FINANCIAL MARKET SUPERVISION REPORT

2007

CZECH NATIONAL BANK

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In accordance with its mission,[1] and under the powers vested in it by the laws of the Czech Republic, the Czech National Bank (CNB) as the integrated financial market regulatory and supervisory authority works to ensure the stability of the financial system and the safe and smooth development of the financial market in the Czech Republic. A stable financial system and a dynamically developing financial market, based on financially sound and prospering financial institutions, contribute significantly to the long-term growth of the economy and are in the interests of businesses and the public alike. In exercising its supervisory powers and in its activities generally, the CNB not only strives to ensure that the entities it supervises comply with the relevant regulations, but also focuses on enhancing the institutional infrastructure of the Czech financial market and on increasing its transparency and competitiveness, its credibility in the eyes of the public and its attractiveness to business. The CNB strives to be seen as a competent, dynamic and flexible institution recognised by the market, the public and specialists for working to exacting standards and for taking a professional, sensitive, yet effective approach to the regulation of the financial market and the exercise of supervision.

The CNB performs its role of integrated regulatory and supervisory authority by means of regulatory work, licensing and authorisation work and supervisory work, consisting of off-site surveillance and on-site examinations in financial institutions and other institutions making up the infrastructure of the capital market. Other tools of integrated regulation and supervision include remedial measures and, where appropriate, penalties where the CNB uncovers shortcomings, and also the collection, compilation and evaluation of information, which is used to support supervision and to inform the public about the situation and development of the Czech financial market. In connection with the integration of financial market supervision into the CNB, a new legal obligation was imposed on the CNB to compile a Financial Market Supervision Report each year and submit it for information to the Chamber of Deputies, the Senate and the Government by 30 June of the following year.

Besides fulfilling the legal obligation, this report is also intended to inform the public about financial market supervisory activities and financial market developments in the previous year.

The report is divided into two parts. Part A deals with financial market supervision in 2007, changes in legislation affecting the financial market, the introduction of new methods to enhance the stability and transparency of the financial market, and international cooperation in the supervisory area. Part B describes developments in the individual segments of the financial market (in particular the banking sector, the capital market and the insurance sector) in 2007. Each the part contains a brief summary of the principal conclusions.

In accordance with the Act on the Czech National Bank, the draft report was submitted to the Financial Market Committee, which exercised its right to append its opinion to the report. The report was discussed and approved by the CNB Bank Board – Part A on 15 May 2008 and Part B on 12 June 2008.

1 *The Mission of the Czech National Bank for the Supervision of the Czech Financial Market;* for details, see: http://www.cnb.cz – Financial market supervision.

FINANCIAL MARKET COMMITTEE

The Financial Market Committee (the Committee) was established on the basis of Act No. 57/2006 Coll., under which financial market supervision in the Czech Republic was integrated into the Czech National Bank,[2] as an advisory body to the CNB Bank Board for financial market supervision. The Committee debates matters of a conceptual nature relating to financial market regulation and supervision and also provides its opinion on significant financial sector trends having a regulatory aspect. However, the Committee does not deal with matters concerning specific financial market entities.

The seven-member Committee comprises:
- Jiří Rusnok, Chairman, Radek Urban, Vice-Chairman and Václav Tomek (elected by the Budget Committee of the Chamber of Deputies from candidates proposed by financial market professional organisations),
- František Klufa, Financial Arbiter of the Czech Republic (who replaced his predecessor Otakar Schlossberger on 2 January 2008),
- Milan Šimáček, Deputy Finance Minister, and Libuše Horáková, Executive Director of State Inspection on the Financial Market of the Ministry of Finance (who replaced Klára Cetlová on 1 May 2008),
- Miroslav Singer, Vice-Governor of the CNB.

The members of the Committee perform their duties in person and without remuneration.

Given its composition, encompassing representatives of both the private and public sectors, the Committee is an independent forum that provides the CNB with feedback, opinions, recommendations and suggestions on matters associated with the CNB's function as the domestic financial market supervisory authority. The Committee's staffing and remit also mean that it in fact also acts in an advisory capacity to the Ministry of Finance as the central government authority for the financial market, particularly in terms of the configuration and form of future legislation governing business and supervision in this area.

In practice, detailed minutes are prepared after each Committee meeting, containing a written record of the discussion, the opinions of the individual members of the Committee and the conclusions approved by the Committee. After being approved, these minutes are passed on to the CNB Bank Board for information. To make the Committee's activities transparent, a record is also made of the main items on the agenda and the conclusions of the debate. After approval, this record is published on the CNB website (in Czech only: http://www.cnb.cz – *Dohled nad finančním trhem – Výbor pro finanční trh*). The Committee also posts the agenda of its next meeting in advance on the website and its members can, at their discretion, consult financial market professional associations on most of the documents under discussion.

By law, the Financial Market Committee should meet at least twice a year. In reality, it met four times last year (i.e. since it issued its opinion on the Financial Market Supervision Report for 2006) – on 19 June and 30 October 2007 and on 13 February and 12 May 2008. Between its meetings, the Committee deals with operational and routine matters in compliance with its Rules of Procedure by electronic communication.

As regards its specific work activities in the past period, the Committee discussed and made comments on *The Mission of the Czech National Bank for the Supervision of the Czech Financial Market,* which the CNB prepared and published at the initiative of the Committee. This document formulates the basic mission and principles of CNB financial market supervision, subdivided into visions, missions, values and principles. It is aimed at providing a long-term public declaration of the CNB as the regulatory and supervisory body of the domestic financial market, contributing to the transparency and predictability of the CNB's actions in this area and thus to the development of the Czech financial market. The Committee noted the CNB's information about its supervisory plans for 2008. Those plans are based on the aforementioned strategic document and respond to the change in the internal organisational supervisory and regulatory set-up at the central bank from a sectoral to a functional model. The Committee was informed about this change in advance and welcomed it.

Consumer protection on the financial market is another area of activity of the Committee. Despite some legislative amendments, there is still no broad substantive agreement among stakeholders in the Czech Republic on the optimal institutional framework for this issue either for general preventive supervision or for the settlement of individual complaints and disputes. The Committee is discussing, on an ongoing basis, the appropriate form and scope of involvement by the state, the CNB, the Financial Arbiter and self-regulatory or co-regulatory mechanisms in customer protection on the financial market. Closely linked with this are other issues discussed by the Committee, namely the method for setting rules for the distribution of financial products and services and support for financial literacy among the population.

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2 The position of the Financial Market Committee is governed by Articles 45a–45d of Act No. 6/1993 Coll., on the Czech National Bank, as amended by Act No. 57/2006 Coll.

The Committee's activities also include some control function. In addition to the obligation to discuss the CNB's draft financial market supervision report (see below), the CNB is required by law to provide the Committee with information on its core activities in the financial market supervision area for the past period on a six-monthly basis. Similarly, the Ministry of Finance informed the Committee about the state inspection work it performed on the financial market in 2007 in the areas of building savings schemes and pension schemes, and also about its priorities in the financial market area for 2008.

As regards the primary financial market legislation, which is the responsibility of the Ministry of Finance, the Committee generally supports, in addition to the priority task of transposing relevant European directives, the plan to unify the rules governing similar situations across the various segments of the financial market. In addition, the Ministry has drawn up statement of intent for a financial market supervision law laying down the competences and procedures on the basis of which the CNB will exercise financial market supervision. The Committee had an opportunity to express its opinion on this draft, and, despite the fact that this law will in principle not provide for (and thus not unify) the substantive regulation of the financial market, it takes the view that harmonisation of the CNB's procedures for financial market supervision will itself foster more efficient supervision of the financial market. As regards specific financial market legislation, which is undergoing changes, the Committee dealt in more detail in the past period with an amendment to the Capital Market Undertakings Act transposing the Markets in Financial Instruments Directive (MiFID) and with the new Insurance Act. The Committee also gave its backing to Czech membership of the Financial Action Task Force (FATF), the key international authority at the OECD for combating money laundering, since this would help to further develop and increase the prestige of the domestic financial market.

In its second year of life, the Financial Market Committee became a respected forum used not only by the CNB, which it officially comes under, but also by the Ministry of Finance, which is responsible for financial market legislation, as well as by market representatives themselves for informal discussion of topical issues related to the regulation and development of the Czech financial market.

Opinion of the Financial Market Committee on the CNB's Financial Market Supervision Report for 2007

The Financial Market Committee has a statutory duty to discuss the CNB's draft annual Financial Market Supervision Report before it is approved by the CNB Bank Board and submitted to the Chamber of Deputies, the Senate and the Government for information. As in 2007, the CNB agreed the draft plan and schedule for the preparation of the 2007 Financial Market Supervision Report with the Committee well in advance. The draft report was subsequently discussed by the Committee in two parts (first Part A and then Part B). The Committee members were able make comments on the draft in writing. None of them exercised the right to request the convening of a Committee meeting on this report. The Committee is entitled by law to attach its opinion to the report, which it has done in the manner given above and below.

Having acquainted itself with the last year's results of the domestic financial sector, the Committee concluded that most segments had maintained or increased their rate of growth, and from this perspective last year could be viewed as a success. With regard to the assessment of the impacts of the sub-prime crisis on the participants and stability of the Czech financial market, the Committee acknowledged thankfully that the impacts had been insignificant thanks to the prudent investment policies of domestic financial institutions. However, as regards the sectoral analysis, the Committee stated that the Czech pension fund sector – and in particular its legal and institutional framework – was in need of reform. At the very least, planholders' assets need to be separated from funds' assets and greater systemic equilibrium must be created between the assessment of pension funds' assets and the assessment of their liabilities. The Committee also calls for continued work on issues relating to consumer protection on the financial market. Nevertheless, the Committee agreed that the domestic financial market can no longer be viewed as being in its initial and transformation phases, but – enriched by its experience of these phases of development – is converging towards the advanced markets. This is how the Czech Republic should present itself externally to European and international institutions.

To sum up, the Financial Market Committee, being aware that the final version of the Financial Market Supervision Report for 2007 must also be approved by the CNB Bank Board, acknowledges this draft report and has no reservations about its content.

Prague, 5 June 2008
On behalf of the Financial Market Committee:

Jiří Rusnok
Chairman

A. FINANCIAL MARKET SUPERVISION IN 2007

SUMMARY

The major financial market supervisory activities during 2007 – linked with the ongoing integration of supervisory work into the CNB – included intensive alignment of the procedures for supervision of financial market participants, rationalisation of information duties and the preparation for the changeover to the new supervisory set-up. Since 1 January 2008, the CNB has been applying a functional model in its supervisory activities as the next step in the integration of the supervisory departments of the CNB. On this date, the newly established Financial Market Regulation and Analyses Department, Licensing and Enforcement Department and Financial Market Supervision Department began work. Financial market supervisory activities in the new organisational set-up are governed by a single supervisory concept. The CNB, as the integrated regulatory and supervisory authority, focused on unifying its licensing, authorisation and supervisory procedures. When implementing the single supervisory concept and conducting supervision, the CNB takes into account the individual risk profiles of the supervised entities.

At the end of 2007, the CNB was supervising a total of 23 banks and building societies, 19 credit unions, 34 insurance companies, 10 pension funds, 21 depositories, 121 open-end mutual funds, 31 non-bank investment firms and almost 3,000 non-bank foreign exchange entities. To a limited extent, the CNB was also supervising 14 branches of foreign banks and collecting information from 17 branches of insurance companies from the EU and 1 branch of an insurance company from outside the EU/EEA. Regulated markets (the Prague Stock Exchange and RM-Systém) are also subject to CNB supervision. In addition, the CNB approved bond issuance conditions and securities prospectuses and granted consents to takeover bid announcements and squeeze-outs. A total of 191 administrative proceedings were conducted in this area in 2007. The CNB issued brokers' licences and kept a register of investment and insurance intermediaries. The CNB also administers the Central Credit Register (CCR), which allows banks and foreign bank branches operating in the Czech Republic to exchange information on the credit commitments and payment discipline of their clients (legal entities).

In 2007, CNB staff were involved in international and European structures. Following the integration of financial market supervision into the CNB, the supervisory departments together formulate and communicate to international institutions single opinions on common issues under the functional model. Exchange of information and cooperation with foreign partner supervisors was another important aspect of supervisory work last year.

The changes made to the financial market legislation in 2007 mostly related to the transposition of European directives regulating the new capital adequacy framework (Basel II). The Act on Banks, the Act on Credit Unions, the Capital Market Undertakings Act and the Payment System Act were all amended. More legislative changes are expected in 2008 in connection with the transposition of the Markets in Financial Instruments Directive (MiFID) and with the new Insurance Act and the new Act on Certain Measures Against Money Laundering and Terrorist Financing.

As in previous years, the exercise of supervision in 2007 was based on a combination of ongoing off-site surveillance of regulated entities and comprehensive or partial on-site inspections. Off-site surveillance involves comprehensive monitoring of the overall situation and, in particular, the financial condition of supervised entities based on all the information available, the detection of shortcomings and the assessment of risks. On-site examinations are conducted on the basis of the results of off-site surveillance. Such examinations involve a detailed assessment of the methods used to identify, measure and manage the risks undertaken and verification of the effectiveness of internal control systems.

1. INTEGRATION OF FINANCIAL MARKET SUPERVISION

Following the integration of supervisory activities into the CNB the previous year, 2007 saw intensive convergence of procedures for the supervision of the various different financial market entities, further rationalisation of the system of reporting duties of market participants, and above all the preparation of a new organisational set-up for financial market supervision, changing from a sectoral model to a functional model.

The application of the functional model represents a further step forward in the integration of the supervisory units, following on logically from the earlier dissolution of the Czech Securities Commission, the Ministry of Finance's Office of State Inspection in the Insurance and Pension Scheme Industry and the Office for Supervision of Credit Unions and their integration into the CNB and the simultaneous take-over of their responsibilities as of 1 April 2006. Since 1 January 2008, integration has also been going on from the procedural perspective. The new organisational structure allows for better unification and harmonisation of procedures and approaches in the area of licensing, administrative proceedings and regulation and also for the use of synergies in the area of control and analytical procedures and individual support activities relating to data output preparation and information system management.

Starting from 2008, the original Banking Regulation and Supervision Department, Capital Market Regulation Department and Insurance Companies Regulation and Supervision Department were replaced by a Financial Market Regulation and Analyses Department, a Licensing and Enforcement Department and a Financial Market Supervision Department.[3]

Under the new organisational set-up, financial market supervisory activities will be governed by a single supervisory concept for all segments of the financial services sector and will be based on the principle that the same kinds of financial risks and other facts relevant to regulation are subject to the same rules across all segments of the financial services sector, in order to limit the scope for regulatory arbitrage.

The CNB will focus on unifying the rules for granting licences and authorisations to carry on business in the financial market and on ensuring that the same business risks are regulated in the same way across the various sectors of the financial market. Regulation will become one of the instruments for promoting a level playing field for competition in the financial market. The CNB will also focus on the maximum possible unification of procedures for the supervision of the individual financial market sectors previously supervised separately. An integral part of this process is the revision and unification of methods and internal procedures. The CNB will respect the specific features of individual sectors of the financial market wherever it is appropriate to do so.

When implementing the single supervisory concept and in the actual exercise of supervision the CNB will rigorously take account of the individual risk profiles of supervised entities.

3 See Annex 2a for the financial market supervision organisational chart for 2007 and Annex 2b for that in effect since 1 January 2008.

2. LEGISLATIVE CHANGES IN THE FINANCIAL MARKET SUPERVISION AREA IN 2007

2.1 CHANGES TO LAWS

The CNB works in close cooperation with the Czech Ministry of Finance, which has primary responsibility for preparing laws in the financial market area, and acts in accordance with the agreement on cooperation in the preparation of draft national legislation concerning the financial market and other regulations, concluded between the CNB and the Ministry of Finance in May 2006.

Several acts amending and regulating the business activities of financial institutions and other entities subject to regulation and supervision were adopted in 2007.

Act No. 120/2007 Coll., on the Amendment of Some Laws in Connection with the Setting of Capital Requirements for Banks, Credit Unions, Investment Firms and Electronic Money Institutions.
In connection with the transposition of Directives 2006/48/EC and 2006/49/EC of the European Parliament and of the Council regulating the new capital adequacy framework (Basel II), the Act on Banks, the Act on Credit Unions, the Capital Market Undertakings Act and the Payment System Act (the last-mentioned law because certain Basel II rules also apply to electronic money institutions) were amended by Act No. 120/2007 Coll. (the so-called Basel II Act). The amendment took effect on 1 July 2007, although some provisions were deferred until 1 January 2008. A law going beyond the Basel II rules allowed banks to exercise control over real estate companies defined in the Collective Investment Act. A bank's control over a real estate company must be effected via a special real estate fund or a special fund for qualified investors.

2.2 DECREES AND PROVISIONS OF THE CZECH NATIONAL BANK

2.2.1 Decrees

The CNB is entitled to issue implementing legal rules in the form of decrees and provisions. To issue an implementing regulation, authorisation is required. The limits of this authorisation must be defined in the particular acts with respect to which the decree or provision is being issued. The implementing regulations given below were issued on the basis of authorisation arising in particular from Act No. 6/1993 Coll., on the Czech National Bank, as amended, Act No. 21/1992 Coll., on Banks, as amended, Act No. 256/2004 Coll., on Capital Market Undertakings, as amended, Act No. 87/1995 Coll., on Credit Unions, as amended, and Act No. 189/2004 Coll., on Collective Investment, as amended.

Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms, is related to Act No. 120/2007 Coll. and implements the provisions of EC directives that contain the new Basel II capital framework. In addition to the obligation to transpose EC directives, which is binding on the Czech Republic, the Decree also incorporates some rules and standards containing tried and trusted procedures for this area. In principle, the prudential rules incorporated in the Decree are based, in addition to EC directives, on the Core Principles for Effective Banking Supervision, a document issued by the Basel Committee on Banking Supervision (BCBS). Fulfilment of the core principles set out in this document should be the primary goal for ensuring the integrity of banking sectors and supervisors on the international scale. The prudential rules contained in this Decree are also based on specific recommendations of the BCBS and on the recommendations of the Committee of Banking European Supervisors on individual provisions of EC directives, as the CNB has undertaken to abide by these. In the case of the alternative rules (i.e. the areas of national regulatory discretion), the manner of their implementation was also based on national conditions, the CNB's experience with financial market supervision and on discussions with regulated entities. Decree No. 123/2007 Coll., took effect on 1 July 2007. In it, the CNB, as the integrated supervisory authority, has harmonised the capital adequacy requirements, exposure rules and disclosure requirements for banks, credit unions and investment firms. Issuing a single decree thus made it possible for the CNB to repeal a number of existing sectoral implementing regulations.

Decree No. 58/2007 Coll. repealed Decree of the Ministry of Finance No. 121/1998 Coll. stipulating the specimen identity card for state supervision of the capital market and took effect on 28 March 2007 (this authorisation applied only to inspectors of the Czech Securities Commission, which had already been wound up).

Decree No. 59/2007 Coll., on the types of professional trading activities of an investment firm carried out through a broker, on types of specialisation of a broker and on broker examinations, replaced Decree No. 259/2004 Coll. This Decree redefines and clarifies the types of trading activities for which a broker examination is required, the types of broker specialisations and also the way in which broker examinations are conducted. It took effect on 15 April 2007.

Decree No. 92/2007 Coll. amended Decree No. 536/2004 Coll., implementing certain provisions of the Capital Market Undertakings Act in the area of protection against market abuse, with effect from 1 May 2007. The amendment consisted mostly of technical changes relating to changes in the terminology used in the Capital Market Undertakings Act. The Decree also incorporated an explanatory opinion of the Committee of European Securities Regulators (CESR) regarding an extension of the list of persons having access to internal information to include employees of an issuer's contractual partners.

Decree No. 93/2007 Coll., on the disclosure duties of pension funds for supervisory purposes of the CNB, which took effect on 1 May 2007, is part of a series of decrees regulating reporting in the capital market area according to CNB standards. This Decree regulates the submission of information via an application for the collection of data from non-banks, which is available in a manner allowing remote access.

Decree No. 115/2007 Coll., stipulating details for fulfilling the duties of a depository of a collective investment fund, replaced Decree No. 265/2004 Coll. with effect from 15 July 2007. The Decree implements an amendment to the Collective Investment Act dating from 2006. New rules were laid down in the areas of eligible assets of funds and requirements for checking low-value transactions.

Decree No. 139/2007 Coll., regulating the supporting documents proving the trustworthiness and experience of senior officers of a financial holding entity, implements some provisions of Act No. 21/1992 Coll., on Banks, as amended, and Act No. 87/1995 Coll., on Credit Unions and Certain Related Measures and on the Amendment of Czech National Council Act No. 586/1992 Coll., on Income Taxes, as amended, and defines the supporting documents and facts proving the trustworthiness and experience of senior officers of a financial holding entity. Decree No. 139/2007 Coll. took effect on 1 July 2007.

Decree No. 251/2007 Coll., amending Decree No. 582/2004 Coll., implementing certain provisions of the Act on Insurance Intermediaries and Independent Loss Adjusters, contains, in addition to technical changes, revisions to the provisions regarding communication between the CNB and registered insurance intermediaries. New institutions authorised to provide training programmes for insurance intermediaries and loss adjusters were listed in Annex 6 to the Decree. The Decree was issued on 18 September 2007 and took effect on 3 October 2007.

Decree No. 247/2007 Coll., stipulating certain requirements for the governance of banks and credit unions, regulates the area of money laundering and terrorism financing prevention. The issuing of a single decree made it possible to repeal the existing separate regulation of banks and credit unions in this field. The Decree took effect on 25 September 2007.

2.2.2 Provisions

Several CNB provisions regarding credit union regulation were published in the CNB Bulletin in 2007 (e.g. a provision on the internal control system of a credit union for the area of money laundering and terrorism financing prevention). However, these provisions were repealed following the adoption of Act No. 120/2007 Coll. (the Basel II Act) and Implementing Decree No. 123/2007 Coll., which regulates this area for credit unions as well.

The CNB provisions issued in 2007 and remaining in force are as follows:

- Provision of the Czech National Bank No. 2 of 15 March 2007, amending Provision of the Czech National Bank No. 1 of 30 December 2003, stipulating the minimum requirements for disclosure of information by banks, as amended by Provision of the Czech National Bank No. 9 of 22 December 2004;
- Provision of the Czech National Bank No. 3 of 25 June 2007, stipulating the submitting of statements by credit unions to the CNB;

- Provision of the Czech National Bank No. 6 of 12 November 2007, amending CNB Provision No. 2 of 23 September 2003, stipulating the minimum liquidity level and the terms and conditions for creating minimum reserves;
- Provision of the Czech National Bank No. 7 of 4 December 2007, stipulating the submitting of statements by banks and foreign bank branches to the CNB;
- Provision of the Czech National Bank No. 8 of 13 December 2007, amending Provision No. 3 of 25 June 2007, stipulating the submitting of statements by credit unions to the CNB.

2.3 OFFICIAL INFORMATION OF THE CZECH NATIONAL BANK

In the second half of 2007, the CNB's official information focused mostly on issues relating to Basel II. A total of 21 official information documents were issued, containing the explanatory opinions and expectations of the CNB relating to provisions of Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms, and certain provisions of the Act on Banks, the Act on Credit Unions and the Capital Market Undertakings Act.

These documents focus on:

- the internally set capital system (Pillar 2),
- capital adequacy with respect to transitional provisions,
- applications of obliged persons for prior consent to use special approaches,
- netting as a credit risk mitigation technique,
- the adequate period for satisfying a creditor's exposure from collateral,
- financing conditions under the standardised approach to the calculation of the capital requirement for credit risk,
- specialised credit exposures in the calculation of the capital requirement for credit risk,
- operational risk,
- the benchmark for the capital requirement for operational risk,
- the use of outsourcing by an obliged person,
- the disclosure of information by an obliged person,
- information on a consolidated group submitted to the CNB,
- the internal ratings based approach to the calculation of the capital requirement for credit risk,
- the methodology and credit rating of a rating agency,
- currency positions when setting the capital requirement for currency risk,
- groups of economically linked persons,
- retail exposures in approaches to the calculation of the capital requirement for credit risk,
- transactions with a long settlement period,
- position consolidation in the approaches applied when calculating capital adequacy on a consolidated basis,
- some lists and surveys foreseen by Decree No. 123/2007 Coll., e.g. the list of public sector organisations and the survey of recognised standards.

The CNB also issued the following official information documents in 2007:

- Official information of 2 January 2008 on the submitting of an annual report on the activities of insurance agents and insurance brokers.
- Official information of 12 January 2007 regarding certain issues of collective investment in connection with the amendment to the Collective Investment Act (No. 224/2006 Coll.).
- Official information of 16 January 2007 regarding the submitting of other documents on the activities of domestic insurance companies and branches of insurance companies from third countries and documents on the activities of branches of insurance companies from other EU or EEA countries for 2007.
- Official information of 12 February 2007 on a change in the questions set for professional examinations for the medium and higher level of competence of insurance intermediaries.
- Official information of 26 February 2007, 3 April 2007 and 12 October 2007 regarding the supplementing and amending of the register of responsible actuaries.
- Official information of 14 May 2007 regarding the publication of the rules for broker examinations.
- Official information of 21 May 2007 issuing the methodology for selected obligations under Act No. 69/2006 Coll., on the Performance of International Sanctions, for persons that have been granted a foreign exchange licence by the CNB.

- Official information of 20 July 2007 regarding the obligation to make a public share offer in the event of a capital increase.
- Official information of 10 September 2007 regarding the issuing of securities not regulated by Czech law.
- The official information regarding certain provisions of the Act on Banks relating to the single licence was revised in November 2007. It mentions the requirements for foreign bank branches enjoying the advantages of the single licence. Part is devoted to branches of authorised foreign financial institutions and branches of foreign electronic money institutions. Some provisions of this official information relate to banks and electronic money institutions having their registered offices in the Czech Republic and intending to operate abroad via a foreign branch or without establishing a branch.
- Official information of 29 November 2007 regarding the submitting of other documents on the activities of domestic insurance companies and branches of insurance companies from third countries and documents on the activities of branches of insurance companies from other EU or EEA countries for 2008.

A full and updated list of the CNB's decrees, provisions and official information relating to the financial market can be found on the CNB website (http://www.cnb.cz – Legislation).

2.4 CHANGES TO THE REGULATIONS UNDER PREPARATION [4]

Preparation of an amendment to the Capital Market Undertakings Act

Intensive preparations for a number of other regulatory changes took place in the period under review, mostly in order to transpose EC regulations. This applies in particular to a major amendment to Act No. 256/2004 Coll., the Capital Market Undertakings Act (transposing the Markets in Financial Instruments Directive – MiFID), which is introducing numerous changes. These include, for example, additional requirements for best execution of orders, new disclosure duties, pre- and post-trade transparency, commission disclosure, the introduction of tied agents, the inclusion of consultancy among core investment services, etc. At the same time, the bill of a minor amendment to the Capital Market Undertakings Act regarding the income of the Guarantee Fund of Investment Firms was under preparation. This was submitted to the Chamber of Deputies (the lower house of the Czech Parliament) in October 2007.

