts of banks at the CNB, value and number of transactions, etc.).
Assessment	Not applicable
Comments	
6.1.3	The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.
Description	Not applicable
Assessment	Not applicable
Comments	
6.1.4	Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.
Description	The schedule of fees charged per transaction in the payment system run by the CNB is appended to the settlement account agreement of each bank.
Assessment	Observed
Comments	
6.1.5	Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.
Description	Currently, CNB is the sole operator of payment systems in the Czech Republic. There are no formal procedures for information sharing and consultation with other agencies.
Assessment	Not applicable
Comments	
6.2	Significant changes in financial policies should be publicly announced and explained in a timely manner.
Description	CNB regulations are promulgated in the Collection of Laws, issued as circulars, published in the non-periodic publication "Vestník," and some of them are available on the CNB website (www.cnb.cz/en/_legislativa). A list of all regulations issued by CNB is available on its website (www.cnb.cz/_legislativa/seznam/p/seznam-p1.htm). These regulations are available for inspection at the CNB Special Library in Prague and in the secretariats of the Executive Directors of CNB branches.
Assessment	Observed
Comments	
6.3	Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.
Description	The CNB publishes Annual Reports, in which there is a separate chapter on the payment system (www.cnb.cz/en/_o_cnb/vz.htm).
Assessment	Partly observed

Comments	It would be advisable to broaden the coverage of the chapter on payment system to include explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.).
6.4	For proposed substantive technical changes to the structure of financial regulations, there should be a presumption in favor of public consultations, within an appropriate period.
Description	The 1992 Regulation on Interbank Relations and Settlement is revised from time to time as necessary to reflect the evolution of general policy principles. Any change in detail, such as risk management policies, information provision, etc., is discussed in a timely manner with the Committee on Payments and Payment Instruments of the Czech Bankers Association. The consultation period was described as lasting six months. Substantive changes lead to additional or revised clauses in the settlement account agreements between the CNB and each bank.
Assessment	Observed
Comments	
VII. PUBLIC AVAILABILITY OF INFORMATION ON FINANCIAL POLICIES	
7.1	Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.
Description	The CNB publishes Annual Reports, in which there is a separate chapter on the payment system (www.cnb.cz/en/ o_cnb/vz.htm http://www.cnb.cz/en/ o_cnb/hospodareni_cnb.htm). Descriptions of the Czech payments system in the “Red Book” of the Bank for International Settlements, and the “Blue Book” of the European Central Bank. These publications, however, has not been translated in Czech and are not accessible by the general public. The publication of the Blue Book was announced in a press-release by CNB, and posted on its website with a link to the full-text in English (www.cnb.cz/en/ media/tz/990831.htm).
Assessment	Partly observed
Comments	It would be advisable to broaden the coverage of the chapter on payment system to include explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.). The descriptions of the payment system in the Czech Republic that have been produced in the form of a “Blue Book” and “Red Book” should be translated in Czech and made available to the general public.
7.2	Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.
Description	The chapter on the payment system in the CNB publishes Annual Reports provide some graphs presenting data on the volume and value of transaction.
Assessment	Partly observed
Comments	The usefulness of these chapters would be greatly enhanced with the provision of more detailed quantitative information on the nature of transactions carried out through the payment system.
7.3	Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.
Description	The Payment Systems Department is part of the organizational structure of CNB and its funding and expenditures are determined as part of CNB’s budget.
Assessment	Not applicable
Comments	
7.3.1	Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.
Description	Not applicable
Assessment	Not applicable

Comments	
7.4	Financial agencies should establish and maintain public information services.
Description	The Public Relations Division in CNB is responsible for issuing press-releases, organization of press-conferences and maintenance of the CNB website (www.cnb.cz/en/). The Freedom of Information Act ⁷⁵ requires CNB to respond in writing to individual requests for information within fifteen days.
Assessment	Observed
Comments	
7.4.1	Financial agencies should have a publications program, including a periodic public report on their principal activities issued at least annually.
Description	The CNB publishes Annual Reports, in which there is a separate chapter on the payment system (www.cnb.cz/en/_o_cnb/vz.htm http://www.cnb.cz/en/_o_cnb/hospodareni_cnb.htm).
Assessment	Partly observed
Comments	It would be advisable to broaden the coverage of the chapter on payment system to include explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.).
7.4.2	Senior financial agency officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.
Description	Once a year there is a meeting of all the participants in the payment system, i.e., all banks and the seven "third party" participants such as the securities clearing agencies which can initiate a transfer in the system electronically. The senior officers of the Payment System Department of the CNB participate in seminars and conferences both in the Czech Republic and abroad.
Assessment	Observed
Comments	
7.5	Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies should be readily available to the public.
Description	CNB regulations are promulgated in the Collection of Laws, issued as circulars, published in the non-periodic publication "Vestník," and some of them are available on the CNB website (www.cnb.cz/en/legislativa/vybrane.htm). A list of all regulations issued by CNB is available on its website (www.cnb.cz/legislativa/seznam/p/seznam-pl.htm). These regulations are available for inspection at the CNB Special Library in Prague and in the secretariats of the Executive Directors of CNB branches. References: Banks Act, Article 15.
Assessment	Observed
Comments	
7.6	Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.
Description	Not applicable
Assessment	Not applicable
Comments	
7.7	Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.