In connection with the planned amendment of the Capital Market Undertakings Act, legislative work commenced in 2007 on decrees implementing this Act, which are expected to be completed in 2008. These include:

- a decree stipulating the details of some rules for providing investment services – the decree lays down prudential rules for providing investment services and governance and risk management requirements, and also the rules of conduct of investment services providers towards clients;
- a decree on specimen forms and the content of annexes thereto for submitting applications in compliance with Act No. 256/2004 Coll., the Capital Market Undertakings Act – the decree will replace Decree No. 268/2004 Coll. of the Czech Securities Commission. It includes specimen forms for applications which by law are subject to decisions by the CNB, and specifies the content of their annexes;
- a decree amending Decree No. 58/2006 Coll., on the method of keeping a separate register of investment instruments and a register linked to a separate register of investment instruments – the decree reacts to changes to the law and newly regulates the keeping of a register of closed-end mutual fund units and of investment fund shares;
- a decree on the disclosure duties of a regulated market operator and a multilateral trading system operator – the decree regulates the content, dates, manner and forms of information disclosure and submission of information to the CNB with a view to increasing market transparency;
- a decree on disclosure duties of a settlement system operator and the central depository – the decree regulates the content, dates, manner and forms of submitting information needed to perform supervision to the CNB;
- a decree amending Decree No. 605/2006 Coll. of the Czech National Bank, on certain disclosure duties of an investment firm – the decree amends the form and manner of notifying the CNB of transactions in listed investment instruments by investment firms.

4 Planned changes in the regulations relating to Basel II, Solvency II and MiFID are dealt with in detail in section 3. *Enhancement of financial market stability and transparency.*

Preparation of a new act on certain measures against money laundering and terrorist financing
In connection with the transposition of Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council, a new act on certain measures against money laundering and terrorist financing (the AML Act) has been prepared. This act transposes the provisions concerning the definition of "politically exposed person" and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis. Together with the draft AML Act, a bill has been prepared amending certain acts in connection with the adoption of the Act on Certain Measures against Money Laundering and Terrorist Financing. It also includes draft amendments to the Foreign Exchange Act and the Payment System Act. Both these amendments are being made in order to implement Directive 2005/60/EC, and in the case of the Foreign Exchange Act the draft also removes some shortcomings in the present legislation, e.g. double-track authorisation for cash purchases and sales of foreign currency. The bills were submitted to the Chamber of Deputies in December 2007.

Preparation of a new insurance act
The preparation of a new insurance act, in which the CNB was actively involved, was completed in 2007. A comments procedure took place at the end of 2007 and a bill was submitted for discussion to the committees of the Government's Legislative Council at the start of February 2008. The CNB then started preparing draft decrees, which it is authorised to issue by law. These decrees will relate mainly to reporting by insurance companies and also to the calculation of required and available solvency margins, the investment of assets arising from technical provisions, governance of insurance companies, reports by responsible actuaries, etc.

Other amendments to laws under preparation
The CNB was actively involved in the work of the Czech Ministry of Finance working group dealing with possible changes in pension fund regulation, which discussed in particular the segregation of policyholders' and shareholders' assets. The CNB worked closely with the Ministry of Justice on a new act on takeover bids, which was submitted to the Chamber of Deputies in November 2007.

In the second half of 2007, the CNB was actively involved in the preparatory work on the transposition of Directive 2007/64/EC on payment services in the internal market, which was adopted by the European Parliament and the EU Council in 2007. The directive entered into force on 25 December 2007 following its publication in the Official Journal of the EU. The deadline for transposing it into the Member States' national legislation is 1 November 2009. The CNB and the Ministry of Finance prepared a public consultation document on the transposition of the directive on payment services in the internal market into Czech law. This document can be found on the websites of both institutions. It covers quite a large number of provisions of the directive, including national discretions for Member States, explains what they are about and formulates questions regarding the application of these discretions. The aim was to gather the opinions of as wide a range of stakeholders as possible, in particular payment service providers (bank and non-bank), clients (including consumers) and finance professionals. The deadline for the public consultation was originally set at 31 December 2007, but, at the request of some entities, the discussion continued until February 2008. After assessing the results of the consultation, the two institutions prepared a joint document addressing respondents' comments and containing draft solutions. In mid-April 2008, the CNB Bank Board and the Ministry of Finance approved all the conclusions proposed in the document, thereby starting the next phase of preparation of the transposition act on payment services.

2.5 ASSESSMENT OF THE SITUATION IN FINANCIAL MARKET REGULATION

The CNB's aim in the financial market regulation area is to facilitate harmonisation at the European level. To this end, it is actively involved in transposing European legislation into Czech law, working in close cooperation with the Ministry of Finance, which is responsible for primary legislation, and preparing the relevant implementing legal rules. Most of the European legislation has by now been successfully implemented into the relevant laws and thereby harmonised with European regulations. In the banking sector area, Directives 2006/48/EC and

2006/49/EC were transposed in 2007.[5] As regards the insurance sector, Directive 2005/68/EC on reinsurance – for which the transposition deadline was 10 December 2007 – has not yet been fully incorporated into Czech law. In this regard, however, we can say that the current version of the Insurance Act does regulate the business of reinsurance companies. The new Insurance Act and its implementing decrees[6] will harmonise the Czech legal rules with the European legislation.

In the capital market area, the transposition deadlines have not been met for the Markets in Financial Instruments Directive (MiFID), the takeover bids directive and the transparency directive. An amendment to the Capital Market Undertakings Act, via which the MiFID will be transposed, was submitted to the Chamber of Deputies[7] in February 2008. Similarly, an amendment to the Takeover Bids Act has already been submitted to the Chamber of Deputies. The adoption of these acts will mean a significant shift in capital market regulation.

Core Principles for Effective Banking Supervision

The Core Principles for Effective Banking Supervision play a significant self-assessment role for supervisory authorities. The Core Principles were issued by the Basel Committee on Banking Supervision (BCBS) in 1997, and the BCBS published a corresponding methodology in 1999. At the international conference of banking supervisors held in October 2006, the representatives of central banks and banking supervisory agencies approved a revised version of the Principles and the methodology. These documents contain 25 principles approved as minimum standards for banking regulation and supervision, covering a wide range of aspects, such as the powers and objectives of the supervisory authority, permitted activities, licensing criteria, consents to ownership changes and large acquisitions, capital adequacy, risk management, consolidated supervision, dealing with problem banks, the division of roles and responsibilities between home and host supervisors, etc.

5 For details, see section 3.1 *The New Basel Capital Accord.*
6 For details, see section 2.4 *Changes to the regulations under preparation.*
7 For details, see section 2.4 *Changes to the regulations under preparation.*

3. ENHANCEMENT OF FINANCIAL MARKET STABILITY AND TRANSPARENCY

The enhancement of financial market stability and transparency through the implementation of Basel II is a long-term process whose initial preparatory phase started at the turn of the century. This process took legal shape in the Czech Republic in 2007. At present, the new framework is being implemented and improved and experience is being gained.

3.1 THE NEW BASEL CAPITAL ACCORD

In 2007, the CNB continued working to implement the new capital framework usually referred to as Basel II. The first draft of the new framework was prepared by the Basel Committee on Banking Supervision (BCBS)[8] in 1999 in response to the rapid development of the financial markets and in order to increase the stability of the financial system, strengthen management responsibility and competitive equality, and allow banks to use more comprehensive approaches to risk management for regulatory purposes. The final version of the new framework, entitled International Convergence of Capital Measurement and Capital Standards, was published by the BCBS in June 2006. The main emphasis is laid on more sensitive and accurate risk measurement and thus on more efficient use of capital. The new rules are more comprehensive, offer a wider range of options for measuring the risks faced and allow banks to align their internal risk measurement and management systems with the regulatory rules. They cover not only the risk of the bank alone, but also the risk of the whole bank group on a consolidated basis.

Basel II is based on three pillars. Pillar 1 contains methods for risk measurement and for setting capital requirements for credit and market risk and a new capital requirement for operational risk. Pillar 2 is focused on the assessment of capital adequacy in relation to the risks faced. The basic principle is that a regulated entity should have in place appropriate internal processes to set, continuously assess and maintain its internal capital in relation to its risk profile. At the same time, the supervisor is entitled to insist on a higher capital requirement than that calculated under Pillar 1 (above the threshold corresponding to the sum of the capital requirements for risk coverage), if it does not consider the institution's compliance with Pillar 2 to be adequate. A capital ratio of 8% of the value of risk-weighted assets will be still considered the absolute minimum. Pillar 3 concentrates mainly on bolstering market discipline and transparency through reporting and comprehensive disclosure of relevant information so that all market participants have sufficient information about the risk profiles of regulated entities and about the adequacy of capital coverage of risks. Pillar 1 is based on the existing rules, but Pillars 2 and 3 are completely new. Their importance has increased in the context of, among other things, the crisis in the financial market and particularly in the US mortgage market in summer 2007.

Transformation of Basel II into EC directives and Czech law

Owing to the Czech Republic's membership of the European Communities, Basel II is binding on it in the form resulting from its transformation into Community law, i.e. into Directives 2006/48/EC and 2006/49/EC, which were published in the Official Journal of the EU on 30 June 2006 after being approved by the European Parliament and EU Council. The core of the framework drawn up by the BCBS remains unchanged. However, it differs in some minor respects, taking into account the specifics of the European market. One of the principal differences of the directives compared to Basel II is their wider scope of application. The directives apply to banks, credit unions, investment firms and to a limited extent also to electronic money institutions, while the BCBS document is primarily intended for internationally active banks.

The CNB worked closely with the Ministry of Finance on the preparation of other amendments to laws implementing Basel II, namely amendments to the Act on Banks, the Credit Unions Act, the Payment System Act and the Capital Market Undertakings Act, and prepared a draft implementing decree[9] for Act No. 120/2007 Coll., on the amendment of some laws in connection with the setting of capital requirements for banks, credit unions,

8 The Basel Committee on Banking Supervision is an international committee (at the Bank for International Settlements) that issues recommendations and standards for various areas of banking supervision.

9 Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms.

investment firms and electronic money institutions. The transposition of the directives into the Member States' national legislation should have been completed by 31 December 2006. However, owing to general delays in legislative processes caused by the political discussions following the June 2006 elections, the new rules took effect in the Czech Republic on 1 July 2007. Until that time, regulated entities were subject to the original rules,[10] which could be applied on an optional basis until 31 December 2007.

Information about progress with the work and the CNB's approach to the implementation of Basel II was published regularly on the CNB website, which at present includes the final version of Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms, which implements the new capital framework, and related official information and explanatory opinions in which the CNB responds to questions asked by regulated entities in relation to the application of the new rules.

Implementation of the framework in the Czech financial sector and international cooperation

Basel II meant a fundamental change in banking sector regulation. The CNB therefore launched the preparations for its implementation already in the initial phase of formation of the new rules and was actively involved in their creation through its membership in BCBS working groups. In an effort to inform regulated entities in time about the new framework, the CNB entered into a joint trilateral project with the Czech Banking Association and the Chamber of Auditors of the Czech Republic. Its objectives were fulfilled at the end of 2006. Over the almost five-year life of the project, an effective communication platform was established and the financial market participants concerned were familiarised with the tasks arising from the new rules, facilitating their subsequent implementation in 2007.

In 2007, CNB Banking Supervision continued to work directly with the individual regulated entities intending to switch to one of the special, and hence more advanced, capital requirement calculation approaches. These approaches require validation and subsequent approval by the competent supervisory authority. In particular this concerns the internal ratings based approach to the calculation of the capital requirement for credit risk (which was implemented in 2007 by a total of five banks) and the alternative standardised approach and the advanced approach to the calculation of the capital requirement for operational risk, which is applicable from 1 January 2008.[11]

As regards consolidated groups, much closer international cooperation is expected of supervisory authorities, with the home supervisory authority of the parent bank or financial holding entity playing a coordinating role. The CNB banking supervisor, which in most cases is in the position of host supervisor, therefore worked intensively with the relevant foreign supervisory authorities. Bilateral cooperation under international agreements such as Memoranda of Understanding (MoU) was supplemented with regular contacts with foreign partners as and when necessary. In the case of selected groups headed by a European parent bank which applied for approval of a special internal ratings based approach, specific cooperation was focused chiefly on verifying the relevant requirements for this approach and on subsequently granting consent.

Contacts were established with rating agencies with a view to entering them in the list of credit assessment agencies kept by the CNB pursuant to Article 12b of Act No. 21/1992 Coll., on Banks, as amended. Without such entry the ratings set by the agency cannot be used for regulatory purposes. The list of approved agencies and the mapping of their ratings to the credit quality steps is published on the CNB website.[12] The first rating agency entered in the list was Fitch (Fitch, Inc. and Fitch Ratings Ltd.) with effect from 8 February 2008.

Involvement in international working groups

The objectives of the new capital framework can also be achieved through active involvement in international institutions. The CNB is represented in BCBS working groups and in groups operating within European structures. Within these groups, individual topics are addressed at a working level and the CNB thus acquires information and contributes to the implementation and uniform interpretation of Basel II in the EU.

10 Decree No. 333/2002 Coll., stipulating the prudential rules of parent undertakings on a consolidated basis.

11 A complete list of the approaches to the calculation of the capital requirement regarded as special approaches is provided in Article 77 of Decree No. 123/2007 Coll.

12 For details, see http://www.cnb.cz – Financial market supervision – List of credit assessment agencies.

Through these groups, the CNB is also involved in the preparation of explanatory opinions and answers to questions drawn up by the European Commission[13] as well as in the process of preparation of amendments to directives associated with the existence of transitional, temporary or discretionary provisions and with the need to revise some provisions contained in the directives implementing Basel II.

In an effort to unify approaches and ensure a level playing field across the individual Member States, a working group for mutual recognition of discretions has been created within CEBS under the Expert Group on Capital Requirements (EGCR), which the CNB was also involved in. In February 2007, this group's activities resulted in the publication of a series of documents mapping the discretion provisions contained in the directives, the approaches of national regulators to their use and their willingness to harmonise those approaches. In April 2007, the European Commission mandated CEBS to conduct an in-depth analysis of the use of national discretions and options in the directives. To prepare the analysis, a Working Group on National Discretions (WGOND) was set up within the EGCR. The WGOND drew on the findings of the group for mutual recognition of discretions and also based its analysis on discussions with representatives of regulated entities in a consultative panel (in which the Czech Republic was represented) and on answers given by regulated entities and regulators to a questionnaire on harmonising the approach to the discretionary provisions. In formulating its opinions, the CNB aimed above all not to increase the administrative burden on regulated entities and to eliminate the differences in their treatment as much as possible (except for areas where different treatment results from different national market conditions).

3.2 SOLVENCY II

The preparations for the implementation of the new system of regulation of the European insurance industry, known as Solvency II, continued in 2007. The starting points for the new rules and supervision are analogous to those for banks under Basel II. The system will be based on three pillars, as in the banking sector. It will contain quantitative requirements, qualitative supervisory requirements and reporting and disclosure requirements. The quantitative requirements in Pillar 1 will determine in particular the method of calculation of technical provisions and capital requirements, which will be calculated using either a standard formula or internal models approved by the supervisor. Pillar 2 will stipulate the supervisor's powers and responsibilities and specify rules for supervisory authorities for supervising individual entities and reviewing risk assessment and management systems, internal control systems, the competence of managers, etc. On the strength of such findings, remedial measures will be adopted, including higher capital requirements. Pillar 3 will bolster market discipline and market transparency based on reporting and comprehensive disclosure of information by supervised entities.

Solvency II took a more definite shape during 2007. After completing the preparation of a new general directive incorporating the texts of the present 13 European "insurance" directives, the European Commission on 10 July 2007 approved the draft Solvency II directive. This draft was submitted to the Council of the EU and the European Parliament for discussion. At the time of writing (April 2008), the text – and particularly the insurance group supervision method – is still subject to intensive debate in the EU Council's financial services working group. In this area, the Commission's proposal transfers some powers to enforce compliance with the solvency capital requirement from the host supervisor to the supervisor of the entire group. At the same time, the proposal would allow part of the own funds of a subsidiary insurance company to be allocated to its parent company. The CNB is of the view that it must retain powers allowing it to exercise effective supervision, so it is taking a broadly negative stance in the discussions of the two proposals. The draft can be expected to be approved by the EU Council and the European Parliament in the second half of 2008, but it is also possible that the negotiations will be completed during the Czech Presidency of the EU at the start of 2009. The CNB, together with the Ministry of Finance, is participating in the negotiations on the text as an expert.

Within the Lamfalussy framework, the Commission may adopt implementing rules for the general directive which will regulate some areas in more detail. Preparatory work on these norms started in the second half of 2007. Under the Lamfalussy framework, draft implementing rules are prepared by Level 3 committees – CEIOPS in this case.[14] In the second half of 2007, CEIOPS was asked informally by the European Commission to prepare the first

13 For details, see the European Commission website – http://ec.europa.eu/internal_market/bank/regcapital/ transposition_en.htm.

14 Committee of European Insurance and Occupational Pensions Supervisors.

draft regulations concerning the principle of proportionality and supervision of insurance groups. These first drafts should serve as a basis for the discussions on the general directive. Other implementing rules will deal with valuation of assets and insurance liabilities, the calculation of capital requirements, etc. As a CEIOPS member, the CNB has been and will continue to be involved in the preparation of these implementing rules.

The Czech insurance market is starting to take a serious interest in the Solvency II implementation issue. The Solvency II preparations include quantitative impact studies (QIS) conducted by the CEIOPS Committee at European level. The third round of QIS – aimed primarily at preparing the final version of the standard formula for calculating the capital requirements of insurance companies – took place between April and June 2007. The capital adequacy of insurance companies was tested within groups for the first time. Thanks to more intensive cooperation between the CNB and the insurance market, the participation of Czech insurance companies in this impact study was several times higher than previously. A total of 12 domestic insurance companies and one branch of an insurance company from the EU, together accounting for 84.7% of the Czech life insurance market and 90.9% of the non-life insurance market, took part in this study.[15] The final report is available on the CEIOPS website.[16] The results for Czech insurance companies do not differ substantially from the European average.

The fourth round of QIS is scheduled for 2008. This will focus on further testing of the standard formula for the calculation of the capital requirements of insurance companies and on simplifying the calculations of technical provisions.

3.3 IMPLEMENTATION OF MIFID

Enhancing capital market transparency is one of the main objectives of Directive 2004/39/EC on markets in financial instruments (MiFID). MiFID lays down conditions for doing business on the capital market and trading on both regulated and open markets. It broadens the range of investment instruments (the range of investment instruments in the Czech Republic was wider than in the original directive even before MiFID, but will have to be extended to include some types of derivatives) and investment services (particularly investment consultancy, which will now be the sole reserve of investment firms and investment intermediaries). MiFID also defines alternative market platforms (the multilateral trading facility) and expands the requirements for market transparency, primarily by requiring investment firms to disclose information on unexecuted transactions and by opening up access to data on trading in individual securities through the Transaction Reporting Exchange Mechanism (TREM) coordinated by the CESR.[17]

The implementation of MiFID necessitated a fundamental amendment of the Capital Market Undertakings Act and its implementing regulations. The MiFID transposition deadline was originally set by the European Commission at 30 April 2006. Because of a delay in the preparation of the EC's implementing measures, this deadline was later shifted to 31 January 2007. Following public consultations in which the CNB and other market participants expressed their opinions on the implementation of MiFID into Czech law, the Ministry of Finance in March 2007 prepared a draft amendment to the Capital Market Undertakings Act and in April 2007 circulated it for comments from other government departments. The CNB prepared and presented detailed comments on this draft. The Ministry of Finance submitted the draft amendment to the Government's Legislative Council for the first time in June 2007. After initial discussions it was withdrawn and changes were made. The draft had not been approved by the Government by the end of 2007.[18] The Czech Republic thus failed to comply with both the transposition and implementation deadlines (November 2007). As a result, the European Commission opened a formal infringement procedure.

The CNB subjected MiFID to detailed examination back in 2006 and prepared an analysis of the individual areas, paying particular regard to their impact on Czech capital market participants. Since it was obvious in 2007 that

15 For comparison, no Czech institution participated in QIS1, while Czech insurance companies with a combined market share of 13% took part in QIS2.
16 http://www.ceiops.eu, section Consultations/QIS
17 Committee of European Securities Regulators.
18 The draft amendment to the Capital Market Undertakings Act was approved by Government on 16 January 2008.

the transposition deadline would not be met, the CNB also examined the impacts of late transposition, including possible changes to the Czech regulation resulting from the direct and indirect effects of MiFID and its implementing measures. The CNB took account of the results in its supervisory practice and in statements provided to market participants, for example on the conditions of admission to the regulated and open markets.

At the same time, the CNB worked on the implementing decrees for the amendment to the Capital Market Undertakings Act. Following discussions with market participants, the principal transposition decrees were circulated for comments from other government departments in July 2007. The work on the decrees had to be coordinated with the preparation of the Capital Market Undertakings Act with regard to the frequent changes made to its text.

As well as preparing the decrees, the CNB was involved in the activities of the CESR, which, together with the TREM project (involving changes to domestic information systems and the creation of pan-European ones), included the gradual establishment of a database of answers to questions in partnership with the European Commission.

More detailed information about the preparations for MiFID implementation is published regularly on the CNB website (in Czech only: http://www.cnb.cz – Legislativa – Kapitálový trh – Materiály k transpozici MiFID). The CNB assumes that after the legislative process of transposing the directive into Czech law is completed, it will continue to provide capital market participants with opinions on problematic areas of the new legislation, give answers to frequently asked questions and continue issuing methodologies to help supervised entities adjust to the new requirements of the act and its implementing regulations.

3.4 INTERNATIONAL ACCOUNTING STANDARDS

In May 2007, the International Accounting Standards Board (IASB) published a discussion paper *Preliminary Views on Insurance Contracts*, thereby launching the second phase of development of international accounting standards, in particular the insurance contract standard (IFRS 4) of 2005. Some of the preliminary proposals mentioned in this document will mean substantial changes in insurance companies' accounting systems. The proposals deal primarily with market-consistent valuation of insurance liabilities. This new approach will have a substantial effect on all insurance market participants. In this connection, the link between phase two of IFRS 4 and Solvency II should be mentioned, as the latter also assumes market-consistent valuation of both assets and insurance liabilities.

As the next step, the IASB intends to issue another document – an Exposure Draft – by the end of 2008. The draft insurance accounting standard, which should amend and extend IFRS 4, is expected to be finalised in 2010.

4. DIRECT FINANCIAL MARKET SUPERVISION IN 2007

4.1 LICENSING, APPROVAL AND AUTHORISATION ACTIVITIES

Credit institutions

In 2007, the CNB received a total of 67 petitions for the opening of administrative proceedings, 29 of them from banks, 35 from credit unions and 3 from rating agencies. No administrative proceedings were conducted in respect of electronic money institutions under Act No. 124/2002 Coll., on the Payment System. In the period under review, a total of 11 penalty proceedings were conducted with credit unions, 10 of which concerned a fine for a minor violation of Act No. 87/1995 Coll., on Credit Unions, and 1 concerned a withdrawal of a credit union licence (České národní spořitelní družstvo) for very serious shortcomings in the credit union's activities found during an on-site inspection conducted by the CNB's supervisory units.

A total of 62 administrative decision were issued in 2007, 18 of which were prior consents to the acquisition of qualifying holdings in banks, prior consents of the regulator to the merger of two banks and the dissolution of one of them without liquidation and to the merger of two credit unions and the dissolution of one of them, 20 involved certificates of competence for members of credit union bodies and 2 concerned changes (extensions) to a licence. At the end of 2007, prior consents were given to the use of special approaches to the calculation of the operational risk capital requirement of a bank and a credit union and two consenting decisions concerning a registration in the list of rating agencies kept by the CNB were issued. Also issued were 7 prior consents to invest another membership contribution in a credit union, 1 consent to a decrease in the basic membership contribution and 1 consent to a subordinated deposit in a credit union. In addition, 11 penalty decisions (fines pursuant to the Act on Credit Unions) and 1 decision to withdraw a credit union licence were issued. The remaining administrative proceedings were not concluded in 2007. These include a licensing procedure for a bank, applications for changes in or extensions of authorisations for other activities of banks and a credit union, a procedure to enter an entity in the list of credit assessment agencies, a procedure to approve special approaches to the calculation of the capital requirement, etc.

An application for a banking licence for Banka mezinárodní spolupráce, a. s., Praha was submitted to the CNB by an applicant based in a non-EU country – První česko-ruská banka, společnost s ručením omezeným, Moscow, Russian Federation – in April 2007. This was the third application by the same applicant. On 17 April 2008, the CNB issued an decision approving the application and granted a banking licence to Banka mezinárodní spolupráce, a. s.

In summer 2007, CNB Banking Supervision received notification of the establishment of a branch under the single banking licence principle from Poland's BRE Bank SA, Warsaw (commercial name on the banking market: mBank), which opened for business in the Czech Republic in November 2007. The CNB also received notification from the Irish regulator of the establishment of a branch under the single banking licence principle by the Irish Citibank Europe plc, which the Czech Citibank a. s., Prague was transformed into on 1 January 2008.

During 2007, one domestic bank (J&T BANKA, a. s.) exercised the right of establishment under the European legislation on the basis of the single licence principle in another EU Member State, namely Slovakia. Four domestic credit unions (Fio družstevní záložna, Unibon – spořitelní a úvěrní družstvo, WPB Capital, spořitelní družstvo and Prague Credit Union, spořitelní družstvo) exercised the same right in Slovakia, Poland, Hungary and Cyprus.

A total of 23 banks and building societies and, to a limited extent, 14 foreign bank branches active on the domestic banking market were subject to banking supervision at the end of 2007. A total of 19 credit unions were also subject to CNB supervision of credit institutions.

Capital market

In all, 233 administrative proceedings were opened in the area of collective investment and pension funds in 2007, with 80 uncompleted administrative proceedings having been carried over from 2006. Of this total, 287 proceedings had been decided and 5 proceedings discontinued by the end of 2007. A total of 58 decisions concerned the approval of directors, 128 concerned changes to statutes, 6 involved licences to establish investment companies, 49 related to licences to establish mutual funds, 5 concerned the withdrawal of licences to establish mutual funds, 1 involved an authorisation to merge mutual funds, 6 related to the establishment of an investment fund, 11 concerned authorisations for a foreign collective investment entity to trade in securities in the Czech Republic, 4 involved authorisations to acquire qualifying holdings, 1 concerned an authorisation to establish and operate a pension fund and 2 related to authorisations to change a retirement plan. There were 16 other decisions.

Six new investment companies were granted licences in 2007: ATLANTIK Asset Management investiční společnost, a. s., CEE FUND MANAGEMENT investiční společnost, a. s., Realtia investiční společnost, a. s., Conseq investiční společnost, a. s., Bayerische Investment Fonds a. s. – investiční společnost, Fortius Global Investments, investiční společnost, a. s. and the pension fund AEGON Penzijní fond, a. s. The following seven investment funds were granted licences in 2007: ČSOB Property fund, uzavřený investiční fond, a. s., člen skupiny ČSOB; Protos, uzavřený investiční fond, a. s.; UTIS uzavřený investiční fond, a. s.; ORION 001, uzavřený investiční fond, a. s.; Harmonie uzavřený investiční fond, a. s.; Pražský fond, uzavřený investiční fond, a. s., and CFQI uzavřený investiční fond, a. s. The entry of new entities into the collective investment sector was linked chiefly with an amendment to the Collective Investment Act in 2006, which introduced, among other things, real estate funds for the public and funds for qualified investors. In 2007, there was increased interest in establishing or creating special funds for qualified investors specialising in investment in real estate and real estate companies (in the form of both investment funds and mutual funds).

In the area of collective investment and pension funds, 18 investment companies (actively operating or newly authorised), 7 investment funds, 11 pension funds, 121 open-end mutual funds, 38 of them standard funds, and 8 banks or foreign bank branches as active depositories of collective investment funds and pension funds were subject to financial market supervision as of 31 December 2007.

In the area of investment services providers, a total of 46 entities holding investment firm licences, 13 of them banks, were registered under Article 5 of Act No. 256/2004 Coll., on Capital Market Undertakings, at the beginning of 2007. During 2007, no new investment firm licences were granted and 2 such licences expired under the legislation owing to changes in objects of business. The CNB registered 44 investment firms, 13 of them banks, as at the end of 2007.

The CNB issued 788 first instance decisions in the area of investment services provision, more than one-half of which were decisions to grant investment intermediary registration. Four concerned the extension of current investment firm licences and in 2 cases the CNB discontinued applications for such extensions. A decision to allow the conclusion of a contract on the transfer of part of a business was issued in 1 case. 25 decisions concerned prior consents to the discharge of office of director of an investment firm. The CNB issued prior consent to the acquisition of qualifying holdings in investment firms in 4 cases. Other decisions in the investment services area mostly concerned the issuance, extension or withdrawal of broker's licences (117 issued/extended; 21 withdrawn), registration of investment intermediaries (55 withdrawn and 4 refused) and approval of investment firms' auction rules (2 approvals).

A total of 1,859 entities holding a broker's licence under Article 14(1) of the Capital Market Undertakings Act were registered at the start of 2007. In the period under review, the CNB issued 79 broker's licences and withdrew such licences in 21 cases. It organised 39 rounds of broker examinations in 2007, with 394 participants.

The CNB thus registered a total of 1,917 entities holding a broker's licence as of the end of 2007.

Administrative proceedings relating to market infrastructure in 2007 primarily concerned the Prague Stock Exchange (PSE). The application of RM-Systém, a. s. for an extension of its licence to operate the SVYT settlement system was approved, as were related changes in the OTC market trading rules (this extension enabled RM-Systém, a. s. to implement its plan to trade foreign securities, which will be registered in the settlement system's register). In addition, RM-Systém's licence to operate an OTC market was extended to include the possibility of organising a derivative securities market, involving warrants and investment certificates in particular. Its licence to operate a settlement system was also extended to include settlement of derivative securities, and related changes in the SVYT settlement system rules were approved. In autumn 2007, the CNB approved further changes to the rules of trading on the OTC market organised by RM-Systém, a. s. These changes concerned the admission of securities to trading and the possibility of admitting securities with limited transferability. As regards UNIVYC, a. s., the CNB approved changes to its settlement system rules (relating to the disclosure duties of stock exchange members). The CNB also approved an application from UNIVYC, a. s. for approval of a change to the settlement system rules enabling settlement of transactions in derivative securities of all types. Two prior consents to the discharge of office of director were also granted in 2007 (one case concerned the Prague Stock Exchange, while the other related to RM-Systém, a. s.). A central depository licensing proceeding continued in 2007, with the applicant preparing documents for the granting of the licence.

Two basic types of approval procedures are conducted in the area of securities issues. The first is the approval of documents connected with new securities issues, various combinations of bond issue conditions under Act No. 190/2004 Coll., on Bonds, and securities prospectuses and combinations thereof for the purpose of offers to the public and admission of securities to trading on the regulated market under the Capital Market Undertakings Act. In the case of bond issue conditions this involves a more or less formal check of the essential elements of such documents. In the case of approvals of securities prospectuses, compliance with the conditions laid down in Commission Regulation No. 809/2004, regulating the information contained in prospectuses, is checked; specifically, the adequacy of the information stated in the prospectus is verified, particularly with regard to the issuer's management and activities and the description of the rights associated with the security. A total of 191 administrative proceedings were held in this area in 2007.

The second type of approval procedure concerns the granting of consent to the publication of takeover bids and other public share-purchase contract offers relating to listed participating securities, and since September 2005 also the granting of prior consent to squeeze-out decisions made by general meetings. In both cases, the proceedings focus on examining company valuations and assessing the adequacy of prices offered or considerations provided. A total of 9 administrative proceedings were held in the takeover bids area and 68 in the squeeze-out area in 2007. These proceedings are subject to time limits laid down in the Commercial Code. However, the CNB always decides before the time limit expires.

In addition to these basic types of proceedings, 8 proceedings were held in 2007 in relation to the disclosure duties of issuers of listed securities, in particular proceedings concerning the narrowing of the scope of annual reports.

Insurance companies
Domestic insurance companies and reinsurance companies and insurance companies from third countries (non-EU/EEA countries) were subject to licensing and approvals. In the insurance sector, a total of 100 administrative proceedings were conducted in 2007, 89 of which were closed by an administrative decision. 73 decisions concerned the approval of senior officers, 1 decision concerned an authorisation to carry on insurance activities, 4 decisions concerned the extension of licenses of existing insurance companies, 6 decisions concerned the acquisition of qualifying holdings in insurance companies, 1 decision concerned the approval of a transfer of the insurance portfolio from a domestic insurance company to a branch of a foreign insurance company from the EU, and 1 decision concerned a merger of an insurance company and its subsidiary. An additional 3 decisions were issued. A total of 11 administrative proceedings were not concluded in 2007. Of these, 2 related to administrative proceedings concerning an application for an insurance licence for a new insurance company, 3 involved an extension of an existing licence of an insurance company, 4 concerned the acquisition of qualifying holdings in an insurance company and 2 concerned prior consents for senior officers.

The CNB granted an authorisation to carry on insurance activities to GDII Czech, a. s., for non-life insurance classes 1, 3, 7, 8, 9, 10 (a) and (c) and 18 as listed in part B of Annex 1 to Act No. 363/1994, on Insurance (Insurance Act). The company name was subsequently changed to DIRECT Pojišťovna, a. s.

The CNB approved the merger of Kooperativa pojišťovna, a. s. and its subsidiary Celetná 25, s. r. o., and the transfer of the insurance portfolio from AIG CZECH REPUBLIC pojišťovna, a. s. to AIG EUROPE, S.A., pobočka pro Českou republiku. The Czech Insurers' Bureau was granted consent to the creation of another technical provision set forth in Article 13(3)(g) of the Insurance Act.

At the start of the second half of 2006, an administrative proceeding was opened concerning the identification of a group as a financial conglomerate. Due to the difficulty in assessing this proceeding, the opinion of the Czech Ministry of Finance was sought. The opinions and a calculation of the balance sheets of companies controlled by the state through the Ministry of Finance showed that the group failed to comply with the identification features of a financial conglomerate. For this reason, the administrative proceeding was discontinued in the first half of 2007.

A total of 34 domestic insurance companies and the Czech Insurers' Bureau were subject to supervision by the CNB as of the end of 2007. To a limited extent, the CNB also supervised 17 branches of insurance companies from EU/EEA countries and 1 branch of an insurance company from a third country. These branches report to the CNB on their activities.

Other regulated entities
Under Act No. 219/1995 Coll., the Foreign Exchange Act, the CNB also supervises almost 3,000 non-bank foreign exchange entities. This group includes both entrepreneurs offering cash purchases and sales of foreign currency and entities engaged in non-cash foreign exchange transactions or money services.

Licensing certificates for bureau-de-change activities are issued locally by trade licensing offices. Such certificates only authorise entrepreneurs (natural persons or legal entities) to purchase foreign currencies in cash. Trade licensing offices request the CNB's opinion prior to granting licensing certificates. Entrepreneurs can carry on the purchase of foreign currencies only in premises and exchange machines that have been approved by the CNB in advance. In 2007, the CNB issued 113 opinions on the granting of licensing certificates and 209 opinions on the approval of premises. The total number of foreign exchange entities with licensing certificates was 2,560 at the end of 2007. According to data available to CNB branches, roughly 53% of them were carrying on bureau-de-change activities. The number of foreign exchange entities has been flat since 2002. Compared to 2006 the number declined slightly, as did the number of foreign exchange premises, which totalled 2,372 at the end of 2007. The lower number of premises than that of licensing certificates issued is due to the failure by bureau-de-change licence holders to carry on bureau-de-change activities.

Foreign exchange licences to sell foreign currencies in exchange for Czech currency in cash are issued by CNB branches, while other foreign exchange licences are issued by CNB headquarters. The CNB received 38 foreign exchange licence applications in 2007. Most of these applications were granted by the CNB; applications were refused due to failure to meet the conditions for granting a foreign exchange licence.[19]

In 2007, the CNB issued 14 permits to issue electronic money under Article 19 of Act No. 124/2002 Coll., on the Payment System. A total of 52 entities had such a permit as of 31 December 2007.[20] This figure puts the Czech Republic in a leading position among the EU Member States. The vast majority of these electronic money issuers are transport companies (especially those providing bus transport services) who issue chip cards that can be used to pay fares between regions to other transport companies. At the end of 2007, three companies were issuing electronic money for internet payments and one was using electronic money to enable employees to withdraw money from a social fund. No entity has so far shown any interest in obtaining an electronic money institution licence under Article 18b of the Payment System Act, or a payment system operator's licence.

The licensing, approval and authorisation workload of the CNB is not diminishing even with the gradual stabilisation of the structure of the economy and its convergence towards the standards of advanced Western European economies. This is due in part to the repeated occurrence of shortcomings in licensing, approval and authorisation proceedings, consisting in often poor-quality and inadequate preparation of applications by some applicants.

4.2 NOTIFICATIONS

The Czech Republic's accession to the EU has also opened up the Czech financial market to other entities entitled to benefit from the free movement of services under the single licence (the European passport).[21]

During 2007, the CNB received 478 announcements by foreign regulators of notifications of cross-border provision of services, of which 64 from banks (5 of them electronic money institutions), 82 from insurance

19 A complete list of foreign exchange licences, updated quarterly, is available at http://www.cnb.cz (Financial market supervision – Foreign exchange supervision – Complete list of foreign exchange entities from the register of foreign exchange entities).

20 A list of entities which have been given a permit to issue electronic money by the CNB is available at http://www.cnb.cz (in Czech only: Platební styk – Elektronické peníze).

21 More details on the single licence are available at http://www.cnb.cz (in Czech only: Dohled nad finančním trhem – Bankovní dohled – Výklad ČNB k jednotné bankovní licenci).

companies,[22] 291 from collective investment funds, 8 from investment companies and 221 from investment services providers.

The competent supervisory authorities from EU/EEA Member States were notified of the intention of one domestic insurance company to carry on insurance business within their territory under the freedom to provide services.

Summary of cross-border service provision notifications received
(end-of-year data)

	Banks	Of which: Electronic money institutions	Insurance companies	Funds	Investment companies	Investment services providers
2007	198	6	478[23]	1 479	37	518

In the area of prospectus notifications, the CNB received 109 notifications from foreign regulators.

During 2007, the CNB also received notification of the intention to carry on business in the Czech Republic from 2,723 insurance intermediaries having a home Member State other than the Czech Republic (2,375 of them from the Slovak Republic).

4.3 REGISTRATIONS

Under Article 39 of the Act on the CNB, another 5 representations of foreign banks and financial institutions were registered in 2007. Such representations do not carry on banking business directly, but intermediate and offer the services of their banks in the Czech Republic. Two representations terminated their activities in 2007. A total of 27 foreign bank representations were registered in the Czech Republic as of the end of 2007.[24]

In all, 10,628 investment intermediaries were registered under Article 30 of the Capital Market Undertakings Act as of the beginning of 2007. During 2007, 2,792 certificates of registration of an investment intermediary were issued and 55 were cancelled. The CNB thus registered 13,365 investment intermediaries as of 31 December 2007.

In 2007, a total of 17,408 intermediaries were listed in the register of insurance intermediaries and independent loss adjusters, 95 of which were insurance agents and 62 insurance brokers. Decisions to cancel entries were made in 3,353 cases at the request of the insurance intermediaries concerned pursuant to Article 29 of Act No. 38/2004 Coll., on Insurance Intermediaries and Independent Loss Adjusters. The register of insurance intermediaries is available on the CNB website (http://ispoz.cnb.cz). At the end of 2007 it contained 67,529 insurance intermediaries,[25] 5,226 of them foreign. A total of 61,482 active insurance intermediaries were entered in the register as of 31 December 2007.

In connection with the registration of insurance intermediaries, the CNB holds professional examinations of insurance agents and insurance brokers. The purpose of these examinations is to verify whether the applicants are competent to perform intermediary activities for which a medium or higher level of competence is required. In all, 682 candidates took these examinations and 666 passed.

During 2007, decisions were taken to register 6 entities in the register of responsible actuaries.

22 In addition to insurance companies, insurance company branches operating in other EU/EEA countries are notified in this manner. In 2007, the CNB was notified by foreign regulators of the intention of 21 branches to provide services in the Czech Republic (this figure is included in the total of 82 notifications).

23 Of which 100 are branches of such insurance companies in the EU/EEA.

24 Sparkasse Oberlausitz-Niederschlesien was registered in January 2008.

25 This figure represents the total number of registered intermediaries, including withdrawn registrations.

4.4 OFF-SITE SURVEILLANCE

Off-site surveillance consists in continuously monitoring the activity and financial performance of the individual entities operating on the market and assessing the evolution of the market as a whole and its key segments. The CNB's supervisory work involves checking compliance with the relevant legal rules, compliance with prudential rules and regular assessment of the financial condition of individual regulated entities.

Information is obtained mainly from the statements and reports regularly submitted by individual entities on a solo and in some cases also a consolidated basis. The required frequency and manner of sending data to the CNB still differ across market segments. As the integration of financial market supervision progresses, however, efforts are being made to align them gradually in terms of both content and manner of reporting to the CNB. Where more intensive monitoring of the situation is needed, an extraordinary reporting duty is imposed on financial institutions.

In addition to the regular reports, all other available information from various sources is used for continuous monitoring of entities and the market. These sources include financial statements, annual reports, auditors' reports, information from on-site inspections and information-gathering visits, public presentations and press releases. Where additional information is needed, meetings with representatives of the supervised entities are organised on an ongoing basis.

In 2007, off-site surveillance focused more on the potential impacts of the global market turbulence caused by the problems in the US subprime mortgage segment on the performance of domestic financial institutions. In this context, the portfolios of individual institutions were inspected and their exposure to the US mortgage market, for example through direct holdings of CDOs or other securities backed by these mortgages, was determined. These instruments were held only exceptionally, their volumes were relatively low and so their impacts on institutions' financial results were only limited. Exposures to such instruments should in this sense have no major impact on financial institutions' solvency, capital adequacy or liquidity. Nevertheless, significant attention continues to be devoted to the evolution of the value of these securities. Related aspects, such as the method of valuing such securities given the currently lower liquidity in the markets for these instruments, are also being monitored. In this context, a number of information-gathering visits were made to the supervised institutions.

In 2007, the CNB and the Czech Ministry of Finance signed an agreement on cooperation in the exchange of information relating to the financial market. Under this agreement, the two institutions regularly exchange aggregated data on the financial market.

Off-site surveillance helps the CNB to form a comprehensive picture of the financial condition of the supervised financial market entities and allows it to identify potential problems and risks, which provide a starting signal for conducting on-site examinations or making decisions on further action to be taken against a supervised entity.

4.4.1 Supervision of credit institutions

Off-site surveillance consists mainly in continuously assessing the activities and financial condition of banks and the risks they undertake. This work is based on three basic analytical pillars: appraisal of signal information, regular analyses of individual banks and internal bank ratings.

The signal information system is an automated early warning system which helps supervisors to identify potential negative tendencies in individual banks in good time. Its outputs are assessed for individual banks at monthly frequency. Compliance with prudential limits (e.g. for credit exposure and capital adequacy) and other prudential rules is also monitored on a monthly basis for all banks. An analysis of the financial condition of each bank and the risks it undertakes is prepared quarterly, serving as a basis for decisions on the intensity and manner of supervision of that particular bank. Foreign bank branches are assessed under a slightly simpler regime, as the CNB's powers of supervision of these entities are limited.[26] Ratings dividing banks into five categories according

26 Primary responsibility for supervision of foreign bank branches lies with home country supervisors. In the case of branches of foreign banks from EU Member States, the CNB mainly monitors their liquidity and compliance with the obligations in the Act on Banks.

to their financial condition and management quality are prepared for internal CNB supervisory purposes twice a year. These internal ratings also form part of the six-monthly information on the development of the banking sector provided to the CNB Bank Board.

Staff involved in off-site surveillance use an automated Banking Supervision Information Centre. This tool, created in-house at the CNB, allows supervisors to view data from all the supervisory reports and statements and generates standard outputs. It also enables the creation of specific outputs for analytical assessments of individual banks and the banking sector as a whole. This informational support provides an instant overview of the main indicators of the financial condition of each bank and the banking sector and of compliance with the prudential rules.

In order to obtain additional information on banks' activities and performance, including their plans for the future, meetings with bank representatives or information-gathering visits are held where necessary. In 2007, these visits focused on the potential impacts of the global financial market turbulence on the performance of domestic credit institutions. These impacts were assessed as limited. Auditors' reports on banks' internal control systems pursuant to Article 22(1)(b) of Act No. 21/1992 Coll., on Banks, as amended, are an important source of information for supervision of banks. These reports are requested from banks particularly in periods when no on-site examination covering the given area is conducted. In 2007, CNB Banking Supervision obtained auditors' reports on control systems in 6 banks, evaluating the situation in these banks as of 31 December 2006. For 2007, requests for such audits were placed in three cases (audits as of 31 December 2007). These audits were made available to the CNB in the first quarter of 2008.

In addition to regular assessment of banks' financial condition, off-site surveillance focuses on some other aspects of their activities. In 2007, a total of 74 decisions were issued relating to the assessment of the competence and integrity of proposed senior officers in banks, the approval of external auditors, lists of shareholders prior to general meetings, the inclusion of subordinated debt in a bank's capital, etc. Apart from that, off-site supervision involves continuously monitoring whether banks are complying with the Act on Banks and other legal regulations.

Cooperation with regulators from other countries, in particular those supervising the parent banks of banks operating in the Czech Republic, is an important component of supervisory activities. The CNB has concluded eight bilateral Memoranda of Understanding with foreign bank regulators. This number remained unchanged in 2007, reflecting the relatively stable shareholder structure of domestic banks as regards the home country of their owners. In addition to the exchange of information on the financial condition of banks and other entities from financial groups operating in both countries, discussions with foreign regulators focused mainly on practical issues connected with the implementation of Basel II and more recently also on closer supervisory cooperation in resolving potential crises. CNB Banking Supervision is currently involved in the work of the committees and working groups of the European Commission, the European Central Bank and the Bank for International Settlements.

Apart from assessments of individual banks, the development of the banking sector as a whole, and, where appropriate, individual segments of the sector, is also subject to continuous analysis. Basic indicators of the development of the banking sector are published quarterly on the CNB website (http://www.cnb.cz – *Financial market supervision – Banking supervision – Banking sector – Basic indicators of the banking sector*). CNB Banking Supervision also communicates regularly with numerous entities interested in the development of the Czech banking and financial sector (international organisations such as the IMF, the World Bank, the OECD, the ECB, rating agencies, etc.).

On 1 April 2006, in connection with the integration of supervisory activities, the CNB also assumed responsibility for supervising the credit union sector. In the first half of 2007, České národní spořitelní družstvo had its licence withdrawn due to shortcomings in its activity identified during an on-site examination. In 2007, CNB supervisors continued reviewing the current situation in the credit union sector, through on-site examinations and intensive off-site surveillance, with a view to further aligning the procedures for the supervision of these entities with those applied to banks. In autumn 2007, a second credit union became a CERTIS payment system participant. Credit unions have been reporting through the Non-bank Data Collection System (SDNS) since July 2007.

Shortcomings in credit institutions' activities identified during continuous off-site surveillance are resolved with these institutions using appropriate means to remedy the problem and achieve the required situation. In the event of less serious shortcomings, the credit institution is asked to inform the CNB about how and when the shortcomings will be remedied. The CNB will consider the submitted solution, request changes where necessary and then continuously assess whether the bank is removing the shortcomings in accordance with the timetable submitted. To this end, credit institutions are required to send a list of measures adopted, usually on a quarterly basis. Less serious shortcomings detected during on-site examinations are dealt with in the same way. If more serious violations of the legal regulations or prudential rules are found in an institution's activities, remedial measures are imposed. The remedial measures listed in Article 26 of the Act on Banks can be applied.

As mentioned in the introduction, off-site surveillance in 2007 was focused on the potential impacts of the global market turbulence. In this respect, credit institutions' portfolios were examined and their exposure to the US mortgage market was determined.

4.4.2 Supervision of capital market undertakings

In the capital market area, the CNB performs supervision in several main segments – collective investment entities, pension funds, investment firms and other entities operating in the capital market. Capital market supervision relates both to entities and to transactions.

Off-site surveillance in the investment firms segment was focused mainly on analysing data sent to the CNB under the information duty. Particular attention was paid to the inspection of data from investment firms' order books. In connection with data analysis, regular assessments of the level of risk associated with supervised entities and the potential impact of their failure on the stability of the financial market were carried out. In addition to regular analyses, the data were used mainly in the context of on-site inspections and other activities, usually in the area of licensing.

Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms, implementing Basel II, entered into force in July 2007. Most non-bank investment firms used the legal option of continuing to apply the original (Basel I) capital adequacy calculation method in the second half of 2007. A series of meetings were held with investment firm representatives to discuss the definition of consolidated groups and the application of some provisions of the prudential rules decree.

The activities of the exchange chamber, exchange committees and bodies of the Exchange Guarantee Fund were monitored. Information sent by the OTC market operator under its disclosure duty was regularly evaluated.

Transactions on regulated markets were monitored continuously to detect irregular trading situations. In addition to making suggestions for further investigations, in one case the CNB filed a report on the commission of a crime with the relevant prosecuting attorney's office and informed the Financial Analytical Unit at the Ministry of Finance. Compliance with Decree No. 114/2006 Coll., on the fair presentation of investment recommendations, was monitored. The capital market monitoring information system was upgraded with the launch of a module facilitating the international exchange of data on transactions at the request of the CESR.

In the area of IT support development, a new capital market monitoring information system was under preparation. This system, which should allow efficient administration and sophisticated analysis of collected data, is scheduled to go live in 2009.

Standard off-site surveillance in the collective investment and pension fund sectors was focused on analysing data acquired under the disclosure duties. Asset eligibility was verified and asset valuations checked. Compliance with the investment limits was also inspected. Some minor shortcomings – the absence of depositories' reports on the overstepping of limits – were detected. As regards the level of risk, some degree of imbalance between the usable assets of some pension funds and the volume of funds credited to pension planholders was identified as a potential problem area.

The possible impact of the financial market developments in some countries on the collective investment and pension fund sector in the Czech Republic was analysed. The direct effect was not assessed as significant.

In off-site surveillance of the capital market, attention was also focused on cooperation with the regulation department on the implementation of the Markets in Financial Instruments Directive (MiFID) into the primary and secondary legislation and also on the methodological documents provided by the CNB to supervised entities in order to ensure greater transparency and predictability of their approaches to individual topics (professional care, management of conflicts of interest and others). As mentioned in the introduction, the attention was also devoted to the impacts of the global financial crisis on the entities supervised by the CNB. In this respect, we can say that the sector was not affected by any significant instability or crisis.

4.4.3 Supervision of insurance companies

The CNB's financial market supervisory work involves checking insurance companies' compliance with the relevant legal rules as well as their solvency and financial management from the point of view of their ability to fulfil their obligations. It also includes verifying the methods of creation and application of technical provisions and the financial placement of assets arising from technical provisions, checking compliance with the CNB's decisions, inspecting the conformity of activities performed with licences granted, and checking accounting procedures and the effectiveness of control systems.

Off-site surveillance is based on regular assessments of the financial condition of insurance companies, including compliance with the prudential rules, as well as imposing remedial measures where shortcomings are detected. Key economic indicators of insurance companies are assessed on the basis of mandatory reports. In insurance companies that belong to an insurance group, data obtained from supplementary supervision of insurance companies in groups are also evaluated.

In addition to the reports presented to the CNB on the dates stipulated by law, it was decided in administrative proceedings to impose a duty on some insurance undertakings to present their reports for supervisory purposes on dates other than those stipulated by law, e.g. monthly or quarterly. Three insurance companies were obliged to present their reports in this manner in 2007.

In line with the new strategy for risk-based supervision, a set of indicators of an insurance company's financial soundness, including early warning criteria, was defined in 2007. This system should serve as one of the main analytical tools for monitoring trends in the financial condition of an insurance company based on data from its financial statements, also enabling the detection of weaknesses in an insurance company's financial performance.

Information-gathering visits to the most significant Czech insurance companies, focusing in particular on business and investment strategies, risk management systems and internal control systems, were an integral part of the supervisory activities in 2007. Information-gathering visits to domestic insurance companies are also planned for 2008, focusing chiefly on insurance companies' business strategies and financial management.

Owing to the specific and diverse nature of insurance companies' activities, detailed actuarial analyses of individual segments will be conducted as part of the supervisory work in 2008.

Joint inspections by the CNB and relevant foreign supervisory activities are planned for 2008 at the international financial group level. These joint inspections will be targeted at unifying the methodologies for individual areas of supervision within the EU.

For example, the biggest problems identified and dealt with in off-site surveillance of some insurance companies included the misinterpretation of the scope of one type of liability insurance and the suspicion of insufficient provisions for unearned premiums. The impact of developments on financial markets linked to the mortgage crisis on the financial condition of individual insurance companies is also being analysed on an ongoing basis, as is the impact of the rising interest rates on the fair value of financial placements. Although the rise in interest rates is having a significant negative impact on the financial condition of a number of institutions, neither the solvency nor the liquidity of any of them is at risk.

4.4.4 Supplementary supervision of financial conglomerates

Financial conglomerates are groups in which insurance companies, banks and/or investment firms have a significant share in all the financial activities carried on by the members of the group. Off-site surveillance includes supplementary supervision of such groups (under Act No. 377/2005 Coll. and Decree No. 347/2006 Coll.).

Supplementary supervision of financial conglomerates focuses on capital adequacy, intra-group transactions, risk concentrations, internal control systems and risk management systems. Responsibility for supplementary supervision lies with a coordinator, who monitors the relevant indicators, including compliance with the requirements for capital adequacy and risk management systems, and ensures cooperation with other supervisory bodies. In 2007, the CNB acted as a supplementary supervision coordinator for one financial conglomerate.