⁷⁵ Act No. 106/1999 Coll., on Freedom of Information.

Description	Not applicable
Assessment	Not applicable
Comments	
VIII. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY FINANCIAL AGENCIES	
8.1	Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.
Description	The CNB Act obliges the Governor of the CNB to submit to the Chamber of Deputies of Parliament at least twice a year for review a report on monetary development, attend the session on which the report is discussed and testify. References: CNB Act, Article 3.
Assessment	Observed
Comments	
8.2	Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.
Description	The Payment Systems Department is part of the organizational structure of CNB and its funding and expenditures are determined as part of CNB's budget.
Assessment	Not applicable
Comments	
8.2.1	Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.
Description	The Payment Systems Department is part of the organizational structure of CNB and its funding and expenditures are determined as part of CNB's budget.
Assessment	Not applicable
Comments	
8.2.2	Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.
Description	CNB's internal governance procedures are not publicly disclosed.
Assessment	Not observed
Comments	CNB's internal governance procedures are not publicly disclosed.
8.3	Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.
Description	The Payment Systems Department is part of the organizational structure of CNB and its funding and expenditures are determined as part of CNB's budget.
Assessment	Not applicable
Comments	
8.4	Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.
Description	There is no code of conduct of CNB officials and staff. Officials and staff of the CNB are not allowed to have a second job without permission of the Bank Board. These rules are not publicly disclosed.
Assessment	Not applicable
Comments	
8.4.1	Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.
Description	There are no legal protections for officials and staff of CNB.
Assessment	Not applicable
Comments	

Table 20. Payment Systems Transparency: Observance of Individual Practices

Principle	Gradings					Comments
	O ^{1/}	BO ^{2/}	PO ^{3/}	NO ^{4/}	NA ^{5/}	
V. Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies						
5.1 The broad objective(s) and institutional framework of financial agencies should be clearly defined, preferably in relevant legislation or regulation.	X					
5.1.1 The broad objective(s) of financial agencies should be publicly disclosed and explained.	X					
5.1.2 The responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed.	X					
5.1.3 Where applicable, the broad modalities of accountability for financial agencies should be publicly disclosed.	X					
5.1.4 Where applicable, the procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing bodies of financial agencies should be publicly disclosed.	X					
5.2 The relationship between financial agencies should be publicly disclosed.					X	
5.3 The role of oversight agencies with regard to payment systems should be publicly disclosed.	X					
5.3.1 The agencies overseeing the payment system should promote the timely public disclosure of general policy principles (including risk management policies) that affect the robustness of systemically important payment systems.	X					
5.4 Where financial agencies have oversight responsibilities for self-regulatory organizations (e.g., payment systems), the relationship between them should be publicly disclosed.					X	
5.5 Where self-regulatory organizations are authorized to perform part of the regulatory and supervisory process, they					X	

should be guided by the same good transparency practices specified for financial agencies.						
VI. Open Process for Formulating and Reporting of Financial Policies						
6.1 The conduct of policies by financial agencies should be transparent, compatible with confidentiality considerations and the need to preserve the effectiveness of actions by regulatory and oversight agencies.		X				The chapter on the payment system in the Annual Report of CNB is limited to general discussion of trends in the volume and value of transactions. It lacks a detailed description of the working of the payment system, explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.).
6.1.1 The regulatory framework and operating procedures governing the conduct of financial policies should be publicly disclosed and explained.	X					
6.1.2 The regulations for financial reporting by financial institutions to financial agencies should be publicly disclosed.					X	
6.1.3 The regulations for the operation of organized financial markets (including those for issuers of traded financial instruments) should be publicly disclosed.					X	
6.1.4 Where financial agencies charge fees to financial institutions, the structure of such fees should be publicly disclosed.	X					
6.1.5 Where applicable, formal procedures for information sharing and consultation between financial agencies (including central banks), domestic and international, should be publicly disclosed.					X	
6.2 Significant changes in financial policies should be publicly announced and explained in a timely manner.	X					
6.3 Financial agencies should issue periodic public reports on how their overall policy objectives are being pursued.			X			The chapter on the payment system in the Annual Report of CNB is limited to general discussion of trends in the volume and value of transactions. It lacks a detailed description of the working of the payment system, explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.).
6.4 For proposed substantive technical changes to the structure of financial	X					