4.4.5 Supervision of other regulated entities

In the area of foreign exchange supervision, the CNB may open administrative proceedings to impose sanctions if it detects a violation of the foreign exchange regulations.[27] If the suspicion of a violation of the foreign exchange regulations is proved, the participant's foreign exchange licence may be limited, suspended or revoked depending on the extent, manner and duration of the violation. If a violation of the foreign exchange regulations while performing bureau-de-change activities is proved, the CNB may propose suspension or cancellation of the bureau-de-change licence. A fine of up to CZK 50 million, or up to 50% of the amount to which the illegal conduct relates, can be imposed in both cases. Administrative proceedings in foreign exchange matters are conducted by CNB headquarters. In 2007, a total of 37 administrative proceedings initiated due to suspicion of violation of the foreign exchange regulations were closed with final and conclusive effect. The fines imposed in 2007 totalled CZK 1.2 million. These fees constitute revenues to the state budget.

In 2007, as in previous years, most of the foreign exchange offences were due to breaches of the conditions for cash purchases and sales of foreign currency in return for Czech currency. These included in particular erroneously made and labelled deductions for foreign currency sales and purchases, insufficient identification of clients in transactions exceeding CZK 100,000 and failure to fulfil the reporting duty. The offence of unauthorised offering, performance or intermediation of foreign exchange trading (cash or non-cash) was identified in 6 cases. Where the CNB finds out that the violation of the foreign exchange regulations consists in unauthorised offering, performance or intermediation of foreign exchange trading, it orders the entity concerned to terminate the illegal activity or opens administrative proceedings to impose sanctions.

The CNB also supervises foreign exchange licence holders' compliance with the obligations laid down in Act No. 61/1996 Coll., on Some Measures against Money Laundering and on the Amendment of Related Acts, Act No. 69/2006 Coll., on the Performance of International Sanctions, and selected directly applicable EC legal rules.

Act No. 160/2007 Coll., amending some acts in the field of consumer protection, took effect on 2 July 2007. This Act, *inter alia*, amended Act No. 6/1993 Coll., on the Czech National Bank, by inserting an Article 44a laying down the supervisory powers of the CNB in the area of the remote conclusion of agreements. These are new powers in the case of entities supervised by the CNB in the foreign exchange area, i.e. in the case of bureau-de-change licence holders and foreign exchange licence holders.

The CNB's supervision of electronic money institutions – based on the permits referred to in Article 19 of the Payment System Act – consists in monitoring compliance with the conditions under which licences to issue electronic money are granted. This CNB activity is based on regular half-yearly statistical reports and other information provided. By law, the CNB may revoke a licence in administrative proceedings due to violation of the conditions or failure to comply with the reporting duty. Experience with individual issuers is positive and no licence has been revoked for this reason so far.

4.5 ON-SITE EXAMINATIONS

On-site examinations are a major component of financial market supervision. Their main purpose is to identify financial institutions' risks in good time and to adopt appropriate measures if any shortcoming are detected. In 2007, the CNB continued incorporating the documents and conclusions of the European Commission and other relevant EU and BCBS working groups into its on-site examination procedures. On-site examinations continued focusing on compliance with the prudential rules by financial institutions and on internal control systems, whose quality and integrity significantly affect the risk potential of entities operating in the financial market. During on-

27 List of foreign exchange regulations: http://www.cnb.cz – Financial market supervision – Foreign exchange supervision – Foreign exchange regulations in force. For a complete list, see the Czech version of the CNB website.

site examinations, the methods used by financial institutions to identify, measure, evaluate, monitor and limit individual risks they face were also assessed.

The CNB's on-site supervision work involves both comprehensive and partial examinations. Comprehensive examinations cover all the activities of the examined entity, while partial examinations deal with selected areas.

The examinations conducted in 2007 were based on off-site surveillance findings. They also took into account the time that had elapsed since the last on-site examination and indicators from the risk assessment system, where this system is used in the market segment concerned. Other factors reflecting the present or expected situation of the supervised entity were also considered.

Remedial measures were imposed on individual entities based on the shortcomings detected. Compliance with such measures is monitored by the CNB. This is a standard process used for on-site examinations.

4.5.1 On-site examinations at credit institutions

As part of the supervision of banks and credit unions, 14 on-site examinations were carried out in 2007, of which 7 at banks and 7 at credit unions. These examinations focused on the management of credit risk, market risks and operational risks, including information systems risks, as well as on the prevention of money laundering and on overall assessment of the internal control systems of banks and credit unions. All these areas or a selected set thereof were examined. One specialised extraordinary on-site examination was conducted in 2007.

A new CNB Decree No. 123/2007 Coll., implementing directives of the European Parliament and of the Council, the conclusions and recommendations of EU and BCBS working groups, and other recognised principles and standards, took effect on 1 July 2007. The on-site examinations based on these principles thus acquired comprehensive and up-to-date local regulatory support in mid-2007.

The examinations were planned primarily on the basis of risk assessments of the individual entities, in which the results of previous examinations and recent developments in the relevant segment of the financial market had a significant weight.

An important part of the examinations of banks' and credit unions' individual risks in 2007 was a check of the system used by these institutions for their regular reporting to CNB Banking Supervision. Such reports, submitted to the CNB on a regular basis, are important indicators of a financial institution's soundness and are vital information for off-site surveillance. The information must therefore be correct and undistorted.

Cooperation with foreign banking supervisors continued in 2007, particularly in the preparation and approval of advanced methods for the calculation of capital requirements for credit risk (IRB, Internal Ratings Based Approach) and operational risk (AMA, Advanced Measurement Approach) introduced by some banks and financial groups operating in the Czech Republic.

All these aspects are gradually being reflected in the procedures applied in on-site examinations. The procedures and assessment benchmarks applied by the CNB were also presented at domestic and foreign professional forums in 2007.

The examinations conducted in 2007 focused on credit and operational risk management. In the credit risk area, supervisors assessed the conditions created for the proper operation of set processes and the provision of credit transactions (balance-sheet and off-balance-sheet), the monitoring of such transactions, the processing and transfer of information on risks undertaken, and the sufficiency of such information for high-quality credit risk management.

The main shortcomings detected in the on-site examinations conducted in 2007 included insufficient documentation of transaction approval and monitoring processes. As a result, decision-making processes could not be retraced and control systems did not cover the lending process as a whole. This could have given rise to errors in entering data on loans provided and collateral accepted in internal bank systems, errors which partially fed through to their accounting (and on to their reports for management and reports for the CNB). However, the distortions detected were insignificant in terms of volume. Supervisors also found shortcomings in the regulations of the inspected entities, shortcomings which exposed them to the risk of different interpretation of these regulations by the bank's employees.

The examinations of banks also identified some shortcomings in the area of operational risk management and risks associated with the use of information systems and technology. These included shortcomings in identifying operational risk caused by a non-systematic approach of individual organisational units to recording and collecting events in the operational risk database. In some cases, banks also failed to ensure clear assignment of responsibility for preparation, implementation and control in the information system risk management area in compliance with the principles of segregation of conflicting duties. This was often accompanied by shortcomings in processes connected with the identification, assessment and examination of information system and technology risks. Examples of such shortcomings include insufficient classification and management of information assets, low efficiency and effectiveness of assessment of security incidents, and insufficient verification of privileged users.

The most common and most significant shortcomings detected in the examinations of credit unions in 2007 were as follows: low quality internal control systems, shortcomings in the activities of elected bodies, poor identification of risks undertaken (particularly credit and interest rate risk) and a resulting limited ability to measure and manage these risks correctly, non-segregation of conflicting duties, insufficient control elements for cash and non-cash payments and a generally insufficient internal control system, and poor internal regulations. Decision-making processes in credit unions were not being documented in a retraceable manner, and in most credit unions shortcomings were identified in the money laundering prevention area.

The nature and extent of the shortcomings detected in 2007 make it clear that the examined entities had not incorporated the regulatory requirements laid down in CNB Provision No. 6/2006 Coll., stipulating rules for the capital adequacy, exposure and internal control system of credit unions (which credit unions were required to be compliant with by 31 December 2006) and in Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms (which took effect on 1 July 2007), into their business activities to the required extent.

Examinations of credit risk management systems
In the area of credit risk management, on-site examinations in the credit union sector continued in 2007. In these examinations, credit risk management systems were inspected in three credit unions, taking account of the new legislation introduced in this sector of the financial market, including prudential rules.

Two on-site examinations focused on credit risk management and one extraordinary on-site examination were conducted in banks. In parallel with these examinations, the internal inspection methodology was updated in connection with the implementation of Basel II.

Another area closely connected with credit risk management on which the on-site examinations in 2007 were focused was the validation of IRB credit risk management systems in banks. In this context, the updating of the internal on-site examination procedures for assessing the efficiency and effectiveness of IRB systems continued.

Examinations of management of market risks, liquidity risk and risks associated with trading on financial markets
Owing to the deepening integration of the individual components of financial market supervision, the on-site supervision in the areas of market risks, liquidity risk and credit and operational risk relating to financial market transactions during 2007 involved not only examinations of credit unions and banks, but also – for the first time – examinations of insurance companies.

As in banks, the examinations in credit unions and insurance companies were aimed at assessing the sufficiency of organisational arrangements and staffing, the quality of risk measurement methods, the correctness of input data and parameters, the sufficiency and suitability of systems of internal limits and stress testing, the sufficiency of information made available to top management and the sufficiency and independence of control mechanisms. When applying the regulatory requirements to the various types of financial institutions (credit unions, banks and insurance companies), the CNB took into account the specific features of the individual types of supervised institutions.

Another activity that comes under on-site supervision is the validation of internal models for market risks. In the course of 2007, the CNB completed a process of validation of one internal model for the calculation of capital requirements for general interest rate risk and foreign exchange risk. In the light of the results of this validation, the CNB decided to allow the bank to use this model.

Examinations of operational risk management, including IS/IT risks

The CNB stepped up its operational risk examinations in connection with an amendment to the prudential rules for banks and credit unions and with the verification of banks' preparedness for the implementation of the advanced capital requirement calculation methods. The on-site inspections of compliance with the regulatory requirements verified the way in which banks and credit unions identify and limit the risks of losses due to shortcomings in internal processes, the human factor, systems, external events and non-compliance with legal regulations. Supervisors evaluated whether the causes of the risks identified are assessed and whether effective measures are adopted to minimise their negative impact on banks and credit unions. Special attention was also given to issues relating to business continuity management and outsourcing. The latter has expanded particularly in the IS/IT area. In particular, large financial groups are gradually concentrating the provision of information services for their members into separate companies.

Checks of the risks associated with information systems and information technology were a significant component of examinations of operational risk. The influence of this area on the overall risk profile of regulated entities is rising, especially in banks. In 2007, supervisors also assessed the settings of control processes and the level of information system security. Specific procedures and measures in the area of physical, logical and personal security were evaluated. Security aspects were also dominant in the evaluation of the development and operation of information systems. In 2007, the CNB devoted increased attention to electronic banking in the context of a rising number and risk of incidents in this area of banking business.

In the operational risk area, on-site supervision also involved verifying banks' preparedness for the introduction of the advanced methods for determining the capital requirement for operational risk. CNB Banking Supervision also prepared and sent to foreign home regulators opinions on the introduction of advanced methods in groups whose members included banks licensed by the CNB.

Examinations of the operation and effectiveness of internal control systems

Examinations in this area are conducted in two ways. One way is to assess the components of internal control systems as integral parts of the management of individual risks. Secondly, the internal control system area is subject to examinations focusing on verifying the conditions for sound corporate governance and the internal control system on the basis of Decree No. 123/2007 Coll.

Examinations in the area of corporate governance focus on evaluating the role of the bank's bodies and their committees, the organisational structure of the inspected entity as a whole and information flows and mutual links.

The internal control system examinations focus on the compliance function (based on international directives, standards and guidelines, in particular the BIS's April 2005 document *The Compliance Function in Banks* and the CEBS's January 2006 *Guidelines on the Application of the Supervisory Review Process under Pillar 2*) and the internal audit function.

Anti-money laundering

The examinations are focused on verifying the operation and effectiveness of the AML system. Supervisors check, among other things, the compliance of the examined entity's system with Act No. 61/1996 Coll. and CNB provisions, the application of appropriate "know-your-customer" policies and the examined entity's ability to identify and analyse suspicious transactions and to notify the Ministry of Finance's Financial Analytical Unit (FAU) within the set time limit, and its strategies and control system in this area. The CNB works closely with the FAU in this respect.

Basel II implementation as regards advanced methods for determining capital requirements

Under the new capital adequacy framework (Basel II), in the wording of EU Directives 2006/48/EC and 2006/49/EC as transposed into CNB Decree No. 123 of 15 May 2007, banks are allowed to use advanced approaches based on mathematical models in order to calculate capital requirements.

In 2007, the teams set up in order to examine special methods continued consultations with all regulated institutions that have shown an interest in using the IRB approach for credit risk or the ASA (Alternative Standardized Approach) and AMA approaches for operational risk. The activities of the two teams included ongoing communication with foreign banking supervisory authorities in order to establish a common approach to validating these advanced approaches in multinational banking groups. Several meetings were held on this issue in 2007, with intensive meetings continuing into 2008.

Intensive pre-validation[28] and validation processes for the IRB approach were conducted in five banking groups in the Czech Republic, while the AMA approach was addressed by CNB staff in three banking groups. The ASA approach was assessed in one bank and in one credit union on the basis of applications submitted.

In 2007, the first authorisation to use the IRB approach to capital requirements calculation was granted to three banking groups in the Czech Republic, which had been included in their foreign parent banks' applications to use the IRB approach. Consent to the use of the AMA approach was granted to one bank in the Czech Republic, which had also been included in its parent bank's application.

4.5.2 On-site examinations in capital market institutions

In the collective investment area, three inspections of the internal operations of investment companies were commenced and completed in 2007. A report on the examination of an investment company's internal operations, which had started the previous year, was issued in one case.

These inspections focused chiefly on identifying potential shortcomings concerning compliance with the prudential rules and the rules of organisation of the internal operations of investment companies, particularly in terms of internal regulations, the investment process and the process of execution of transactions in investment instruments or other assets, the process of issuing, registering and repurchasing securities of a collective investment fund, the reconciliation rules, the process of valuation of assets in mutual funds, the operation of the internal control system, control and security measures for the processing and recording of data, and procedures designed to prevent conflicts of interests. Shortcomings were detected in one case, consisting in inadequate operation of the management structure and organisational processes when changing members of the board of directors. In the case of less serious shortcomings, the examined entities were advised, for example, to strengthen their internal audit function, to change certain control mechanisms, to reinforce staffing in the portfolio management area, and to make changes to their control and security measures for data processing and recording.

In the area of private pension plans, a total of four inspections were commenced and completed in pension funds in 2007. These were focused on risk assessment of pension funds and compliance with the rules for the management of assets entrusted to third parties and rules for the calculation of the fair value of assets. In addition, reports on two inspections focusing on this area commenced in the previous year were issued in 2007.

A finding relating to the valuation of securities held until maturity was detected in one case, and two infringements of the obligation to manage fund assets with professional care (concerning portfolio structure and the prohibition of handling assets in a manner inconsistent with the interests of participants) were also found in one case. In addition to examination findings, less serious shortcomings were detected, especially in the area of informing private pension planholders of benefit amounts, the area of contractual relationships with entities to which management of a fund's assets had been delegated, and in the internal control system area (the compliance function). The examined entities were advised on how to take remedial action in these areas.

An on-site examination focusing on the settlement of newly introduced financial derivatives transactions was conducted at a settlement system operator.

Nine on-site examinations were commenced in the area of investment service provision in 2007, all of them in investment firms. Four of these examinations were comprehensive, focusing on compliance with rules for prudent

28 This is a preliminary informal examination of advanced methods for the capital requirements calculation before a bank or a financial group as a whole applies to use these methods for regulatory purposes.

provision of investment services (in particular, administrative and accounting principles, internal control systems, financial risk management systems and liquidity management systems) and rules of conduct towards clients. Two examinations were directed at maintenance of a register by an investment firm and one at compliance with the rules for prudent provision of investment services focusing on risk management and maintenance of a register. One examination was focused on the implementation of rules and procedures for SPAD system trading and related rules of conduct towards clients. One examination was cancelled when the investment firm changed its objects of business after receiving notification of the commencement of the inspection. The inspections focused both on entities where shortcomings had been detected during a previous inspection and on entities where an inspection had not previously been conducted.

The inspections revealed no acute problems in the capital market sector as a whole, although some quite serious violations of the legal regulations were detected. Numerous formal shortcomings were identified due to non-compliance with the internal regulations of an investment firm by its employees. One common shortcoming was a wrongly configured – and therefore ineffective – internal control system. In on-site examinations, CNB supervisors also detected problems concerning records of client assets and the method of carrying out reconciliations between actual stocks of client assets and the stocks reported in investment firms' trading systems, as well as breaches of the authorisations granted by the CNB during the provision of investment services.

Actions following up on inspections commenced in the previous period were completed. This included in particular the completion of two examinations and three objection proceedings, including the subsequent assessment of remedial measures. Increased attention was paid to the activities of AFIN BROKERS, a. s., whose investment firm licence had been revoked at the end of 2006, in respect of the closure of clients' open positions and the release of client assets.

An on-site inspection was conducted in the OTC market operator RM-Systém, a. s. This focused on the functioning of the system of measures to detect market manipulation and insider trading. The inspection led to requirements to modify and extend the system, which have been gradually met.

In the collective investment area, in one case shortcomings were detected consisting in inadequate operation of the management structure and organisational processes when changing members of the board of directors. In the case of less serious shortcomings, the examined collective investment entities were advised, for example, to strengthen their internal audit function, to change certain control mechanisms, to reinforce staffing in the portfolio management area, and to make changes to their control and security measures for data processing and recording. In the area of private pension plans, a finding relating to the valuation of securities held until maturity was detected in one case, and two infringements of the obligation to manage fund assets with professional care (concerning portfolio structure and the prohibition of handling assets in a manner inconsistent with the interests of participants) were also found in one case. In addition to examination findings, less serious shortcomings were detected, especially in the area of informing private pension planholders of benefit amounts, the area of contractual relationships with entities to which management of a fund's assets had been delegated, and in the internal control system area (the compliance function). The examined pension funds were advised on how to take remedial action in these areas.

4.5.3 On-site examinations in insurance companies

In its on-site examinations in 2007, the CNB focused its attention on financial placement (investment) and the creation and application of technical provisions. Compared to previous years, greater emphasis was also laid on the quality of internal processes, the sufficiency of control mechanisms and the operation of internal control systems.

A total of 8 on-site examinations were commenced in 2007, of which 4 were comprehensive, 2 focused solely on non-life insurance and the remaining 2 dealt with financial placements and risk management in relation to the investment activities of the examined entities. By the end of 2007, inspection reports had been submitted to the representatives of 5 insurance companies. The remaining 3 inspections, which were launched at the end of 2007, were completed with the handover of inspection reports at the start of 2008.

The most frequent shortcomings arose from non-compliance with provisions of the Insurance Act (seasonal undervaluation of gross technical provisions, failure to respect the principle of financial placement liquidity, unjustified inclusion of some assets in financial placements) and the Accounting Act (accounting of provisions for some titles without an evident reason) and from non-compliance with internal guidelines, erroneous or insufficient amendments thereto (particularly non-compliance with the legislation in force) and failure to ensure adequate internal control elements.

In the second half of 2007, in addition to inspection reports, the CNB started issuing "side letters". In accordance with the State Inspection Act, the inspection report specifies direct infringements of legal rules or implementing regulations and supervised entities are notified by means of "side letters" of potential risks to insurance companies' activities identified by the CNB during its inspection. During the handover of inspection reports, the responsible representatives of insurance companies are also made familiar with the content of the "side letter". The CNB expects the examined entities not only to deliver an opinion on the examination findings given in the report, but also to propose measures to eliminate the risks given in the "side letter". The CNB's experience to date is that insurance companies welcome this new procedure.

One insurance company filed objections to the wording of an inspection report (for an examination completed with the handover of an inspection report at the close of 2006). In this case, changes to the wording of the inspection report were made in respect of two examination findings, but these had no effect on the substance of the examination findings. The head of the examination team rejected the insurance company's other objections as unjustified. In other cases, together with opinions on the inspection report the CNB received proposed measures to eliminate the shortcomings detected, including timetables for implementing them.

In 2007, the CNB conducted three penalty proceedings against supervised entities. It opened these after assessing the insurance companies' approach to the shortcomings detected during on-site examinations and evaluating the adequacy and effectiveness of the measures proposed by the insurance companies. The number and seriousness of the examination findings were also a significant criterion. In one case, together with the commencement of administrative proceedings the CNB issued one precautionary measure prohibiting the insurance company from concluding insurance contracts and extending the existing liabilities in sectors for which the company did not have a permit from the supervisory authority. In decisions in administrative proceedings, the CNB imposed on all three entities concerned the obligation to prepare and submit measures to eliminate the shortcomings detected, including a timetable for adopting them, to inform the CNB about all measures taken on a quarterly basis, and to put in place a functioning system for identifying, assessing and managing risks in the areas where the shortcomings had been detected. None of the insurance companies filed any appeals against the CNB's decisions.

4.5.4 On-site examinations in other regulated entities

The CNB conducts on-site foreign exchange examinations through its branches. The aim of the inspections is to verify effectively all activities performed by a particular non-bank foreign exchange entity and its individual establishments. A total of 451 on-site foreign exchange examinations were conducted in 2007. Breaches of legal regulations were found in 297 cases. Where the CNB found that the foreign exchange regulations had been contravened, it opened administrative proceedings or imposed measures to remedy the shortcomings outside the framework of administrative proceedings.

The CNB is not authorised by law to conduct on-site examinations of entities that issue electronic money pursuant to Article 19 of the Payment System Act.

4.6 COOPERATION WITH SUPERVISED ENTITIES

Under the reporting duty, the CNB receives a whole range of reports and statements for supervisory and statistical purposes from regulated entities. The fulfilment of these reporting duties can be assessed as satisfactory. The overwhelming majority of entities submit reports of the required quality and within the required deadlines, though in some cases there is still some room for improvement. The sporadic cases in which discrepancies were found in the submitted data were dealt with through communication between the CNB and the supervised entity. This supervisory practice has proved its worth and helps to improve the quality of the data submitted.

As part of the supervision of fulfilment of the regular reporting duty, supervisors focus on continuous, regular and timely compliance and also on the formal and objective accuracy of the reporting and of the data disclosed. When analysing the data acquired, the supervisory objective is to determine and monitor the regulatory risks occurring in the individual segments of the financial market.

The information contained in the regular reports is not always sufficient for financial market supervisory purposes, since by its very nature it relates primarily to past events. Given the rapid development of the financial market it is vital to communicate with regulated entities regarding their current situation, future prospects, strategies, intentions and so on. From the point of view of both the CNB and the individual regulated entities, successful and effective supervision requires regular and open communication between the supervisory authority and supervised entities. An ongoing exchange of information is also necessary during the preparation of amended or new regulatory measures.

The CNB rates positively and appreciates the approach of the individual regulated entities to cooperation and the exchange of information. It is endeavouring to further strengthen this cooperation in relation to both individual entities and their professional associations.

5. CENTRAL CREDIT REGISTER

The Central Credit Register (CCR) administered by the CNB has been enabling banks and foreign bank branches operating in the Czech Republic to exchange information on the credit commitments and payment discipline of bank clients since 2002. The CCR is an information system based on the obligation of banks and foreign bank branches to submit specified data on all balance sheet and off-balance sheet loan receivables every month. On the other hand, a bank or foreign bank branch is entitled to submit queries regarding the credit commitments, i.e. the sum of all receivables across the banking sector, of its current or potential clients, receiving an instant reply.

New functions were added to the CCR in 2006, intended mainly for analysts and statisticians from commercial banks and the CNB. Information on individual loans and information on clients obtained from the Business Register enables the creation of detailed aggregated outputs broken down by industry, loan purpose, economic sector, currency, company size measured by turnover and by number of employees, etc. These outputs provide broad scope for analyses of the development, quality and other aspects of the credit market.

The ever-increasing use of the CCR is apparent from the key data summarised in the table below. The number of users in banks is rising gradually, although one should bear in mind that the organisation of access to the CCR differs across individual banks. Some banks prefer to give numerous users from its credit departments individual access, while others deal with individual requests for information centrally through a limited set of employees. Verification of client creditworthiness has become an integral part of the lending process in banks. As a result, demands to allow direct communication between banks' internal systems and the CCR are appearing ever more frequently.

Key statistics on the Central Credit Register

	31 Dec. 2005	31 Dec. 2006	31 Dec. 2007
Number of users	1,927	2,284	2,422
No. of clients registered	302,799	356,247	403,417
of which: individual entrepreneurs	184,062	213,704	237,703
	(61%)	(60%)	(59%)
legal entities	118,737	142,543	165,714
	(39%)	(40%)	(41%)
Total loans in CZK billions*	897	1,101	1,141
Number of enquiries about total credit commitments of clients for year **	2,214,371	2,388,625	2,535,935
Number of extracts made for clients for year	133	195	225

* Including loans granted by the ČSOB branch in Slovakia.
** Including credit commitments of own clients obtained via batch reports made available to bank after each update.

The number of clients represents the number of all clients for whom a bank or foreign bank branch recorded at least one receivable since the establishment of the register in 2002. Outstanding receivables of 227,000 clients were registered as of 31 December 2007. The breakdown of clients by the number of banks from which they borrowed is also interesting. Most clients (199,000) borrowed only from one bank, 23,000 clients borrowed from two banks and 5,000 clients borrowed from more than three banks. The highest number of banks lending to a single client was 15.

Most banks check the credit commitments of their clients every month after new data are added to the database. To avoid abuse of CCR information for market research, for seeking potential clients and suchlike, a decree limits credit enquiries to persons for whom the bank or foreign bank branch can prove interest in the provision of a loan. Banks and foreign bank branches submitted enquiries regarding 38,693 clients of other banks in 2007.

As the operator of the Central Credit Register, the CNB puts great emphasis on data quality and use of the register in accordance with the purpose for which it was established. To this end, it carries out methodological inspections in banks to check whether CCR data are correct, complete and up to date and whether requests for information are justified. In addition to methodological issues, banks' suggestions for changes to the CCR database are addressed during these inspections. Such inspections were carried out in three banks in 2007.

Suggestions gathered during inspections and in a survey among CCR users were reflected in a new optimisation phase of the CCR's development. User requirements and a feasibility study for a "CCR Optimisation and Stabilisation" project were prepared in 2007. In this phase, banks will get the opportunity to connect their information systems directly to the CCR, resulting in greater user convenience. Great attention is being devoted to client management. On the one hand the identification processes for clients registered in the CZSO's Business Register will be simplified, while on the other hand such processes will be made stricter for foreign clients owing to the planned international exchange of data. The Business Register for the Slovak Republic will be made fully operational for client identification. The section of the register providing analytical data selection will be made easier to operate and user suggestions will be incorporated. Sharing of selected outputs will be made available to facilitate cooperation between users. Systems relating to statistical monitoring, extract management, user records and operational characteristics will also be optimised. New web forms enabling faster and easier work will be prepared as an alternative to selected forms. The training environment will also be upgraded and a number of new user reports will be prepared. The project also aims to modernise and unify all user modules. An integral part of the new project is an assessment of the CCR's methodological and technical preparedness for integration into the international data exchange system.

The project tasks started to be addressed in 2007 Q4. A new aggregation tool was put into operation in January 2008. This tool has significantly changed the philosophy underlying the analytical data provided. The CCR previously enabled extensive but only stock-related analytical selections in addition to its main function of providing information on the total credit commitments of clients in the form of time series. The new tool captures and aggregates the month-on-month changes for each receivable, making it possible to monitor rates of growth for selected indicators. This view is accessible to statisticians and analysts from banks and the CNB through the analytical module or direct reports. The scope of the information depends on the type of information reported by banks to the CCR. At the same time, these new outputs are also transferred to the financial market supervision information centre, where they can be processed in the same way as reports submitted directly by banks.

6. INTERNATIONAL COOPERATION

In the field of financial market supervision, the CNB is involved in the work of international – in particular European – institutions via 14 committees and 28 working groups. In terms of numbers of representatives, the CNB is most involved in the areas of banking and the capital market.

6.1 COOPERATION WITHIN EUROPEAN COMMISSION STRUCTURES AND LAMFALUSSY LEVEL 3 COMMITTEES

European Banking Committee (EBC)

In 2007, the CNB worked in partnership with the Ministry of Finance, through a technical expert, in preparing for and participating in the meetings of the European Commission's advisory body – the European Banking Committee.

One of the topical issues discussed in the EBC was the optimum supervisory setup in Europe given the integration of the market and the entities operating on it. The discussion is supported by the European Financial Services Roundtable, advocating the concept of a lead supervisor. This issue was also opened and discussed at other European forums. The European Commission is trying to understand the various aspects connected with the possible future changes to the current supervisory setup and is of the opinion that supervisory responsibilities will not be transferred from host to home supervisors in the near future. In this context, the Commission is examining the areas of crisis management including the issue of cost sharing when dealing with cross-border crises, liquidity risk management, central banks acting as lenders of last resort, deposit insurance schemes and the reorganisation and winding up of credit institutions. The discussions were influenced by the recent mortgage crisis and its potential effects on the European financial system and by the related recommendations made by ECOFIN in October and December 2007.

The Commission and the EBC focused on drafting proposals for a possible amendment of the CRD (the proposed changes will be submitted to the EU Council and the European Parliament in October 2008). The changes will mainly concern the following areas:

- capital – examining the inclusion of hybrids (instruments having the characteristics of both equity and debt instruments) in the capital of credit institutions and the principles for such inclusion,

- crisis management and cooperation between home and host supervisors – draft provisions of the CRD reinforcing mutual cooperation in the event of cross-border crises, and

- large exposures – a draft amendment to the existing rules not affected by the adoption of the CRD, aiming to enhance their quality and efficiency with regard to, *inter alia*, the impact on banking groups operating on a cross-border basis.

The EBC also discussed the issue of national discretions under the CRD, requesting the assistance of CEBS to identify national discretion provisions subject to mutual recognition that can be revoked and are justified in the directive. In 2007, the EBC also started work towards a potential revision of the directive on the reorganisation and winding up of credit institutions, one of the key directives that need to be amended in connection with the resolution of cross-border crises, including asset transfer. The Commission has gathered information on national legislative arrangements and will examine the possibility of including insolvent subsidiaries under the aforementioned directive and reducing the barriers to asset transfer. The aims are to support crisis resolution preferably by private entities, to avoid counterproductive asset retention and to ensure smooth crisis management. The draft is expected to be issued in September 2008.

The Capital Requirements Directive Transposition Group, an EBC working group focusing on the interpretation of the CRD in partnership with CEBS, was active in 2007. It responded to 231 enquiries, which can be accessed on the Commission and CEBS websites (anyone can submit questions regarding the CRD on the CEBS website).[29]

Interim Working Committee on Financial Conglomerates (IWCFC)

The Interim Working Committee on Financial Conglomerates was established by the European Financial Conglomerates Committee (EFCC). Its work covers issues relating to practical supervision of financial conglomerates. It is not a Lamfalussy Level 3 committee, but it is similar in nature and works closely with the CEBS, CESR and CEIOPS sectoral committees. The Czech Republic is represented in this Committee by the CNB. In 2007, the Committee was involved in comparing sectoral capital rules and analysing any differences in the application of the individual methods used for calculating the additional capital adequacy requirement for a financial conglomerate. This resulted in a report on the impact of such differences on financial conglomerates. The Committee also assessed the equivalence of supervision in the USA and Switzerland (a report is to be published in the first half of 2008) and drew up a list of financial conglomerates operating in the EU. A report on the functioning of financial conglomerates, which may result in proposals for the amendment of the financial conglomerates directive, will be published in 2008. Working in this Committee is beneficial for the Czech Republic, as there is one financial conglomerate active on the Czech market and it is supervised by the CNB. The CNB also acts as coordinator vis-à-vis foreign supervisors and cooperates with them in the supervision of five other conglomerates from EU countries.

Committee of European Banking Supervisors (CEBS)

The aims of the Committee of European Banking Supervisors, in which the CNB has a representative, are to achieve better regulation, to promote convergence in approaches to regulation and supervisory practices, and to enhance cooperation between supervisors. CEBS works to achieve these aims through three standing expert groups, in which the CNB is actively involved (the Groupe de Contact, the Expert Group on Capital Requirements and the Expert Group on Financial Information).

CEBS has issued 13 sets of guidelines for credit institutions and supervisors since its establishment. Since the beginning of 2007 it has focused on the implementation of these guidelines and on the convergence in supervisory practices. This should be achieved mainly by promoting active cooperation between supervisors of large cross-border banking groups (the SON – Subgroup on Operational Networking – project), by organising various seminars and facilitating staff exchanges between supervisors, by introducing new mechanisms to monitor the implementation of CEBS guidelines (self-assessment and peer review) and by updating the existing guidelines where useful or necessary to achieve a given objective (or for other reasons). For example, the SON was involved in the preparation of a specimen Memorandum of Understanding (MoU) to be used by the expert groups when drawing up specific agreements laying down the principles of cooperation between supervisors, and prepared an overview of best practices of supervisory colleges.

CEBS continues to provide the European Commission with opinions based on Calls for Advice. In 2007, these primarily concerned the issues of large exposures and liquidity. Work in the liquidity area is coordinated with the Working Group on Liquidity of the Basel Committee on Banking Supervision.

In 2007, CEBS approved an amendment of the common reporting on capital adequacy (COREP) and on financial statements (FINREP) introduced in 2006, a quantitative analysis of instruments used in the Member States as components of own funds, an analysis of large exposures and an extension of operational networking to include the implementation of Pillar 2 of the CRD. It also examined the scope of national discretions, including the option of further reducing their number.

29 For details, see the European Commission: http://ec.europa.eu/internal_market/bank/regcapital/transposition_en.htm and the CEBS: http://www.c-ebs.org/crdtg.htm.

Committee of European Securities Regulators (CESR)

The Committee of European Securities Regulators aims to improve the coordination and cooperation among regulators and ensure consistent and timely implementation of EU legislation in the Member States. The CNB is represented in all its major working groups (CESR-Fin, CESR-Pol, CESR-Tech, MiFID Level 3, the Prospectus Expert Group, the Investment Management Expert Group and recently also the Post-Trading Expert Group).

In 2007, CESR focused on activities relating to the implementation of the Markets in Financial Instruments Directive (MiFID) and its two implementing measures. It issued a protocol on the supervision of branches under MiFID, a protocol on MiFID passport notifications and a statement aiming to minimise disruption to existing cross-border trading activity in cases where the MiFID has not taken legal effect in a Member State.

CESR completed the first phase of the Transaction Reporting Exchange Mechanism (TREM) project. The system went live on 1 November 2007. Until the Capital Market Undertakings Act is amended, the CNB will obtain data on transactions for international exchange chiefly from data from the regulated markets. The CNB also used its authority to request information from investment firms to obtain information on transactions executed off the regulated markets.

As regards collective investment, CESR focused on analysing data obtained by investors when investing in mutual funds. In the future, the simplified statute should be replaced by a document containing only the key information needed by investors when deciding to invest in mutual funds. CESR also conducted a self-assessment of the implementation of guidelines on simplification of the cross-border notification procedure of harmonised mutual funds (UCITS) between European supervisors. The self-assessment and subsequent peer review are intended to determine the extent of convergence of supervisory practices among CESR members in this area. CESR also dealt with the enquiries of the European Commission regarding potential changes to the single framework for non-public allocation of securities, the planned amendment to the UCITS Directive and the regulation of "substitute investment products".

In its operational groups, CESR continued working on the project of equivalence and convergence of accounting standards, prepared a report on the initial experience with the application and enforcement of IFRS and carried on its cooperation with the US Securities Commission. It also continued work on the methodology concerning the Market Abuse Directive and surveyed the powers of supervisors under the Prospectus Directive and the Market Abuse Directive to determine currently prevailing divergences and supervisory practices as regards responsibilities.

In 2007, CESR established a new expert group on securities settlement to monitor the implementation of the Code of Conduct for firms offering securities settlement and discuss the European Central Bank's TARGET2-Securities project.

Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

CEIOPS continued working on the new Solvency II prudential framework. Preparation of implementing rules began after the European Commission approved the draft Solvency II directive in July 2007. CNB representatives in the Financial Requirements Working Group, the Internal Models Expert Group, the Internal Governance, Supervisory Review and Reporting Expert Group and the Insurance Groups Supervision Committee also contributed to the draft implementing rules. The CNB also played an active role in the meetings of the Convergence Committee. The groups were reorganised in mid-2007 to reflect priorities related to the preparation of technical advice for the European Commission. The Commission informally asked CEIOPS to prepare the first draft rules for the most important areas by May 2008. These rules relate chiefly to the proportionality principle and supervision of insurance groups, where the Commission has significantly bolstered the role of group supervisor.

At the beginning of 2007, representatives of the CNB and the Ministry of Finance attended a meeting of the Commission's working group on solvency of insurance companies, which was preparing the draft framework directive.

In 2007, CEIOPS also focused on the preparation, implementation and assessment of the third round of the quantitative impact study (QIS3). It launched work on the technical specification for the fourth round (QIS4), sending a draft to the European Commission in December 2007. The Commission should subsequently carry out a public consultation and take on board the comments made on this document. QIS4 is to take place from April to June 2008.[30]

CEIOPS regularly assesses conditions on the European insurance market and to this end collects data from its members. Twice a year it publishes a report on developments and financial stability in the insurance sector, which is sent to other European institutions and authorities (e.g. FSC, EFC).

Cooperation between CEBS, CESR and CEIOPS

2007 saw continued cooperation between the Lamfalussy Level 3 committees (CEBS, CESR and CEIOPS), which started in 2005 under a joint protocol on cooperation. The work of the IWFCC was focused on fostering convergence of supervisory practices, instruments and methods across sectors. Reports were prepared on the conditions under which financial institutions in individual Member States offer comparable products to the public, on the reporting requirements of Member States and on the legal bases for these requirements. As part of these reports, information on non-cooperative countries was provided in a presentation of the experience from cooperation with supervisors from off-shore centres. The possibility of establishing a common European training platform for supervisory bodies was also analysed and a common methodology was created for impact studies for use by the individual committees. A common work programme for 2008–2010 was formulated, focusing on cooperation between home and host supervisors, delegation of tasks, competing products, rating agencies, internal governance, conglomerates and valuation of financial instruments.

6.2 COOPERATION WITHIN THE STRUCTURES OF THE EUROPEAN CENTRAL BANK

The CNB is represented in the Banking Supervision Committee (BSC) and its Working Group on Macroprudential Analysis (WGMA), Working Group on Developments in Banking (WGBD) and Working Group on Credit Registers (WGCR). In the second half of 2007, the CNB also sent representatives to two working sub-groups of the WGBD, namely the sub-group on the structure of banks' income and the sub-group on liquidity. In addition to supervisory issues, the Banking Supervision Committee and its working groups and sub-groups also devote much attention to the area of financial stability. The CNB's experts on supervision and financial stability, who are jointly represented in these structures, work together very closely in this field of activity.

In 2007, the BSC focused mainly on analysing and assessing the development of euro area and EU financial systems, and especially banking sectors, from the point of view of financial stability. It also assessed the impact of regulatory rules and supervisory requirements on the structure and stability of financial systems as well as the financial conditions in the real economy and support for cooperation and information exchange among central banks and supervisors in EU Member States, including cooperation in dealing with crises. In connection with these topics, which have much in common, the BSC discussed numerous reports and other methodological and analytical documents.

6.3 COOPERATION WITHIN THE BASEL COMMITTEE ON BANKING SUPERVISION (BCBS)

The CNB is represented in the International Liaison Group (ILG), established by the BCBS as a successor to the Core Principles Liaison Group (CPLG), which achieved much in creating the revised *Core Principles for Effective Banking Supervision*. The Core Principles have become an internationally acknowledged standard for banking supervision. Three meetings of the ILG took place in 2007, focusing mainly on the implementation of Basel II in the context of cross-border banking, proposals for refining the definition of capital and rules for creating provisions for credit losses. The ILG agreed that a supervisory body cannot confine itself only to accounting aspects when assessing the adequacy of provisions; it must also assess the overall quality of the risk management system,

30 For details, see section 3.2 *Solvency II*.

especially credit risk management and the compliance function in banks. Another priority is the application of existing international guidelines regarding the compliance function. The ILG also discussed the risk-based approach to supervision, microfinancing and measures that can support this form of business financing in developing countries.

6.4 COOPERATION WITH SUPERVISORS FROM CENTRAL AND EASTERN EUROPE

The CNB is a member of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), which now has 20 members. Its main activity consists in organising seminars and an annual conference. In May 2007, the annual conference was held in Budapest. It focused on the following topics: social responsibility and the principles of correct corporate governance in banking and the principles and regulatory rules for assessing the integrity of a bank's management and owners. In addition to expert discussions on key topics, the benefits of BSCEE conferences and seminars consist in creating a platform for informal debate on current developments in the banking sectors of the BSCEE member countries and on innovations in banking regulation and the procedures applied by banking supervisors in these countries. Austria applied for BSCEE membership in 2007, owing chiefly to the significant share that some Austrian banks have on BSCEE markets through their subsidiaries and foreign bank branches.

6.5 COOPERATION IN OTHER INTERNATIONAL ORGANISATIONS

In March 2007, the CNB became a signatory to the Multilateral Memorandum of Understanding within the International Organization of Securities Commissions (IOSCO). It has already started cooperating actively with specific countries under the Memorandum, which has replaced the existing bilateral MoUs.

IOSCO's vision is to cooperate together to promote high standards of regulation in order to maintain just, efficient and sound capital markets. The CNB's representatives are involved mainly in the European Regional Committee and the Emerging Markets Committee. In 2007, the CNB also attended the IOSCO Annual Conference.

The main topics of the IOSCO meetings in 2007 included convergence of international accounting standards, competition between and consolidation of exchanges around the world and related international cooperation between regulators, and the approach to the regulation of multinational conglomerates. Regulation of alternative forms of investment was a subject of intense debate, especially due to the financial market turbulence during the holiday season and the growing interest in these forms of investment, in particular hedge funds and private equity funds.

The CNB was also involved in the International Association of Insurance Supervisors (IAIS) in 2007, actively monitoring work on individual standards and guidelines and participating in various surveys conducted by the IAIS.

Since 1 January 2007, the CNB has also been a member of the International Organisation of Pension Supervisors (IOPS). In 2007, it was actively involved in the meetings of the Technical Committee and the Annual General Meeting. During the course of the year, IOPS created or discussed documents concerning licensing standards, guidelines for on- and off-site supervision and the performance of due diligence. Other issues covered by IOPS included cross-border supervisory cooperation, supervision of risk management in pension funds in the case of alternative investments, corporate governance and sectoral guarantee schemes. Membership of IOPS gives the CNB access to more detailed information on various pension systems in individual member states.

Newly launched activities will focus on projects concerning analyses of risk assessment in pension funds, comparison and valuation of annuity products, standards for supervisory action, sanctions and enforcement. Work will continue on the preparation of standards for corporate governance and off- and on-site supervision, on the operational risk project, on standards for monitoring and due diligence, etc. In the future, the CNB may also benefit from planned analyses of the effects of regulation of the pension system, as the Czech system requires changes.

B. THE FINANCIAL MARKET IN 2007

SUMMARY

Global markets were affected above all in 2007 by the US sub-prime mortgage market crisis. The Czech financial markets proved to be very resilient to these problems and the Report underlines this fact by assessing the impacts of the global market volatility as negligible in relation to the other trends described. The CNB has so far recorded virtually no direct impacts on the Czech financial system. This is due to the fact that domestic financial institutions have minimal exposure to structured investment vehicle markets and the financial sector is highly liquid.

As regards the number of banks and their ownership, the Czech **banking sector** has been unchanged for several years now. At the end of 2007, a total of 37 banks and foreign bank branches were operating on the market and the structure of the market changed minimally. As of the end of 2007, a total of 198 banks from EU countries could also provide banking services in the Czech Republic under the freedom to provide services and the relevant notification. The CNB received 64 such notifications during 2007. About 98% of the banking sector's assets are directly or indirectly controlled by foreign entities.

The total assets of the banking sector increased by 18.9% in 2007, to CZK 3,746.6 billion. Loans provided to clients continued to grow dynamically. Loans to non-financial corporations rose by 17.1% to CZK 743.9 billion and loans to households by 35.2% to CZK 668.8 billion in 2007. As regards households, growth was recorded particularly for housing loans, which rose by 37.6% to CZK 510.9 billion. At the end of 2007, housing loans accounted for 76.4% and mortgage loans for 49.9% of all loans to households. Consumer credit grew by 26.1% to CZK 137.7 billion.

The banking sector undertook similar risks as in the previous year. Credit risk remains the main risk. Since 2007, credit quality has been rated according to whether loans are in default or not. Non-default loans made up the large majority of the investment portfolio (almost 95%) at the end of 2007. The total value of loans in default fell by 4.2% to CZK 51.9 billion in 2007. More than half of the default loans consisted of loans in default for more than a year.

Domestic banks still focus mainly on the domestic market. The shares of transactions with non-residents and of foreign currency activities are relatively low. Operations on foreign markets are usually executed by other entities from the financial group to which the domestic bank belongs. Transactions with non-residents are significant mainly on the interbank market, particularly as regards derivatives transactions. More sophisticated transactions tend to be executed at the level of parent banks, as they have the necessary resources and operate on wider markets.

The banking sector has adequate liquidity at its disposal. The liquidity crisis resulting from insufficient liquidity in some European countries was not observed in the Czech Republic. Sufficient primary funds are available to finance the loans of the banking sector.

Despite rising capital requirements, the capital ratio of the banking sector edged up by 0.09 percentage point to 11.50% in 2007, mainly due to faster growth in regulatory capital. In 2007, banks also made capital savings as a result of the implementation of Basel II. At the end of 2007, six banks – representing around 50% of the banking sector's total assets – were applying the new approach to calculating capital requirements, while all other banks were using the Basel I methodology. Compared to the previous period, the banking sector's capital increased more in the retained profit item. Tier 2 capital was affected by an increase in subordinated debt. Tier 1 still has a dominant position in the sector's capital, accounting for roughly 85% of total regulatory capital.

The profit achieved by the Czech banking sector reflects the favourable macroeconomic performance of the domestic economy in 2007. The banking sector generated an unconsolidated net profit of CZK 47.2 billion, up by CZK 9.2 billion compared to the previous year. The main source of the growth in net profit was an increase in profit from financial activities. Interest income increased significantly owing to growth in loans provided in recent years and rising interest rates in 2007. On the other hand, this was partly offset by rising depreciation, reserves and loan impairment. Administrative costs grew much more slowly (by 7.1% overall). At CZK 12.1 billion, aggregate income tax increased by less than CZK 1 billion year on year. The 2007 profit was largely unaffected by one-off income from specific transactions.

At the end of 2007, the **credit union sector** consisted of 19 active credit unions, i.e. one less than in 2006. The number of credit union members rose by 8,152 to 44,789 in 2007, i.e. by around 22%. The credit unions sector has seen relatively rapid growth in recent years. In 2007, the sector's assets grew by 31.3% to CZK 9.0 billion. The sector generated a profit of CZK 83.2 billion, up by 1.0% compared to 2006.

The shocks on global markets had only an indirect and limited impact on the Czech **capital market**. In August and at the end of the year, domestic markets recorded a decline in prices, heightened volatility and increased trading volumes. The collective investment sector saw withdrawals of invested funds.

Trading volumes on both regulated markets – the Prague Stock Exchange (PSE) and the OTC market organised by RM-Systém (RM-S) – increased compared to 2006. The PSE saw an increase of 5.3% to CZK 1,525 billion, while RM-S recorded a substantial rise of 95.1% to CZK 7.7 billion. The main indices on both markets also recorded year-on-year growth. The PSE's PX index ended 2007 at 1,815.1 points, rising by 14.2% year on year. RM-S's PK 30 index showed even stronger growth of 31.2% to 3,404.4 points. The CNB extended the licence of the OTC market operator and settlement system operator RM-Systém to include trading in foreign securities. Consents were also granted to changes in the UNIVYC and RM-Systém settlement system rules and proceedings to grant a central securities depository licence continued.

The number of investment firms licensed by the CNB declined by two to 44 in 2007, of which 13 were banking licences. During 2007, no new investment firm licences were granted and two such licences expired owing to changes in objects of business. As of 31 December 2007, a total of 518 foreign non-banks authorised to provide investment services in the Czech Republic under the single European licence were registered. As of the same date, investment firms had concluded 1.3 billion contracts (a year-on-year increase of 14.8%), of which almost 210,000 were active. Client assets amounted to CZK 1,998.9 billion. The activities of investment service providers were affected by the new capital adequacy framework (Basel II), introduced on 1 July 2007. Intensive preparations were also under way to implement the Markets in Financial Instruments Directive (MiFID). However, this was not implemented into Czech law before the end of the year.

At the end of 2007, a total of 18 investment companies licensed by the CNB were active in the collective investment area. These companies managed 121 open-end mutual funds, 38 of which were standard and 83 specialised. The number of foreign collective investment undertakings offering products in the Czech Republic increased further, to 64 companies with 1,479 funds and sub-funds. The undertakings licensed by the CNB managed assets worth CZK 174.2 billion in mutual funds at the end of 2007. Interest in establishing new open-end mutual funds, real estate funds and funds for qualified investors increased in 2007 in the collective investment sector following an amendment to the Collective Investment Act.

At the beginning of 2007, a total of 10 active pension funds were operating on the private pension scheme market. During the year, the CNB permitted the establishment of one new fund, and two funds merged at the end of the year. Ten active pension funds thus again entered 2008. The total assets managed by pension funds amounted to CZK 167.2 billion at the end of 2007, up by CZK 21.3 billion compared to the previous year. However, the sector recorded a significant decline in equity capital. There were 3.9 million pension planholders at the end of 2007.

In the securities issuance area, the CNB supervised 85 issuers of listed securities, of which 17 were foreign. As for squeeze-outs, the CNB in 2007 granted final consent in 43 cases, refused applications in 10 cases and discontinued proceedings in 2 cases. During 2007, notifications took place in respect of 40 issues of investment certificates listed on the PSE.

As of 31 December 2007, there were 34 domestic insurance companies (one more than a year earlier), 17 branches of insurance companies from the EU and one branch of an insurance company from a non-EU/EEA country operating on the Czech **insurance market**. The number of insurance companies and branches of insurance companies from other EU and EEA Member States increased to 478 at the end of 2007. The ownership structure of domestic insurance companies is stable and 71%-controlled by foreign capital. The rate of growth of premiums written, which for the entire insurance market amounted to CZK 132.9 billion, almost doubled in 2007 compared to the previous period, from 4.3% to 8.8%. This trend is due to high growth in life insurance, where premiums written rose by 14.6% in 2007, compared to just 5.1% in 2006. The share of life insurance in total premiums written rose to a historical high of 40.7%. Since 2004, insurance penetration, as measured by the ratio of premiums written to GDP, has decreased by 0.1 percentage point each year, and stood at 3.7% in 2007.

Turning to life insurance products, the growth trend in investment life insurance strengthened (by 61.9% to a total share of 34.0% in the life insurance market) at the expense of standard products, whose share in premiums written declined, as it did in 2006. The non-life insurance market is still dominated by motor third party liability insurance (with a share of 29.7%), insurance against damage to or loss of property (22.5%) and insurance against damage to or loss of land vehicles (20.6%).

In 2006 claim settlement costs in life insurance had fallen by 4.5%, but in 2007 they recorded a relatively large increase of 33.8%. One of the factors behind this rise in life insurance claim settlement costs was the maturity of some short-term single-payment insurance policies with a savings component signed by clients at the start of the new millennium. In contrast, claim settlement costs in non-life insurance fell by 4.1% (compared to a rise of 12.0% in 2006), as a result of less damage due to natural disasters.

The total assets of insurance undertakings increased by 6.9% to CZK 345.0 billion in 2007, which was almost double the rate of growth compared to a year earlier. The largest component is financial placement (investment), whose share in the insurance sector's total assets is gradually declining, mainly at the expense of investment of unit-linked life assurance. On the liabilities side, technical provisions have a share of more than 74%. The profit of the insurance companies sector was CZK 12.8 billion, down by 10.1% from 2006, when the sector's net profit had been affected by one-off income from sales of ownership interests in the group of large insurance companies.

METHODOLOGICAL NOTE

The data on banking sector developments presented in this Report are based mainly on statements submitted by banks and foreign bank branches for banking supervisory purposes in compliance with the relevant CNB regulations. Data from statements submitted to the CNB for money statistics purposes are used as an additional source of information. These data mostly concern the sector structure of loans and deposits and the sectoral breakdown of the loan classification, which are not included in the banking supervision statements. The methodology for compiling statements for the money statistics is different, however. For this reason, some figures, including ratios, are not fully comparable with those provided in the banking supervision statements. The differences are underlined in the relevant parts of the text. All data in this Report are for commercial banks only, i.e. they do not include the CNB. To better illustrate the situation, external information is sometimes also used in some passages, with the relevant source being cited.

The data presented for 2007 differ partially in structure and content from the pre-2007 data, owing to the implementation of Basel II and the single reporting frameworks FINREP for accounting statements and COREP for capital and capital adequacy statements applied within the EU. The pre-2007 data have been recalculated using the new methodology, but in some cases the comparability of the time series is limited. The most significant differences compared to the data published previously under the 2006 methodology are as follows:

- the monitoring of the structure of assets, liabilities, income and expenses by portfolios derived according to valuation method,
- consistent separation of liability and equity capital items,
- the inclusion of all realised gains and losses and other operating income and expenses in financial and operating profit,
- the recording of some items which used to come under other assets/liabilities in individual portfolios (e.g. receivables or liabilities not divided by sector) or separately (e.g. fair values of derivatives) etc.,
- a major change in the calculation of capital requirements for credit risk – on 1 July 2007 some banks started reporting under the Basel II methodology,
- the introduction of categorisation of receivables into non-default and default receivables (collateral not taken into account) and the introduction of impaired and non-impaired receivables (collateral taken into account).

In addition, the terminology of some indicators has been changed in some cases to bring it into line with legal regulations in force or generally used terms.

1. THE ECONOMIC ENVIRONMENT IN 2007[31]

2007 was a very good year from the macroeconomic point of view in the Czech Republic. This had a positive knock-on effect on the performance of most institutions operating on the Czech financial market. As in previous years, economic growth in the Czech Republic was faster than that in the EU economy as a whole as well as that in the original, pre-enlargement EU Member States. Real GDP growth was also markedly lower in Germany, which has long been the Czech Republic's biggest trading partner. Gross domestic product in the Czech Republic was CZK 3,557.7 billion at current prices. At 6.5%, annual GDP growth remained high.