regulations, there should be a presumption in favor of public consultations, within an appropriate period.						
VII. Public Availability of Information on Financial Policies						
7.1 Financial agencies should issue a periodic public report on the major developments of the sector(s) of the financial system for which they carry designated responsibility.			X			The descriptions of the payment system in the Czech Republic that have been produced in the form of a “Blue Book” and “Red Book.” It would be useful for a Czech translation to be made available to the general public.
7.2 Financial agencies should seek to ensure that, consistent with confidentiality requirements, there is public reporting of aggregate data related to their jurisdictional responsibilities on a timely and regular basis.			X			The usefulness of chapter on the payment system in CNB’s Annual Reports is limited by the lack of a more detailed quantitative information on the nature of transactions carried out through the payment system.
7.3 Where applicable, financial agencies should publicly disclose their balance sheets on a preannounced schedule and, after a predetermined interval, publicly disclose information on aggregate market transactions.					X	
7.3.1 Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by financial agencies should be publicly disclosed through an appropriate statement when such disclosure will not be disruptive to financial stability.					X	
7.4 Financial agencies should establish and maintain public information services.	X					
7.4.1 Financial agencies should have a publications program, including a periodic public report on their principal activities, issued at least annually.			X			The chapter on the payment system in the Annual Report of CNB is limited to general discussion of trends in the volume and value of transactions. It lacks a detailed description of the working of the payment system, explanation of its operating procedures (such as risk management policies) and a more detailed analysis of the transactions carried out through it (foreign exchange versus domestic currency settlements, counterparties, etc.).
7.4.2 Senior financial agency officials should be ready to explain their institution’s objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.	X					
7.5 Texts of regulations and any other generally applicable directives and guidelines issued by financial agencies	X					

should be readily available to the public.						
7.6 Where there are deposit insurance guarantees, policy-holder guarantees, and any other client asset protection schemes, information on the nature and form of such protections, on the operating procedures, on how the guarantee is financed, and on the performance of the arrangement, should be publicly disclosed.					X	
7.7 Where financial agencies oversee consumer protection arrangements (such as dispute settlement processes), information on such arrangements should be publicly disclosed.					X	
VIII. Accountability and Assurances of Integrity by Financial Agencies						
8.1 Officials of financial agencies should be available to appear before a designated public authority to report on the conduct of financial policies, explain the policy objective(s) of their institution, describe their performance in pursuing their objective(s), and, as appropriate, exchange views on the state of the financial system.	X					
8.2 Where applicable, financial agencies should publicly disclose audited financial statements of their operations on a preannounced schedule.					X	
8.2.1 Financial statements, if any, should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.					X	
8.2.2 Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.				X		CNB's internal governance procedures are not publicly disclosed.
8.3 Where applicable, information on the operating expenses and revenues of financial agencies should be publicly disclosed annually.					X	
8.4 Standards for the conduct of personal financial affairs of officials and staff of financial agencies and rules to prevent exploitation of conflicts of interest, including any general fiduciary					X	

obligation, should be publicly disclosed.						
8.4.1 Information about legal protections for officials and staff of financial agencies in the conduct of their official duties should be publicly disclosed.					X	

^{1/} O: Observed.

^{2/} BO: Broadly observed.

^{3/} PO: Partly observed.

^{4/} NO: Nonobserved.

^{5/} NA: Not applicable.

Response to the assessment and recommended action plan

Response to the assessment

177. The CNB was in agreement with the findings of the assessment.

Recommended action plan

178. Thought might be given to disseminate information about the operation of the payment system, its structure and safeguard mechanisms in the form of a pamphlet written in non-technical language. In this regard, the translation of the descriptions of the payment system in the Czech Republic, that have been produced in the form of a “Blue Book” and “Red Book,” might be considered.

179. The chapter on the payment system in the Annual Report of CNB should be expanded to include a more detailed analysis of the transactions carried out through the payment system (foreign exchange versus domestic currency settlements, counterparties, etc.), beside general trends. It should, furthermore, explain the CNB’s policy objectives as a supervisor of the payment system and how the changes in operating procedures contribute to the achievement of these goals.

180. More detailed quantitative information on the nature of transactions carried out through the payment system should be made available to the public on a regular basis, possibly on the CNB website.

181. The nature of CNB’s internal governance procedures should be explained to the public.