The GDP growth continued to be driven mostly by domestic demand, which was affected in particular by still high household consumption. The contribution of gross capital formation was also significant, in line with the phase of the business cycle in terms of both fixed capital formation and change in inventories. The contribution of foreign trade to GDP growth is still low, despite having risen slightly year on year in 2007. The export activity of the Czech economy was mostly related to export and investment activities in EU countries. Production facilities created by foreign direct investment had a positive effect.

Inflation gradually increased in 2007 compared to the previous year. The average figure in 2007 was 2.8%, up by 0.3 percentage point compared to a year earlier. Over the entire period (except for the last quarter) it converged towards the CNB's inflation target of 3%. Consumer price inflation picked up in 2007 Q4, rising above the upper boundary of the inflation target tolerance band. During 2007, inflation was affected primarily by food prices and regulated prices (in particular rises in regulated rents and prices of electricity) and by increases in excise duties.

The koruna's appreciation trend against the euro and the dollar continued throughout 2007. The bulk of exports and imports are traded in these two currencies. The strengthening koruna reduced the prices of most imported commodities, thereby contributing to the low inflation level for most of the year. From an annual average of CZK 28.34 to the euro in 2006, the koruna firmed to CZK 27.76 in 2007. The koruna's annual average exchange rate against the dollar appreciated even more substantially – from CZK 22.61 to CZK 20.31.

The balance of payments saw a gradual improvement in 2007. The favourable macroeconomic trend caused the current account deficit to fall by 0.6 percentage point to 2.5% of GDP, or CZK 89.0 billion. The persisting deficit was due to a widening of the income deficit, reflecting a rapid increase in non-residents' FDI profits in the form of reinvested earnings and dividends. Another reason for the current account deficit is an increasing volume of compensation of foreign employees. As in previous years, the financial account showed a surplus of CZK 104.5 billion in 2007, which is roughly the same as the 2006 level. Growth in net direct investment inflow remained its principal component.

The labour market situation continued improving in 2007. The economic growth was accompanied by job creation. The favourable employment conditions were taken advantage of, and the rising employment and high job creation led to a decline in the unemployment rate. Long-term unemployment decreased to 2.8% on average. The labour market was affected by seasonal factors in individual

31 The data in this section are based on CZSO data available in April 2008.

months of 2007. The registered unemployment rate declined again under the existing methodology, averaging 6.6%. The positive trends also affected average gross monthly nominal wages, which increased by 7.3% year on year, up by 0.9 percentage point on the previous year. Average real wages increased by 4.4% year on year, a rise of 0.6 percentage point compared to 2006. Aggregate labour productivity grew by 4.6% year on year, outpacing real wage growth by 0.2 percentage point.

Despite the persisting robust economic growth, the state budget yet again ended the year in a deficit. The absolute deficit declined compared to the previous year, to CZK 66.4 billion, or 1.9% of GDP. The economic growth greatly helped to stabilise the public debt-to-GDP ratio, which was little changed in 2007, standing at 30.4% at the end of the year.

The CNB raised its key interest rates four times during 2007 (in June, July, September and November), each time by 0.25 percentage point. The monetary policy decisions were based on forecasts for the Czech economy and inflation and the external economic outlook. A gradual rise in interest rates was consistent with these predictions. The domestic two-week repo rate went up from 2.5% to 3.5%, the discount rate from 1.5% to 2.5% and the Lombard rate from 3.5% to 4.5%.

2. THE BANKING SECTOR

2.1 THE STRUCTURE OF THE BANKING SECTOR

As of 31 December 2007, the Czech banking sector consisted of 37 banks and foreign bank branches. Compared to the end of 2006, the number of banks was unchanged and the same number of entities were offering banking services in the domestic banking sector. The internal structure of the banking sector changed during 2007. Mergers of banking groups outside the Czech Republic resulted in the amalgamation of HVB Bank Czech Republic, a. s. and Živnostenská banka, a. s., with UniCredit Bank Czech Republic, a. s. starting up on 5 November 2007. The Italian banking group Banco Popolare Česká republika, a. s. entered the domestic banking market after taking over IC Banka, a. s. By contrast, BRE Bank S.A. (based in Poland) became an entirely new entity on the Czech market, opening for business as a foreign bank branch on 25 November 2007 under the name of mBank. On 1 January 2008, Citibank, a. s. was converted into a branch of the Irish bank Citibank Europe plc., operating in the Czech Republic under the single licence.

As of 31 December 2007, a total of 23 banks (4 large banks, 5 medium-sized banks, 8 small banks and 6 building societies) and 14 foreign bank branches were offering banking services to clients in the Czech Republic.[32] The traditional representation of banking institutions in these five basic groups remained virtually unchanged in 2007. The group of four large banks is still the main component of the domestic banking market. The share of their assets in total banking sector assets slightly exceeded the 61% level in 2007.

TABLE II.1

Shares of bank groups in total assets

(in %; for banks with licences as of the given date)

	2005	2006	2007
BANKS, TOTAL	100.0	100.0	100.0
of which:			
large banks	61.2	59.8	61.8
medium-sized banks	15.1	16.2	13.1
small banks	2.0	2.3	5.1
foreign bank branches	9.5	9.2	8.8
building societies	12.2	12.5	11.2

The process of consolidation of financial and banking groups is a global and European trend affecting the Czech banking sector. UniCredit Bank came into being on the completion of the merger of HVB Bank and Živnostenská banka, which started in 2006. And Banco Popolare started operating in the Czech Republic after taking over a bank operating in the domestic market.

A total of 198 banks from EU Member States were ready to provide banking services under the freedom to provide services as of the end of 2007. These banks had notified the CNB of their activities. They can offer banking services without establishing a branch in the Czech Republic pursuant to Article 21 of Directive 2000/12/EC of the European Parliament and of the Council. The CNB is thus not informed about the scale of such services. Under the notification framework, the CNB is informed in detail about the range of such activities. As in numerous other EU Member States, banks are not subject to a reporting duty in this area and their operations in the domestic banking sector are not subject to CNB supervision. The number of banks that have notified the CNB of the provision of cross-border services in the Czech Republic increased by 64 in 2007. Three banks gave notification of the termination of such activities.

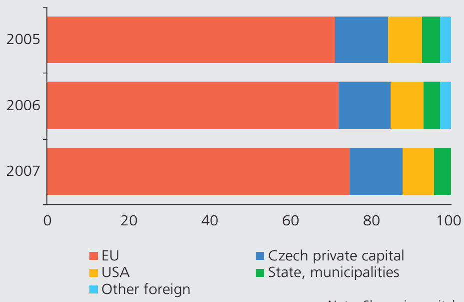
Banking services were also offered in other EU Member States by banks having their head offices in the Czech Republic. As in 2006, the only banks to notify the CNB of the provision of cross-border services were Komerční banka and GE Money

32 The group breakdown is provided in Annex 3. For analytical purposes, bank groups are defined in terms of asset size. Since 2007, the boundaries between the groups have been moved upwards. Large banks now administer total assets of more than CZK 150 billion, medium-sized banks have assets of between CZK 50 billion and CZK 150 billion and small banks' total assets amount to less than CZK 50 billion. The other two groups are building societies and foreign bank branches. For more details, see http://www.cnb.cz – *Financial market supervision – Banking supervision – Banking sector – Basic indicators of the banking sector – Methodology*.

Bank, both in respect of Slovakia. In 2007, no other bank gave notification of the provision of such activities. Until the end of 2007, two banks based in the Czech Republic (ČSOB and J&T Banka) were also offering services through foreign branches in EU countries.[33]

2.1.1 Ownership structure

CHART II.1
Bank ownership structure
(in %; for banks with licences as of the given date)

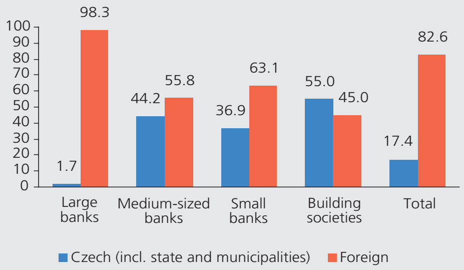


Note: Shares in capital

The shareholder structure of the Czech banking sector is stable. At the end of 2007, as in the previous year, foreign capital dominated the sector's capital, with a direct share of 82.6% (this refers to cases where a legal entity registered outside the Czech Republic holds a direct share in a bank). Foreign capital predominates in 15 banks (from the legal perspective in terms of the banks' registration), ten of them being wholly owned by foreign capital. Eight banks are majority owned by Czech shareholders. Five of them are still wholly Czech-owned (Hypoteční banka, J&T Banka and Modrá pyramida stavební spořitelna plus two state-controlled banks specialising in export and business promotion – Česká exportní banka and Českomoravská záruční a rozvojová banka).

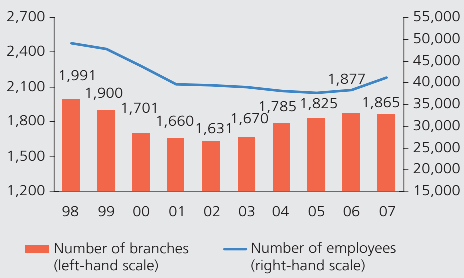
A total of 97.6% of the sector's total assets were controlled by foreign owners at the end of 2007.[34] Owners from EU countries dominate. Their share in the foreign ownership of the sector stabilised at the end of 2007 at 90.7%. Even after a merger resulting in a change of owner at one of the large banks, all the owners of the "Big Four" come from EU countries. Until the end of 2007, two medium-sized banks were owned by US entities. After the conversion of Citibank into a branch on 1 January 2008, only GE Money Bank has a majority owner from the USA.[35] Shareholders from other territories now have a more-than-marginal representation (a 0.3% minority share in Komerční banka). The breakdown of ownership by EU country remains diverse. Austrian shareholders have the largest share (40.6%) in the registered capital of the Czech banking sector.

CHART II.2
Capital origin
(in %; for banks with licences as of 31 December 2007)



2.1.2 Employees and banking units

CHART II.3
Number of employees and number of branches



A total of 41,207 people[36] were employed in the Czech banking sector at the end of 2007, a rise of 2,975 on the previous year. The annual rate of growth of the sector's workforce at the end of 2007 (7.8%) was less than half that of its total assets in the same period. The banking sector recorded year-on-year growth in the number of employees for the second consecutive year following a long period of decline. The number of people employed in the Czech banking sector peaked at 51,000 in 1996. All bank groups took on new employees to serve their clients. Relative to the share of assets managed, the group of large banks increased its workforce by only 411 last year. By contrast, medium-sized and small banks needed, respectively, 1,024 and 1,062 more employees to develop their banking activities in 2007. Foreign bank branches also contributed to the rise in employment in the banking sector with a year-on-year increase in the number of employees of 441. The total number of employees of building societies increased by only 37. This is due to the nature of their activities and their active use of external sellers.

33 On 1 January 2008, an independent legal entity started operating in the Slovak Republic instead of the previous foreign branch of ČSOB. Its business name is Československá obchodná banka, a. s. The bank's shareholders are as follows: ČSOB ČR (56.74%), KBC Bank (39.80%), ČSOB Leasing ČR (2.02%) and ČSOB Factoring ČR (1.44%).

34 This refers to the share of total bank assets controlled by foreign entities (i.e. foreign owners holding directly or indirectly at least 50% of the bank's shares) in the total assets of the banking sector.

35 The conversion of Citibank into a branch on 1 January 2008 is mentioned for information only. All data provided in this publication are valid as of 31 December 2007 (unless stated otherwise).

36 The total number of banking sector employees (full-time and part-time).

Unlike the number of employees, the number of banking units serving clients had been growing regularly since 2003. In 2007, however, the number of banking units in the Czech Republic fell by 12 to 1,865. The fall in the number of banking units was chiefly due to small banks (down by 44 year on year) and building societies (down by 9). The significant decline in the number of banking units in some bank groups is linked with the optimisation of retail networks as a result of bank mergers. Building societies, which tend to be subsidiaries operating within large financial groups, are taking advantage of the opportunity to share retail networks and services of external sellers. By contrast, large and medium-sized banks and foreign bank branches are expanding the range of services they offer in an effort to leverage the growth potential of banking business, and this is leading to a rising number of banking units. On the other hand, banks are trying to streamline their activities and establish banking units in locations where they can achieve maximum effectiveness of sales of products and services. This is reflected in the nature of the units and the ranges of services they offer.

TABLE II.2
Number of employees and banking units in Czech banking sector
(for banks with licences as of the given date)

	2005	2006	2007
Number of employees	37,540	38,232	41,207
Number of banking units	1,825	1,877	1,865
Number of employees			
per bank	1,043	1,033	1,114
per banking unit	20.6	20.4	22.1
Number of citizens			
per bank (thous.)	284.8	278.0	280.6
per banking unit (thous.)	5.6	5.5	5.6
per employee	273.1	269.1	251.9

The performance indicators of the Czech banking sector improved in 2007. At the end of 2007, there were roughly 5,600 citizens per banking unit in the Czech Republic, a slight increase in year-on-year terms. The increased number of citizens served by banks' retail networks reflects, in addition to residents, clients temporarily resident in the Czech Republic and other clients, particularly tourists and other visitors. Productivity as measured by total assets administered per employee is rising constantly and reached CZK 90.7 million at the end of 2007, up by 10.1% year on year.

2.1.3 Electronic banking

Bank clients are increasingly using the option of accessing their accounts without having to visit traditional bank branches. This is being aided by all forms of electronic banking, allowing clients to access their accounts and banking products by card, telephone, computer or mobile phone and the internet. This prevailing trend was initially supported by a rising number of ATMs and is now being driven by the high penetration and popularity of mobile phones in the Czech Republic and the ever increasing number of internet connections. Falling prices for connections to networks allowing the use of electronic banking and also banks' fee policies have encouraged further development in this area.

TABLE II.3
Electronic banking
(for banks with licences as of the given date)

	2005	2006	2007
Number of ATM networks	4	4	4
Number of ATMs	3,005	3,281	3,357
Number of cards issued (thous.)			
total	7,428	8,181	9,044
debit cards	6,556	6,824	7,197
credit cards	872	1,357	1,847
Current and deposit accounts (households; thous.)			
total	7,135	7,563	7,447
with cards issued	5,289	5,523	5,576
with PC access	2,400	2,537	2,801
with telephone access	2,713	2,824	2,773
without electronic service	1,142	1,106	1,140

Although current and deposit accounts of households (individuals) decreased in number slightly, the number of payment cards issued for these accounts increased and PC access to these accounts was much more intensive. Only telephone accesses are decreasing year on year, partly due to a trend away from fixed telephone lines. At the end of 2007, only 15.3% of the almost 7.5 million household accounts lacked electronic access completely. Telephone and PC transactions could be executed on 37.2% and 37.6% of accounts respectively. Banks are responding to trends and client needs, expanding the range of electronic banking products they offer and focusing on further improving the security of transactions conducted in this way and on client data protection. Examples include wider use of chip cards and the introduction of new transaction authorisation features in internet banking. Electronic signatures are also being used ever more frequently.

The number of ATMs increases every year, although the rate of growth is slowing sharply. In 2007, they increased in number by "only" 2.3%. Credit cards are becoming more prevalent, recording annual growth of more than 36% as of the end of 2007, partly due to base effects. The total number of payment cards issued rose by more than 10%. The number of international payment cards issued by banks is constantly rising and increased by roughly 25% in 2007. Retail chains have also started to offer debit card cashback.

Table II.4
Banking sector performance
(in CZK millions)

	2005	2006	2007
PROFIT FROM FINANCIAL ACTIVITIES	111,135	116,864	134,393
of which:			
interest profit	64,043	71,547	84,697
dividend income	2,189	1,676	5,886
profit from fees and commissions	31,831	32,918	35,854
gains on financial assets not measured at FV through profit or loss	145	45	-158
gains on financial assets held for trading	9,523	6,511	4,520
gains on financial assets designated at fair value through profit or loss	0	0	-2,191
gains from hedge accounting	-119	-390	-535
other gains	3,523	4,558	6,320
ADMINISTRATIVE EXPENSES	51,786	55,652	59,589
DEPRECIATION, PROVISIONS	7,283	7,022	9,017
IMPAIRMENT	2,871	5,163	6,525
PROFIT/LOSS FROM CURRENT ACTIVITIES	49,196	49,028	59,262
other profit/loss	76	114	27
GROSS PROFIT before tax	49,272	49,142	59,289
tax expense	10,133	11,132	12,085
NET PROFIT	39,139	38,010	47,204

Chart II.4
Structure of profit from financial activities by profit type
(in %)

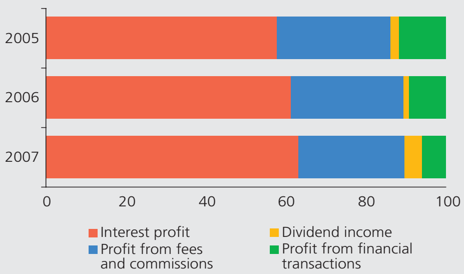
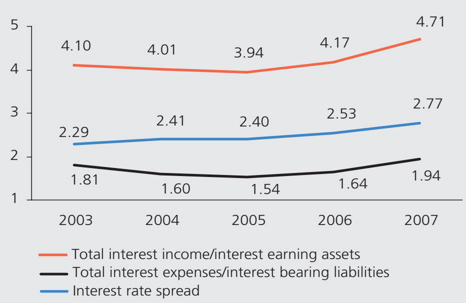


Chart II.5
Interest rate spread
(in %)



2.2 BANKING SECTOR PERFORMANCE

2.2.1 Profit from financial activities and profit from other operating activities[37]

Banking sector stability is conditional on generating profit, primarily profit from financial activities in the longer term. From the operating profit they generate, banks must be able to cover all operating expenses related to banking activities and also any costs arising from risks they undertake.

In 2007, the banking sector's profit from financial activities grew by a record CZK 17.5 billion (15.0%) to CZK 134.4 billion at the year-end. Year-on-year increases were recorded in most of the banking institutions operating in the Czech Republic, but the growth rates varied. The highest rates of growth of profit from financial activities were recorded by small banks (31.3%, or CZK 1.5 billion), foreign bank branches (21.9%, or CZK 1.1 billion) and medium-sized banks (15.4%, or CZK 2.8 billion). A lower rate of growth than for the banking sector as a whole was recorded by building societies, whose profit from financial activities increased by 13.8% (CZK 0.9 billion). The smallest increase was in large banks (13.6%), due to base effects. In absolute terms, profit from financial activities in this group of banks increased by CZK 11.2 billion year on year. Large banks accounted for 63.8% of the profit from financial activities generated in the whole sector.

Interest profit was again the fastest growing category of profit from financial activities, rising by CZK 13.2 billion (18.4%) year on year to CZK 84.7 billion. Interest profit accounted for more than 63% of total profit from financial activities.

The continuing growth in interest profit in 2007 was chiefly due to growing loan portfolios and rising interest rates.[38] The rise in interest profit was largely due to continuing growth in interest received from clients. The annual growth of CZK 22.3 billion (34.2%), to CZK 87.4 billion, was a result of increased activity by banks, in particular continuing credit expansion. Interest received from other clients accounted for 56% of the banking sector's total interest income (for comparison: the 50% level had been exceeded at the end of 2005). By contrast, interest income from general government was down by CZK 1.5 billion year on year, to CZK 14.2 billion, owing to a continuing decrease in the banking sector's exposure to this sector. In particular, the share of interest from general government is constantly falling and was less than 2% at the end of 2007. Interest on debt securities amounted to CZK 28.3 billion, up by 14.8% (CZK 3.7 billion) on 2006.

The banking sector's interest expenses reached CZK 71.7 billion at the end of 2007. Owing to a rising volume of client deposits and increasing interest rates, these expenses grew by 36.5% (CZK 19.2 billion) during the year. As in case of interest income, interest paid to other clients (excluding credit institutions, central banks and the general government) accounted for the largest share (more than 48% of all interest expenses). The amount paid to clients in this way totalled CZK 34.8 billion as of the end of 2007, up by CZK 8.2 billion (30.9%) compared to the end of 2006. As a result of interest rate movements, the interest rate spread increased slightly year on year to 2.77% at the end of 2007. The net interest margin grew as well, reaching 2.51%.

37 2007 saw a change in the structure of income and expenses. The structure of profit from financial activities is different from that in 2006. For this reason, the rates of growth are not comparable, particularly in the longer term.

38 Loans and receivables, accounting for almost 60% of total assets, increased by about 20% year on year. The CNB raised its key interest rate four times during the year, by a total of one percentage point.

The Czech banking sector's profit from fees and commissions rose by CZK 2.9 billion (8.9%) to CZK 35.9 billion in 2007. This is a much larger annual increase than in 2006, but less than the rate of growth of fee and commission profit in 2001–2004 (12.0%–18.9%, i.e. by CZK 2.7–4.9 billion in absolute terms). In year-on-year comparison, some banks even recorded a decline in profit from fees and provisions.[39] This was due primarily to competition on the market and strong media and public interest in fees, which is forcing banks to adjust their business policies. Flexible pricing policy is a means of attracting clients. The rising fee income is thus being driven chiefly by a growing number of transactions and greater bank activity in trading for the account of clients. In 2007, almost 60% of total fee and commission income was attributable to payment system fees and commissions, although their rate of growth was negative (-4.7%). Banks' total income from payment system fees and commissions was more than CZK 25 billion. By contrast, fees and commissions from sales of financial products to clients (securities transactions, products of non-banking financial institutions, etc.) are rising. Commissions on pledges and guarantees are an increasingly important source of fee revenues.

The volume of dividends received by banks also positively affected profit from financial activities. Dividend income was 3.5 times higher than in 2006, amounting to CZK 5.9 billion as of 31 December 2007. This income pertains almost exclusively to the group of large banks. Large banks account for 99.7% of total dividend income, which consists mainly of dividends received from subsidiaries and associates. The year-on-year increase in this indicator was mostly due to an extraordinary dividend received by one of the large banks in 2007.

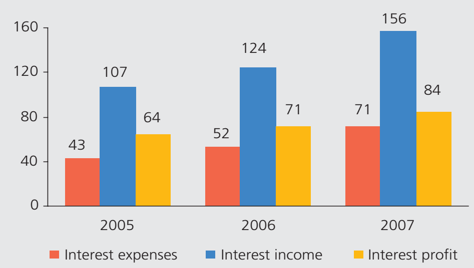
Profit from financial operations dropped by about 30% in 2007, mainly due to a decline in the value of some financial assets, which are revalued to fair value through to the profit and loss account on an ongoing basis. This decline in value is largely due to the problems on global financial markets in the second half of 2007, which were triggered by the mortgage crisis in the USA. In addition to the above revaluation, profit from financial transactions was affected by a fall of 50% in profit from foreign currency operations (foreign currency derivatives). These transactions generate three-quarters of the total profit from financial transactions. However, this item is usually largely offset by valuation changes, which form part of gains/losses from other activities and which grew by 84% year on year, reaching CZK 7.8 billion at the end of 2007 for the banking sector as a whole.

Other operating income and other operating expenses were stable in 2007, the latter being CZK 1.7 billion higher than the former.[40] The most significant item on the expenses side is the contribution to the Deposit Insurance Fund (DIF), which was virtually unchanged in year-on-year terms at CZK 1.7 billion.[41]

CHART II.6

Interest income and expenses

(in CZK billions)

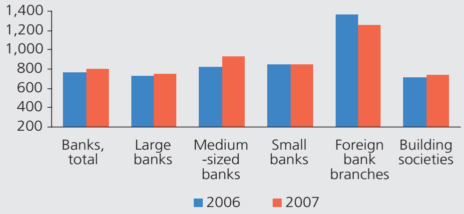


39 For example building societies, which are still experiencing the effects of the new rules for building saving schemes introduced on 1 January 2004. The number of building savings contracts in the saving phase is thus steadily falling (down by 165,000 to 5,132,000 in 2007). Despite this, it is the second-highest in the world behind Germany, according to the European Federation of Building Societies.

40 The aggregate value of other operating income of a reporting entity, particularly income from the renting of operating and non-operating tangible assets, compensation for losses, fines and penalties, net gains from revaluation of property investment to fair value, etc. The aggregate value of other operating expenses includes contributions to the Deposit Insurance Fund, the Guarantee Fund or a similar fund, VAT expenses, losses, etc.

41 The annual contributions of banks, building societies and credit unions to the DIF is laid down in Article 41c(6) and (7) of the Act on Banks. The annual contribution of a bank and a credit union to the Fund shall be 0.1% of the average volume of insured deposit claims for the previous year, including interest accrued. The annual contribution of a building society to the DIF shall be 0.05% of the average volume of insured deposit claims for the previous year, including interest accrued to each building savings participant in the previous year.

CHART II.7
Personnel expenses per employee
(in CZK thousands)



2.2.2 Administrative expenses and impairment

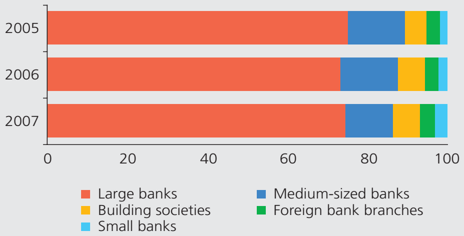
The administrative expenses of the banking sector totalled CZK 59.6 billion in 2007. This represents an annual rise of CZK 3.9 billion (7.1%) as of the end of 2006. The share of administrative expenses in profit from financial activities decreased slightly, to 44.3% as of 31 December 2007. The shares of personnel expenses (52.0%) and other administrative expenses (48.0%) are similar, with the latter rising faster. The strongest growth in terms of volume was recorded by total personnel expenses, which rose by CZK 2.0 billion (6.9%) to CZK 31.0 billion, of which wages and salaries by CZK 1.1 billion (5.4%). Average annual personnel expenses per employee increased by 4.8% to stand at CZK 808,400 at the end of 2007.[42] The increase in administrative expenses was also due in roughly equal measure to the individual items of other administrative costs, e.g. advertising costs, consultancy costs, IT costs, etc.

Asset impairment rose by more than 26% (CZK 1.4 billion) year on year, reaching CZK 6.5 billion at the end of 2007. Impairment on loans and receivables – the biggest contributor to impairment – totalled CZK 6.9 billion (up by 30.9%, or CZK 1.6 billion, year on year). By contrast, the banking sector's total income from non-financial assets was CZK 0.4 billion, thanks to the release of provisions for real estate and ownership interests.

2.2.3 Net profit

The banking sector generated a record net profit in 2007. Gross (pre-tax) profit totalled CZK 59.3 billion, a much higher figure (20.6% higher) than in 2006 (CZK 49.1 billion). The profit structure changed in 2007, partly because of changes in the calculation method. Interest profit rose significantly (by 18.4%), while administrative expenses rose by much less (7.1%), but depreciation, provisions and impairment (of receivables in particular) increased by 27.6%. The 2007 profit was not significantly affected by one-off income from specific transactions.

CHART II.8
Shares of bank groups in profit of sector
(in %)



The net profit of the banking sector increased by CZK 9.2 billion (24.2%) year on year, to CZK 47.2 billion as of 31 December 2007 (compared to a very good result of CZK 38.0 billion as of the end of 2006). The source of the net profit growth is rising profit from financial activities. The sector's record net profit was also due to reported income tax. The total income tax of CZK 12.1 billion (compared to CZK 11.1 billion in 2006 and CZK 10.1 billion in 2005) was less than CZK 1 billion higher than in 2006 (8.6%), reflecting a reduced tax rate and tax optimisation.

The biggest contributor to the sector's net profit was the group of large banks, which generated a profit of CZK 35.1 billion (up by 25.7% year on year), accounting for 74.3% of total banking sector profit. The net profit of medium-sized banks was CZK 5.6 billion (up by 5.3%). Small banks and foreign bank branches achieved net earnings of CZK 1.5 billion (87.7%) and CZK 1.7 billion (31.1%) respectively. Building societies were also highly profitable (CZK 3.3 billion, up by 23.6%). As regards individual banks, only one small bank and four foreign bank branches recorded losses in 2007.

42 Calculated from the average converted stock of employees in 2007 (the average number of employees in the given year converted into full-time equivalents). Personnel expenses consist mainly of wages and social and health insurance, but also include employer contributions to health care, private pension schemes and food allowances, etc.

2.2.4 Profitability, efficiency and productivity

2007 was a very successful year for the banking sector in terms of performance. As a result of the high rate of growth of net profit, the sector's profitability, as measured by net profit generated per unit of capital, increased despite growth in capital. Return on Tier 1 (RoE) was 24.5% at the end of 2007, up by 2.0 percentage points on 2006. Rising profitability ratios were recorded in all the bank groups except medium-sized banks, which showed an annual decline of 2.3 percentage points to 13.2%. The RoE of large banks was 28.4%, up by 3.5 percentage points year on year. The respective figures for small banks and building societies were 10.7% and 27.8%.

The very good results of the banking sector were reflected in a rise of 0.11 percentage point in return on assets (RoA). As of 31 December 2007, the RoA was 1.34%. The performance of large banks was reflected in the fact that they recorded the highest RoA (1.59%). Among the other groups of banks, only the medium-sized banks recorded a RoA higher than 1% (1.33%).

At 44.3% as of the end of 2007, the ratio of administrative expenses to profit from financial activities decreased by 3.3 percentage points year on year. The lowest values were recorded by building societies (38.4%) and large banks (42.6%).

The growth in net profit brought about a rise (of 15.2%) in net profit per employee to CZK 1,145,500. Profit from financial activities per employee increased by 6.7% to CZK 3.3 million, again thanks to the sharp growth in profit from financial activities.

2.3 ACTIVITIES OF THE BANKING SECTOR

The assets of the banking sector rose by CZK 594.8 billion (18.9%) to CZK 3,746.6 billion in 2007. The rate of growth picked up significantly compared to 2006 (when annual growth of CZK 197.4 billion, or 6.6%, had been recorded). The banking sector's activities are very dynamic, mainly thanks to high rates of growth of lending activities. A lower rate of growth was recorded only by building societies, whose assets increased by 7.1% (CZK 27.8 billion), whereas medium-sized and small banks saw higher growth (of 30.2%, or CZK 113.2 billion, and 22.2%, or CZK 34.7 billion, respectively). The assets of large banks increased by 19.7% (CZK 381.1 billion) and those of foreign bank branches by 12.9% (CZK 37.8 billion). Owing to the higher asset growth in large banks, their share in banking sector assets increased to almost 62% at the end of 2007. The degree of concentration, as measured by the Herfindahl index, increased to 0.114, indicating a modest decline in competition in the banking sector. Taking into account the effect of financial groups on the market, the Herfindahl index was even higher, at 0.162. Competition decreases due to the effect of financial groups.[43]

Loans and receivables, whose 20% annual growth expresses in particular the increased credit exposure of the banking sector, account for the largest share (59.1%) of the sector's assets. Receivables from clients recorded the strongest

CHART II.9
RoE for bank groups
(in %)

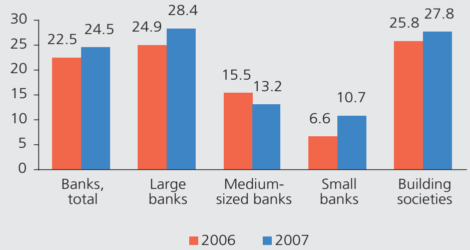


CHART II.10
Profit as a percentage of assets
(in %)

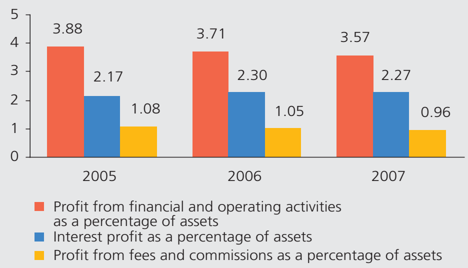


TABLE II.5
Banking sector assets
(at net value; in CZK billions)

	2005	2006	2007	Structure 2007 in %
TOTAL NET ASSETS	2,954	3,152	3,747	100.0
Cash	31	34	36	1.0
Cash balances with central banks	485	365	308	8.2
Financial assets held for trading	158	225	363	9.7
Financial assets designated at fair value through profit or loss	n.a.	n.a	66	1.8
Available-for-sale financial assets	181	234	285	7.6
Loans and receivables	1,646	1,845	2,215	59.1
Held to maturity investments	335	321	327	8.7
Derivatives - hedge accounting (positive fair value)	11	13	11	0.3
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	2	0	0.0
Tangible and intangible assets	49	47	46	1.2
Investments in associates, subsidiaries and joint ventures	36	46	66	1.8
Other assets	22	21	23	0.6

43 The Herfindahl index (HI) is the sum of the squares of the market shares of all entities operating on the market. It takes values between 0 and 1; the closer it is to zero, the lower the concentration, or the stronger the competition, on the market. Values below 0.10 mean a low degree of concentration, values of 0.10–0.18 mean a moderate degree of concentration and values above 0.18 mean a very concentrated market.

CHART II.11

Concentration of banking sector

(as of 31 December 2007; in %)

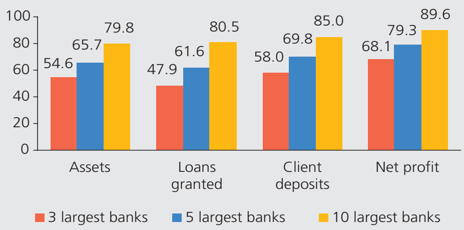


TABLE II.6

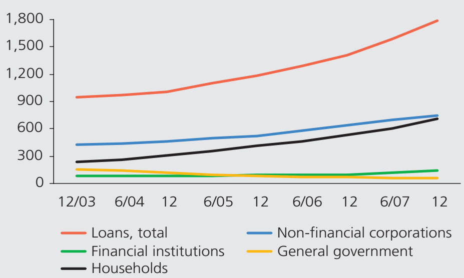
Liabilities by sector

	Volume in CZK billions			Change in % from
	2005	2006	2007	2006
TOTAL	1,179	1,413	1,786	26.4
A. RESIDENTS	1,119	1,339	1,669	24.7
non-financial corporations	525	635	744	17.2
financial institutions	97	100	147	47.5
general government	81	68	57	-15.0
households	413	531	708	33.3
trades	33	36	39	8.7
individuals	380	495	669	35.1
non-profit institutions serving households	2	6	13	134.5
B. NON-RESIDENTS	60	74	116	56.2

CHART II.12

Sector structure of loan porfolio

(in CZK billions)



growth in 2007, rising by 27.5% compared to the end of 2006. Transactions with the CNB (repo operations) were down further in volume as of the end of 2007.[44]

The concentration of the banking sector saw no major changes in 2007. The changes in market shares were affected by a merger in the group of the ten largest banks.

2.3.1 The loan portfolio (sectoral breakdown)[45]

The business activities of the banking sector as a whole continued expanding throughout 2007, thanks mainly to stronger lending activity. In particular, loans to households/individuals recorded much higher growth than in previous years. The high growth rates were fuelled by dynamic growth in mortgage loans, or loans for house purchase. Domestic banks' total loans to clients rose by CZK 372.6 billion (26.4%) to CZK 1,785.6 billion. In 2006 the volume of loans had increased by 19.9% year on year and in 2005 it had gone up by 16.7%.

All groups of banks contributed to the expansion in lending. The large banks performed well, recording the biggest annual rise in loan volume (CZK 187.0 billion), an increase of 22.4% compared to the end of 2006. All the other groups of banks contributed more than 30% to the growth in loans. The contributions of medium-sized banks and small banks were 34.7% (up by CZK 85.4 billion) and 32.8% (up by CZK 29.7 billion) respectively. Foreign bank branches and building societies both provided CZK 44.5 billion more in client loans, representing annual growth rates of 38.3% and 32.8% respectively.

Loans to households (individuals and trades) and loans to corporations, together accounting for more than 81% of all loans provided, showed dynamic portfolio growth in 2007. Receivables from households rose by CZK 177.0 billion (33.4%) to CZK 707.8 billion as of 31 December 2007 and their share in total loans (39.6%) converged towards that of loans to the corporate sector (41.7%). The share of loans to non-financial corporations has long been falling and decreased by almost 3.5 percentage points year on year. Bank loans to non-financial corporations rose by CZK 108.6 billion (17.1%) in 2007, reaching CZK 743.9 billion. Significant growth was recorded in 2007 in lending to private corporations with domestic owners (almost CZK 70 billion). Lending to foreign-owned private corporations showed less growth (more than CZK 25 billion). Loans to private corporations, both domestic and foreign-owned, increased by more than 15%.

The banking sector's exposure to general government continued declining in 2007. Receivables from general government fell by another CZK 10.1 billion (15.0%) to CZK 57.5 billion. In recent periods, this decline has primarily involved a falling exposure to the Czech Consolidation Agency (CCA). Its liabilities to the

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44 In the case of repo operations with the CNB, this was, however, an extraordinary fluctuation, as in December 2007 some banks reported much lower amounts deposited with the CNB than in previous months. The average balance of funds deposited by the banking sector with the CNB at the end of individual months in the form of repo operations was slightly higher in 2007 than in 2006 (up by CZK 43.6 billion to CZK 487.5 billion).

45 Data from the monetary statistics reporting statements submitted by banks were used to prepare this section. These comprise loans provided in the Czech Republic only. These statements use a different methodology than the banking supervision statements, so some of the resulting values (e.g. the total volume of loans provided) are not fully comparable with the data in other parts of the text. For more details, see http://www.cnb.cz – *Statistics – Monetary and financial statistics – FAQs*. The quality (degree of risk) of the loan portfolio is dealt with in section 2.4.1 *Credit risk*.

banking sector fell from CZK 22.1 billion to CZK 5.4 billion in 2006 (compared to CZK 49.3 billion as of 31 December 2004). In mid-2007, they totalled CZK 5.1 billion. By contrast, receivables from local government continued edging up in 2007 (by 4.0% to CZK 32.2 billion), accounting for more than 50% of such loans.

2.3.2 Loans to individuals[46]

Private individuals' debt with domestic banks continued rising in 2007. As of 31 December 2007, bank loans to individuals totalled CZK 668.8 billion, of which CZK 173.8 billion was lent in 2007 alone (up by 35.2% year on year). As usual, mortgage loans for housing, which increased by CZK 95.5 billion (40.0%) during the year to account for 49.9% of all the loans provided to individuals (compared to 48.2% at the end of 2006), showed the highest growth. These trends show that almost 90% of all loans to individuals are long-term ones. Their share has risen steadily from 76.9% in 2004 to 87.1% at the end of 2006. Medium-term loans are the only category of loans recording a downward trend. The increase in short-term loans is due mainly to consumer credit.

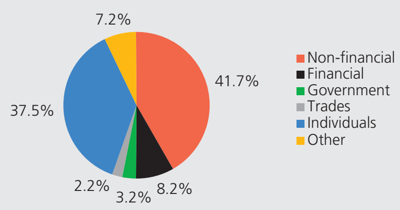
Housing loans accounted for 76.4% of all loans to individuals at the end of 2007.[47] This share increased by 1.4 percentage points year on year. The principal reasons for this loan expansion include the still favourable interest rates, efforts to take advantage of these low rates, a preference for privately-owned or cooperative-owned flats and houses over rented dwellings, persisting strong demand from the baby-boomers of the 1970s, and the fact that people are starting to move up the housing ladder, swapping "starter" homes for higher-quality apartments or family houses. Another factor is the persisting high divorce rate and the popularity of "single" dwellings. An important factor is the relatively high and stable economic growth, and especially the positive labour market trend.

The increase in housing loans was also due to building societies,[48] which provided loans worth CZK 179.3 billion as of the end of 2007 – a record annual increase of CZK 43.8 billion. In 2006, the year-on-year increase in loans granted by building societies had been CZK 27.4 billion. This growth was positively reflected in the loans-to-savings ratio, which rose from 37.6% to 46.6%. This ratio nonetheless remains relatively low compared to similar schemes in advanced countries. The reasons still include the changes in state support for building savings schemes introduced on 1 January 2004. In 2003, building savings clients had signed a record high number of building savings contracts under conditions that were more favourable for them. The following period saw a substantial decrease in the number of building savings contracts, due among other things to the frontloading by clients. Following the saving phase, clients are, as expected, showing interest in obtaining loans. The number of new building savings contracts has been rising again since 2005. In 2007, the number of new contracts rose by 12.3% (580,000 contracts). The average new loan provided by a building society increased from CZK 295,000 to CZK 378,000.[49]

TABLE II.7
Loans to households by time and type

	Volume in CZK billions 2005	2006	2007	Change in % from 2006
TOTAL LOANS AND RECEIVABLES	380	495	669	35.2
of which:				
short-term	21	24	29	18.2
medium-term	47	40	39	-0.7
long-term	311	431	600	39.4
of which:				
housing loans	280	371	511	37.6
consumer credit, including current account overdrafts	89	109	138	26.1
other	10	14	20	40.7

CHART II.13
Structure of loans by economic sector
(as of 31 December 2007)



Note: Only loans granted in the Czech Republic.

TABLE II.8
Basic building society indicators

	Volume in CZK billions 2005	2006	2007	Change in % from 2006
Amount saved	329	360	385	7.0
Total loans	108	135	179	32.4
of which:				
building society loans	32	35	39	10.9
bridging loans	76	100	140	39.9
Total loans/amount saved (%)	32.8	37.6	46.6	23.8

46 This section describes loans to individuals who are residents of the Czech Republic. Individuals are a subcategory of the household sector. In addition to individuals, the household sector includes trades.

47 In addition to mortgage loans, housing loans include building society loans (standard and bridging) and consumer credit for real estate purchase or reconstruction.

48 Table II.8 also includes loans provided by building societies which are of a mortgage loan nature (i.e. secured with a lien on property).

49 Source: Association of Czech Building Societies, http://www.acss.cz.

The loan expansion also concerned consumer credit (including current account overdrafts), which rose by a further CZK 28.5 billion in 2007. As of 31 December 2007, consumer credit provided to households totalled CZK 137.7 billion. The year-on-year increase in consumer credit in 2007 was much higher in absolute terms than in 2006 (CZK 20.3 billion). The annual growth rate increased in relative terms: the consumer credit repayable by households at the end of 2007 was 26.1% higher than a year earlier (compared to a rise of 22.8% in 2006).[50]

2.3.3 Other asset items

Interbank market activities were reflected in an increase of CZK 88.3 billion in receivables from banks to CZK 463.6 billion, which represents 12.4% of the banking sector's total assets. Receivables of CZK 308.1 billion from the CNB are also significant, although they dropped by CZK 57.0 billion compared to the end of 2006. They consist chiefly of receivables arising from repo operations with the CNB. Both components of receivables (from banks and central banks) are quite volatile from month to month.

Bank assets also include securities, the largest item of which is debt securities, as well as equity instruments and investments in associates and subsidiaries. Securities in bank portfolios were worth almost CZK 1 trillion. Debt securities totalled CZK 847.6 billion at the end of 2007, showing annual growth of 16.6% (CZK 120.5 billion). More than half (worth CZK 480.0 billion) were debt securities issued by general government, of which most (49.2%) are held to maturity and a smaller proportion (21.4%) is held for trading. The value of ownership interests grew by more than 45% to CZK 66.5 billion. Almost 94% (CZK 62.2 billion) of this is due to controlling shares. The value of equity instruments[51] was CZK 15.7 billion, up by CZK 2.6 billion on a year earlier. These instruments account for 1.7% of the banking sector's securities.

Most of the securities are held by large banks (70.0%) and building societies (21.9%). Ownership interests are highly concentrated, most of them (99.4%) being held by large banks (CZK 66.1 billion). This is independent of the effect of the large financial groups operating on the Czech banking market, to which the large banks belong.

2.3.4 Banking sector funds

The Czech banking sector has long had sufficient and stable funds. Liabilities arising from client deposits rose by CZK 357.7 billion in 2007 and thus far exceeded CZK 2 trillion (CZK 2,459.9 billion). 2007 saw a large rise in total general government and other client deposits. Other client deposits account for more than 90% of all client deposits. In 2007, (non-government) client accounts recorded an inflow of CZK 297.1 billion. The increases in key interest rates fed through mainly to a rise in rates on new deposits with agreed maturity and deposits redeemable at notice. Rates on overnight deposits were almost unchanged, leading to increased demand for short-term time deposits. Clients continued to prefer current account deposits, which are still recording stronger growth than time deposits. Large banks accounted for CZK 200.6 billion of the growth in primary deposits. Client deposits of medium-sized banks rose by CZK 39.1 billion and those of building societies by CZK 24.6 billion year on year.

TABLE II.9
Banking sector liabilities

	Volume in CZK billions 2005	2006	2007	Structure 2007 in %
TOTAL LIABILITIES	2,954	3,152	3,747	100.0
Deposits, loans and other financial liabilities vis-à-vis central banks	29	0.03	0.01	0.0
Financial liabilities held for trading	60	76	129	3.4
Financial liabilities designated at fair value through profit or loss	n.a.	n.a.	150	4.0
Financial liabilities measured at amortised cost	2,575	2,762	3,125	83.4
Derivatives - hedge accounting (negative fair value)	4	5	9	0.2
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	1	0	0.0
Provisions	13	11	12	0.3
Other liabilities	52	63	65	1.7
Equity, total	220	234	257	6.9
of which:				
issued capital	70	71	74	2.0
retained earnings	58	67	81	2.2
profit for accounting period	39	38	47	1.3

50 For an illustration of the evolution of this type of credit, see Annex 23 *An econometric model for analysis and prediction of the evolution of the bank consumer credit market*.

51 This indicator expresses the total volume of equity instruments regardless of the portfolio where it is placed or of the issuer. It includes shares, units and other equity instruments.

The banking sector's liabilities to banks grew significantly compared to 2006, rising by CZK 86.9 billion to CZK 435.2 billion. Increased activity on the interbank market was recorded in all bank groups. Debt security liabilities increased by a similar amount, to CZK 353.7 billion. The largest increase was recorded by mortgage bonds, which totalled CZK 209.7 billion at the end of 2007, accounting for almost 60% of debt security liabilities.

On the liability side, the banking sector's own funds are increasing almost constantly. Banks are continuing with their strategy of retaining part of their profits in their balance sheets as retained earnings and reserves. In 2007, the growth in retained earnings increased again by comparison with 2006 and reserves were increased in line with legal requirements.[52]

The sector structure of the total deposits of the domestic banking sector is based on monetary statistics data (see Table II.10 and Chart II.11). The shares of the individual sectors were virtually unchanged, despite growing at differing rates. Household deposits still accounted for just over half of total deposits, while non-financial corporations accounted for roughly one quarter. The contributions of general government and financial institutions showed the largest rises, to more than 9% and 5.6% respectively.

2.3.5 Off-balance sheet transactions

The off-balance sheet total continued rising in 2007, chiefly due to a further rise in derivatives transactions. Derivatives transactions comprise transactions for clients, derivatives for banks' own trading purposes and hedging transactions to close banks' open positions vis-à-vis the risks they undertake. Transactions in interest rate instruments (interest rate swaps and forwards) make up the largest share, followed by transactions in currency instruments. Banks engage only minimally in commodity, equity and credit derivatives trading. Receivables/liabilities from futures, forwards, swaps etc., which are the largest-volume items, both increased by more than 40%. Options transactions rose by more than 30%.

The net position from futures, forwards, swaps etc.[53] at nominal value increased by CZK 1.3 billion to CZK 29.6 billion as of 31 December 2007. However, its value fluctuated from month to month (from CZK 52.8 billion at the start of 2007 to CZK -33.2 billion in October 2007). The net fair value of derivatives (a balance sheet item that better expresses the potential level of risk of derivatives operations) remains low.

2.4 RISKS IN BANKING

2.4.1 Credit risk

Credit risk has always been by far the most significant risk undertaken by the Czech banking sector. In the past, domestic banks have performed major operations to clear their balance sheets of bad loans (often with the involvement of the state and its institutions). This process was essentially completed in 2003, when banks posted

CHART II.14
Structure of deposits by economic sector
(as of 31 December 2007)

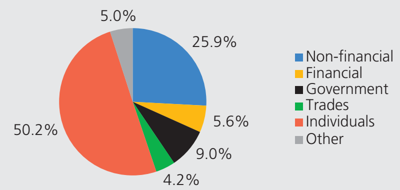


TABLE II.10
Client deposits by sector

	Volume in CZK billions			Change in % from
	2005	2006	2007	2006
TOTAL	1,850	2,025	2,369	17.0
A. RESIDENTS	1,800	1,973	2,282	15.6
non-financial corporations	448	520	614	18.0
financial institutions	94	91	133	47.0
general government	158	161	213	32.8
households	1,077	1,175	1,290	9.7
trades	70	91	100	9.6
individuals	1,007	1,084	1,189	9.7
non-profit institutions serving households	24	27	31	16.0
B. NON-RESIDENTS	51	52	87	68.4

TABLE II.11
Banking sector off-balance sheet

	Volume in CZK billions		
	2005	2006	2007
SELECTED OFF-BALANCE SHEET ASSETS	4,999	6,869	9,642
of which:			
commitments and guarantees given	582	685	844
pledge given	2	3	2
receivables from spot transactions	55	64	91
receivables from futures, forwards, swaps etc.	3,863	5,354	7,724
receivables from options transactions	374	628	850
write-off receivables	40	40	37
values given to custody	83	95	95
SELECTED OFF-BALANCE SHEET LIABILITIES	6,725	8,820	12,113
of which:			
commitments and guarantees received	309	341	471
pledge received	1,169	1,195	1,362
liabilities from spot transactions	55	63	93
liabilities from futures, forwards, swaps etc.	3,843	5,326	7,694
liabilities from options transactions	373	628	852
values received to asset management	30	36	35
values received to custody	945	1,231	1,606
NET POSITION FROM SPOT TRANSACTIONS	-0.3	0.8	-1.6
NET POSITION FROM FUTURES, FORWARDS, SWAPS ETC.	19.9	28.3	29.6
NET POSITION FROM OPTIONS	0.3	-0.1	-1.8

52 For more details on own funds, subordinated debt and banking sector reserves, see section 2.5 *Capital adequacy*.

53 The difference between the nominal value of receivables and liabilities arising from futures, forwards, swaps etc.

TABLE II.12
Classification of receivables from clients

	Volume in CZK billions			Change in % from
	2005	2006	2007	2006
INVESTMENT PORTFOLIO RECEIVABLES, TOTAL	1,663.6	1,863.6	2,191.2	17.6
A. RECEIVABLES FROM CLIENTS	1,204.7	1,457.5	1,846.6	26.7
without default	1,157.6	1,404.0	1,795.4	27.9
standard	1,079.8	1,302.7	1,734.3	33.1
watch	77.9	101.3	61.0	-39.8
with default	47.1	53.5	51.3	-4.1
substandard	18.0	20.4	15.7	-22.7
doubtful	7.6	9.0	8.7	-2.5
loss	21.5	24.1	26.8	11.2
B. RECEIVABLES FROM CREDIT INSTITUTIONS	458.9	406.2	344.5	-15.2
without default	458.9	405.5	344.0	-15.2
standard	456.1	404.2	342.7	-15.2
watch	2.8	1.3	1.2	-0.5
with default	0.0	0.7	0.6	-18.6
substandard	0.0	0.7	0.6	-15.8
doubtful	0	0	0	x
loss	0	0	0	-98.4
C. ALLOWANCES AND LOSS OF VALUE	30.4	32.9	36.1	9.8
allowances for individually assessed financial assets	29.0	31.3	29.3	-6.4
allowances for individually non-impaired assets	0.8	0.9	1.6	76.5
allowances for portfolio of individually immaterial assets	0.6	0.7	5.2	648.8
Allowances and loss of value by sector	30.4	32.9	36.1	9.8
allowances and loss of value for credit institutions	0.0	0.1	0.1	-28.9
allowances and loss of value for clients	30.4	32.8	36.0	10.0
Allowances and loss of value/ investment portfolio receivables (%)	1.83	1.76	1.65	-6.3

CHART II.15
Loan portfolio quality
(client loans assessed individually; in CZK billions)

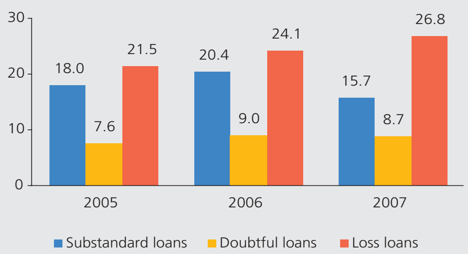


TABLE II.13
Receivables in default by sector

	Volume in CZK billions			Change in % from
	2005	2006	2007	2006
RECEIVABLES IN DEFAULT, TOTAL	48.3	50.3	47.3	-6.0
non-financial corporations	26.7	28.3	22.8	-19.2
financial institutions	1.1	0.6	0.7	15.1
general government	0.1	0.1	0.0	-47.4
households	15.9	18.0	21.1	17.1
of which:				
trades	3.6	3.3	2.8	-14.9
individuals	12.3	14.3	18.3	28.4
of which:				
housing loans	4.7	6.0	7.9	30.6
mortgage loans	2.2	3.1	4.3	38.3
consumer credit	7.4	7.9	10.2	29.6
non-profit institutions serving households	0.01	0.00	0.01	252.5
non-residents	4.6	3.3	2.6	-22.1

a record-low volume of classified loans. Since 2004, the volume of default (non-performing) loans has been going up again, owing to sizeable growth in banks' loan portfolios.

Receivables from financial activities are assessed according to whether or not default took place.[54] A debtor is in default at the moment when it is probable that he will not repay his obligations in a proper and timely manner, or when at least one repayment of principal is more than 90 days past due. Banks assess the financial and economic situation of their clients in accordance with their internal rules. The categorisation of receivables does not take into account collateral, which is considered only when quantifying impairment and in particular when creating allowances (impaired/non-impaired receivables).

Non-default receivables accounted for CZK 2,139.4 billion of the total value of investment portfolio receivables of CZK 2,191.2 billion. The value of all default receivables decreased by CZK 2.3 billion (4.2%) to CZK 51.9 billion in 2007 and their share in total receivables was 2.37%, down by 0.54 percentage point year on year.[55] However, the trends in default loans differed across the groups of banks. In 2007, almost all bank groups recorded at least a minimal decrease in the value of their default receivables. The annual declines were CZK 1.3 billion (4.1%) in large banks, at least CZK 0.2 billion (1.4%) in medium-sized banks, CZK 0.9 billion (24.5%) in small banks and CZK 0.2 billion (5.3%) in foreign bank branches. Building societies were the only exception. The one-third rise in their credit exposure was accompanied by a large increase in default loans (of CZK 0.4 billion, or 16.0%). However, they still recorded a low share of such loans in the total value of their investment portfolio both in absolute terms (1.4%) and relative to the other bank groups. In the group of large banks, default loans account for 2.5% of their portfolio. Substandard and doubtful loans decreased in volume (by 7.7% and 9.7% respectively), but loss loans rose by 11.1% year on year.

Non-default loans assessed as standard loans accounted for most of the banking sector's investment portfolio at the end of 2007 (94.8%, up by more than 3 percentage points on a year earlier). Assessed by default period, default loans were most frequently classified as more than 360 days past due; such loans accounted for more than 60% (CZK 16.2 billion) of total default loans. The share of the banking sector's past-due receivables in default loans exceeded 51% (CZK 26.8 billion).

Allowances rose by CZK 3.2 billion year on year, to CZK 36.1 billion. Allowances assessed individually decreased slightly, while allowances assessed on a portfolio basis increased.

All sectors except households and financial institutions registered a lower volume of default receivables. In relative terms, decreases were recorded in all sectors. The trades sector has long had the highest proportion of default receivables in its loan portfolio. Individuals account for about 41% of all resident default receivables.

In 2007, the decline in default receivables was most pronounced in the non-financial corporations sector. The value of these receivables fell by CZK 5.5 billion year on year and their share in the banking sector was 3.1%.

54 See Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms.

55 Default receivables were greatly affected by a methodological change in one bank, which shifted a substantial part of its portfolio from the default and watch categories to the standard category.

Default loans to individuals rose by CZK 4.1 billion year on year, mainly due to continuing interest in such loans and their strong rate of growth. The share of such default loans in total loans to individuals dropped to 2.74% owing to dynamic growth in lending to individuals. As usual, housing loans recorded a low proportion of problem loans (1.54%). The low degree of risk attached to housing loans is supported by the high reliability of clients when dwellings are used as collateral. The possibility of losing this security encourages timely loan repayments. In addition, banks have a highly prudent approach to providing long-term housing loans and use sophisticated methods to verify client creditworthiness. By contrast, consumer credit defaults increased (by 7.39%). Consumer credit involves high numbers of loans providing small amounts for various, often unspecified purposes. The higher degree of risk of such credit is offset by the interest rate level. Default loans almost tripled in volume in the case of current account overdrafts and debit accounts (with doubtful loans, i.e. loans 180–360 days past due, rising the most).

2.4.2 Foreign exchange risk

The foreign exchange risk of the banking sector remains limited. In 2007, the absolute amount of the sector's foreign currency assets and liabilities increased by more than 20%, but their share in the sector's total assets grew only slightly, by 0.2 percentage point to 21.1% for assets and by 1.2 percentage points to 18.0% for liabilities. In absolute terms, foreign currency assets and liabilities totalled CZK 791.7 billion and CZK 676.2 billion respectively as of 31 December 2007. Off-balance sheet foreign currency assets and liabilities showed a similar pattern. Their shares in off-balance sheet assets and liabilities were almost unchanged compared to the end of 2006, although they recorded higher levels (exceeding 30% and 35% respectively). The development of foreign currency assets and liabilities (both balance sheet and off-balance sheet) over time is reflected in the net foreign exchange position, which ended the period as long in the balance sheet (CZK +115.5 billion) and short in the off-balance sheet (CZK -157.9 billion)..

Receivables, which increased over the course of the year, had the largest share (almost 67%) in foreign currency assets. There was a year-on-year increase in receivables from banks of CZK 53.1 billion (28.7%) to CZK 238.6 billion, while foreign currency receivables from clients recorded an increase of CZK 51.2 billion (21.5%) to CZK 289.9 billion. Foreign currency securities (including ownership interests) held by the banking sector rose by CZK 26.9 billion to CZK 193.3 billion in 2007.

The foreign exchange liabilities of the Czech banking sector saw increases in all main components. Liabilities to banks grew by CZK 72.3 billion to CZK 263.6 billion and foreign currency client deposits rose by CZK 58.0 billion to CZK 328.6 billion.

Roughly 90% of the growth in the shares of off-balance sheet foreign exchange assets and liabilities was due to derivatives transactions. However, the open position is not growing in the off-balance sheet either.

As of 31 December 2007, the banking sector recorded its largest open foreign exchange position vis-à-vis the euro (a short position of CZK 1,300 million), representing 0.6% of total regulatory capital (i.e. bank capital adjusted in accordance with the capital adequacy rules - see section 2.5), followed by the Polish zloty – CZK 886.4 million (long). The third-largest open position is vis-à-vis the Hungarian forint (CZK 723.7 million, short). It is followed by the Slovak koruna (CZK 618.2 million, long). There were no major year-on-year movements in the absolute values.

CHART II.16
Structure of loans in default provided to non-financial corporations as of 31 December 2007

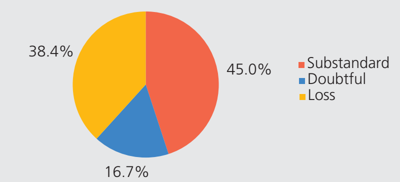


CHART II.17
Structure of loans in default provided to households as of 31 December 2007

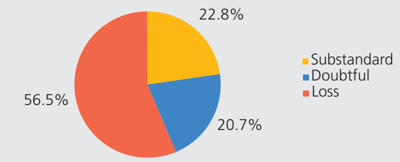


CHART II.18
Shares of foreign currencies in banking sector balance sheet and off-balance sheet
(in %)

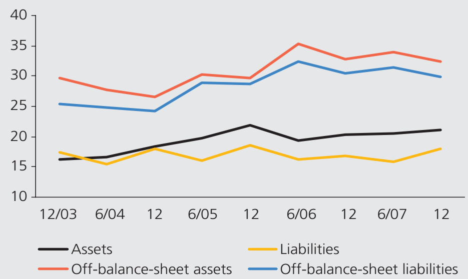
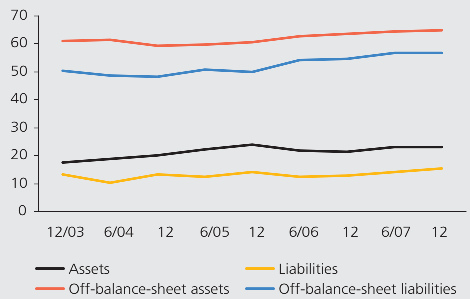


CHART II.19
Shares of non-resident transactions in banking sector balance sheet and off-balance sheet
(in %)



2.4.3 Territorial risk (country risk)

Domestic banks are mostly local in nature and their activities are mostly focused on domestic clients. Transactions with non-residents are significant mainly on the interbank market, especially in respect of derivatives transactions. In addition, banks hold many securities issued by foreign entities. The movements in non-resident assets and liabilities partly correspond to those in foreign currency items; non-resident activities are also concentrated more in the off-balance sheet.

As of 31 December 2007, non-resident assets amounted to CZK 865.4 billion, representing 23.1% of the banking sector's total assets. This is a slight increase of CZK 176.4 billion compared to the end of 2006. Non-resident liabilities showed an increase of CZK 177.1 billion to CZK 581.3 billion in this period.

Interbank transactions dominate both non-resident assets and liabilities. At the end of 2007, liabilities to banks accounted for more than 52% of all financial liabilities of non-residents (CZK 295.5 billion). Receivables from banks (non-residents) were also significant, amounting to CZK 321.4 billion, up by CZK 89.9 billion on a year earlier. Receivables from non-resident clients rose as well, by CZK 29.9 billion to CZK 174.9 billion. Non-resident securities, including ownership interests held by domestic banks, are registered on the liabilities side. Their value exceeded CZK 258.7 billion at the end of 2007 (up by CZK 26.4 billion year on year). Deposits from non-resident clients amounted to CZK 155.9 billion (a rise of CZK 52.3 billion).

The list of ten countries to which the Czech banking sector has the largest exposures as measured by assets traded in this way shows that the representations of the individual countries are virtually unchanged. The leading positions are highly stable. The bottom of the table is the exception, with Poland replacing the USA and Luxembourg. At the end of 2007, the Czech banking sector's exposure was oriented exclusively towards EU countries (the top ten places). The exposure to these ten countries accounts for 78.0% of the total international exposure. The exposure to Slovakia increased by CZK 53.4 billion year on year, mainly because of dynamic growth of receivables from banks (more than 2.8 times higher), although loans to Slovak clients and the volume of bonds continued to grow as well. Activities on the relevant markets are expanding. The list of countries to which domestic banks have the biggest liabilities is almost identical.[56] The Czech banking sector recorded its largest open net positions (i.e. the difference between assets and liabilities transactions) vis-à-vis Slovakia (positive, CZK 98.5 billion), Belgium (negative, CZK 75.2 billion) and Germany (positive, CZK 40.0 billion) as of 31 December 2007.

TABLE II.14

The ten countries with the largest exposures of the Czech banking sector as of 31 December 2007

(in CZK billions)

	Assets, total, of which:	Receivables from credit institutions	Receivables from clients	Bonds
Slovakia	202.2	49.9	68.5	44.4
Germany	86.8	48.4	2.1	26.1
United Kingdom	85.2	42.7	3.0	12.2
Austria	61.3	44.8	1.6	2.6
Netherlands	59.2	22.0	13.6	18.7
France	46.8	21.5	4.4	13.9
Belgium	38.0	17.1	3.5	0.6
Poland	33.3	1.8	17.4	13.6
Greece	31.5	2.4	0.2	28.9
Italy	28.8	11.4	2.5	14.6

2.4.4 Liquidity risk

The domestic banking sector has sufficient liquid funds, despite a slight worsening of some liquidity indicators. The favourable situation in the liquidity area relates to the longer term. Manifestations of the liquidity crisis resulting from insufficient liquidity in some European countries were not observed in the Czech Republic. Quick assets[57] declined further in year-on-year comparison – by CZK 58.2 billion (6.1%) to CZK 899.2 billion – and their share in total assets fell by 6.4 percentage points year on year, mainly because of faster growth in the banking sector's total assets. A change in methodology did not significantly affect the time series.

TABLE II.15

Selected liquidity indicators

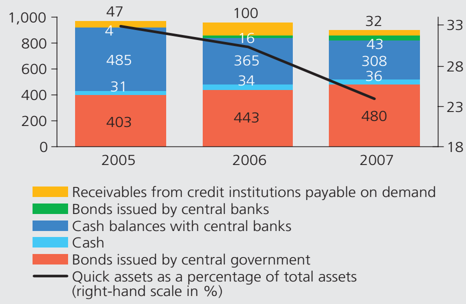
	2005	2006	2007
Total quick assets (in CZK billions)	970	957	899
Total quick assets/total assets (in %)	32.8	30.4	24.0
Total quick assets/total client deposits (in %)	50.5	45.5	36.6
Cumulative net balance sheet position to 3 months net of 80% of demand deposits (in %)	-3.4	-7.6	-10.88
Position on interbank market (in CZK billions)	42	27	28
receivables from banks	423	375	463
liabilities to banks	381	348	435
Loan coverage by primary funds (in %)	164.4	147.6	135.5
Share of demand deposits in total deposits, including banks (in %)	46.4	47.1	44.2

56 In the case of liability transactions, only Poland, Greece and Italy are absent from the list of the ten largest countries. They are replaced by Luxembourg, Ireland and the USA.

The lower volume of quick assets is due mainly to a significant fall in funds deposited with central banks (the CNB and the NBS – a year-on-year decline of CZK 57.0 billion) and a decline in funds deposited with other banks payable on demand, of CZK 34.4 billion compared to the end of 2006. By contrast, debt securities held for trading issued by general government and by central banks recorded slight increases of CZK 33.1 billion and CZK 15.8 billion respectively.

The domestic banking sector as a whole continues to be a net creditor on the interbank market (receivables from banks exceeded liabilities to banks by CZK 27.6 billion at the end of 2007).

CHART II.20
Quick assets
(in CZK billions and %)



2.5 CAPITAL ADEQUACY

Capital adequacy is of critical importance in banking regulation and supervision. Generally, capital adequacy means the ratio of capital to the risks to which a given entity is exposed. This ratio should be high enough so that the capital covers any losses arising from the entity's activities or, to put it differently, so that such losses are also borne by the owners of the capital and not only by the creditors of the entity. Capital adequacy can theoretically be calculated for any entity. However, it is of practical importance in the regulation of entities that use a large amount of external funds in their activities as compared to their own funds. The most difficult problem in calculating capital adequacy is identifying the extent of the risks to which an entity is exposed. It is easier to determine the size of its capital, although there are sometimes problems deciding whether or not certain items count as capital. Therefore, the concept of capital adequacy is subject to constant development and revision, with other types of banking risks being included in the calculation and the capital included being specified. This was also the main reason for issuing a new capital adequacy framework, Basel II. It is aimed at enabling more accurate measurement of credit risks undertaken (mainly using banks' own models) and at including operational risks in the capital adequacy calculation.

In the domestic banking sector, banks have had the option of following this new framework to determine their capital requirements and capital adequacy since the first half of 2007, when Basel II was adopted in the Czech Republic.[58]

The regulatory capital of the banking sector increased by CZK 25.6 billion (13.1%) to CZK 221.3 billion in 2007. This refers to capital adjusted for the purposes of the capital adequacy calculation. The increase in Tier 1 is usually affected by the retention of part of the profit from previous years in the form of retained earnings and reserves. The rise in regulatory capital was quite significantly affected by an increase in share capital, in particular share premium (four banks in total). The increase in Tier 2 was due to the acceptance of subordinated debt. Tier 1 and Tier 2 are reduced by deductible items, which rose in 2007 due to the introduction of a new deductible item for banks using the IRB approach (shortfall in the coverage of expected credit losses), which amounted to CZK 4.9 billion at the end of 2007.

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57 This indicator expresses the volume of quick assets, i.e. assets that are readily available to cover the bank's liabilities. Quick assets comprise the following items: cash, receivables from central banks, receivables from credit institutions payable on demand and bonds issued by central banks and general government (including securities put into repos). The comparability of the time series is not affected by the current methodology. Compared to the 2006 methodology, quick assets no longer include gold, other precious metals and other cash holdings, but only cash. In addition, they include securities issued by central banks and general government put into repos, receivables from credit institutions monitored and payable on demand when in default, debit balances on current accounts of other banks and time deposits over 24 hours with central banks and other claims on central banks.

58 For more details, see part A, section 3.1.

TABLE II.16
Banking sector capital structure
(in CZK billions)

	2005	2006	2007
A. TIER 1	159.8	171.7	197.9
Paid-up share capital registered in Commercial Register	69.4	70.3	73.9
Paid-up share premium	12.9	13.6	23.1
Reserve funds and retained earnings	89.2	100.2	114.1
mandatory reserve funds	26.6	27.9	28.7
other funds created from retained earnings	5.4	6.1	6.4
retained profits	57.2	66.2	79.2
profit for accounting period after tax	0.2	0.0	0.0
accumulated losses	0.1	0.0	0.1
other eligible items	0.0	0.0	-0.2
Items deductible from Tier 1	11.7	12.5	13.0
current year loss	0.0	0.1	0.0
goodwill	2.7	2.7	2.7
intangible assets other than goodwill	8.8	9.2	10.0
own shares	0.0	0.2	0.2
others	0.2	0.3	0.2
B. TIER 2	11.4	28.5	32.9
Subordinated debt	10.3	24.3	32.2
Other capital funds	1.1	4.2	0.7
Items deductible from Tier 1 and Tier 2	4.1	4.5	9.6
Cap. invest. > 10% in banks and fin. inst.	4.1	4.5	4.6
Cap. invest. < 10% in banks and fin. inst.	0.0	0.0	0.0
Others	0.0	0.0	4.9
C. TIER 3	0.0	0.0	0.0
TOTAL CAPITAL	167.1	195.7	221.3

TABLE II.17
Capital requirements and capital adequacy of the banking sector
(in CZK billions and %)

	2005	2006	2007
TOTAL CAPITAL REQUIREMENTS	112.8	137.2	153.9
A. CAPITAL REQUIREMENT FOR CREDIT RISK	106.9	129.9	138.7
STA cap. req. for credit risk	0.0	0.0	6.8
IRB cap. req. for credit risk	0.0	0.0	53.0
BASEL1 cap. req. for credit risk	106.9	129.9	78.9
B. CAPITAL REQUIREMENT FOR SETTLEMENT RISK	0.0	0.0	0.0
C. CAPITAL REQUIREMENT FOR POSIT., FOREX & COMMOD. RISK	5.4	6.4	6.8
D. CAPITAL REQUIREMENT FOR OPERATIONAL RISK	0.0	0.0	7.7
E. CAPITAL REQUIREMENT FOR TRAD. PORT. EXP. RISK	0.4	0.8	0.7
F. CAPITAL REQUIREMENT FOR OTHER TRAD. PORT. INSTR.	0.0	0.0	0.0
G. TRANSITION CAP. REQUIREMENT Top up BASEL I	0.0	0.0	0.0
CAPITAL ADEQUACY	11.86	11.41	11.50

Tier 1 increased by 15.3% in 2007. Reserve funds and retained earnings in the banking sector recorded a year-on-year increase of 13.9%, which is 0.8 percentage point higher than the rise in regulatory capital. Total retained earnings rose by CZK 13.0 billion in 2007, compared to an increase of CZK 9.0 billion in 2006. Mandatory reserve funds rose by CZK 0.8 billion. Contributions to these funds have been broadly unchanged over recent periods.

Tier 2 also grew by more than 15%. It was mainly affected by an increase in subordinated debt[59] of 32.5% since the end of 2006. In 2007, banks reduced the value of this component of capital by repaying subordinated debt (in seven banks in total). Capital grew in five banks through the acceptance of more subordinated debt. The share of Tier 2 in the total regulatory capital of the banking sector remains essentially unchanged, amounting to 14.9% at the end of 2007 compared to 14.6% a year earlier. In 2007, the newly calculated shortfall in the coverage of expected credit losses on an individual basis for exposures using the internal rating based approach (IRB approach) is included in the items deductible from Tier 1 and Tier 2.[60]

Tier 3 capital was still not used in the domestic banking sector in 2007.[61]

In 2007, the structure of the capital requirements of the banking sector changed fundamentally owing to the implementation of Basel II in the Czech Republic with effect from 1 July 2007. Individual banks operating on the Czech banking market were allowed to keep using the Basel I methodology until the end of 2007,[62] and many of them took advantage of this option. Six banks (3 banks and 3 building societies) have been applying the Basel II methodology – using advanced risk measurement methods for regulatory purposes – since its implementation in mid-2007. The assets of these banks accounted for almost 50% of the total assets of the banking sector at the end of the year.

In 2007, the total capital requirements of the banking sector rose by CZK 16.7 billion (12.2%) to CZK 153.9 billion. Basel II is an entirely new approach to the identification of risk and entails new risk measurement methods. Credit risk remains the key risk of the domestic banking sector. This is reflected in the weight of the capital requirement for this risk, which represented 90.1% of the total capital requirement at the end of 2007. Capital requirements for position, foreign exchange and commodity risk account for 4.4% of the capital requirement of the banking sector, while capital requirements for operational risk account for 5.0%.

The increase in the total capital requirements in 2007 was due mainly to continuing growth in the capital requirement for credit risk, although its annual increase

59 Subordinated debt A increases the value of the additional capital (Tier 2). It can be no more than 50% of the value of Tier 1.

60 The shortfall in the coverage of expected credit losses on an individual basis is the negative difference between valuation adjustments for exposures which are assets and provisions for exposures which are off-balance sheet items, and the expected credit losses from these exposures. This applies only to liable entities using the IRB approach. If a liable entity uses the IRB approach combined with the STA approach, the shortfall in the coverage of expected losses is calculated only for exposures to which such entity applies the IRB approach. Expected credit losses from equity exposures, which are not reduced by valuation adjustments for these exposures, always form part of this deductible item. The value of the original and additional capital is reduced in such way.

61 Tier 3 capital consists of subordinated debt with a minimum fixed maturity of two years.

62 As a result of new reporting methodology, data back-calculated for the new capital requirements would not be relevant. For this reason, some of the time series depicting developments in the detailed breakdown of individual items into which the individual capital requirements are broken down, are not sufficient.

(6.8%) was half of that of the total capital requirements. The capital requirements relating to credit risk are being increased mainly as a result of growth in the loan portfolio of the banking sector. The new methodology, consisting of more precise assessment of credit risk in banks, is fostering a lower rate of growth. This more precise assessment should lead to a lower risk assessment of both the investment and trading portfolios of banks and a corresponding decline in capital requirements. Since 2007, the Basel II methodology has newly determined capital requirements for operational risk, which is constructed quite differently. The determination of the capital requirement for operational risk is based on the assessment of banks' risks resulting from their activities. Thus, a bank's process activities are now risk-assessed. The capital requirement for credit risk (including capital requirements for both credit and operational risks) increased by CZK 16.5 billion in 2007 (12.7%), accounting for 95.1% of the total capital requirement of the banking sector as of 31 December 2007.

The capital requirements for the credit portfolio determined under the Basel I methodology (for the banks applying this framework until the end of the year) accounted for 56.9% of the total capital requirements for credit risk at the end of 2007.

The capital ratio of the banking sector edged up by 0.09 percentage point to 11.50% in 2007, as a result of faster growth in regulatory capital than in the capital requirements. The capital ratio of building societies recorded a considerable increase, while that of large banks was unchanged.

All banks were compliant with the set minimum capital ratio of 8% during 2007. Six banks recorded a capital ratio of less than 10% at the end of the year, an annual decrease of three banks.

CNB Banking Supervision is monitoring banks' capital ratios very closely. This is mainly because of the evolution of this indicator at the longer horizon, where it recorded a slight decline. The implementation of Basel II – representing a new approach to risk assessment and a new risk measurement methodology – signifies enhanced use of regulatory capital. The focus on the quality of risk management, especially credit risk management, is having a positive effect on the capital ratio, despite the reduction in capital requirements.

At the end of 2007, the building societies sub-segment allowed the first comparison of the reporting of capital adequacy under the Basel II and Basel I approaches. Of the six building societies, half were applying the Basel II methodology while the remaining three were still using Basel I in this period. The building societies are comparable in this respect: their business activity is centred on an exclusive specialised product (building savings schemes). All the building societies recorded strong demand for loans. The annual increase in total receivables from clients exceeds the analogous indicator for the banking sector as a whole. Building societies are exposed mainly to credit risk. Credit exposure grew at roughly the same rate in both groups of building societies. Owing to a prevalence of retail clients, the risk weight of exposures represented by receivables is reduced for building societies applying the new Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms. As a result, their capital requirements fell by about 30%.[63] In turn, the capital ratios of all three of these building societies increased.

63 Under CNB Decree No. 333, which applied previously (Basel I), a risk weight of 100% was set for receivables from natural persons. Since 1 July 2007, a risk weight of 75% has been assigned for retail exposures (natural persons and small and medium-sized enterprises).

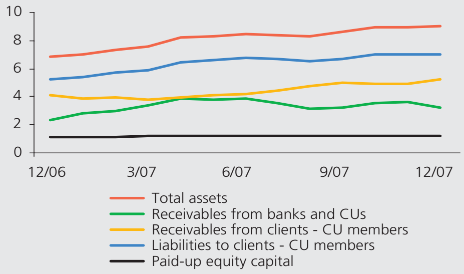
3. THE CREDIT UNIONS SECTOR

3.1 BASIC CHARACTERISTICS

TABLE III.1
Number of CUs and their members

	2005	2006	2007
No. of active credit unions	20	20	19
No. of members	27,047	36,637	44,789

CHART III.1
Basic CU sector indicators
(in CZK billions)



At the end of 2007, the credit unions sector consisted of 19 active credit unions.[64] This number was down by one compared to 2006. The assets of the credit unions sector exceeded CZK 9 billion as of 31 December 2007, representing around 0.2% of the assets of the entire banking sector.[65] The number of credit union members rose from 36,637 to 44,789 in 2007, i.e. by around 22%.

Compared to banks, the credit union form of business predefines certain specific features of the sector. Credit unions carry on activities for their members.[66] These activities chiefly include accepting deposits and providing loans. The capital of a credit union is made up of membership contributions (both basic and any other membership contributions).

Like banks, credit unions must comply with regulatory limits and prudential rules. In addition to a minimum capital requirement (CZK 35 million), the main limits relate to capital adequacy (8%), exposures (20%, 25% and 800% of capital)[67] and liquidity. In connection with the ongoing implementation of Basel II and European directives in the Czech Republic, some qualitative regulatory requirements (for example in the area of control systems and risk management systems) apply to credit unions as credit institutions.

Under the Act on Credit Unions (ACU)[68] certain actions taken by credit unions are subject to CNB approval. This includes for example the approval of persons appointed to credit unions' elected bodies (boards of directors, credit committees and control committees) and the appointment of senior officers, and the approval of auditors, other membership contributions, qualifying holdings, subordinated debt, etc.

If a member's share of a credit union's capital were to exceed 5% as a result of making an additional membership contribution to the capital, this contribution is subject to the prior consent of the CNB. Acquiring a qualifying holding in a credit union (when reaching at least 10% of the capital or of the voting rights) or increasing a qualifying holding to at least 20%, 33% or 50%, is also subject to the prior consent of the CNB.

64 The merger of Moravský Peněžní Ústav – spořitelní družstvo and Privátní Peněžní Ústav and the dissolution of PPU by merger were entered into the Commercial Register on 25 March 2008. The record date of the merger was 1 August 2007.

65 The banking sector is made up of entities carrying on business in the Czech Republic under licence. It consists of banks, foreign bank branches, building societies and credit unions.

66 Credit unions are also authorised, inter alia, to deposit funds in credit unions and banks or to accept loans from credit unions and banks, solely for the purpose of performing activities for their members. Under Article 3(5) of the ACU, the performance of credit union activities for the state and its organisational units and other public institutions is not conditional on credit union membership. However, these activities are insignificant in terms of volume.

67 These capital adequacy and exposure limits were introduced on 1 August 2006 by a CNB Provision. Different limits, laid down in Ministry of Finance decrees, had previously been in effect.

68 Act No. 87/1995 Coll., on Savings and Loan Associations and Certain Related Measures and on the Amendment of Czech National Council Act No. 586/1992 Coll., on Income Tax, as amended.

3.2 THE CREDIT UNIONS SECTOR IN 2007

The credit unions sector has seen relatively rapid growth in recent years. After a record rise in 2006, the assets of this sector increased by 31.3% in 2007 (from CZK 6.9 billion at the end of 2006 to CZK 9.0 billion on 31 December 2007). Growth in assets is particularly visible in the three largest credit unions, whose share in the sector's assets rose by 3.4 percentage points last year. The trends across the sector are mixed – four credit unions recorded a decline in balance-sheet assets last year.

The degree of concentration in the credit unions sector is higher than in the banking sector. At the end of 2007, the three largest credit unions accounted for 61.5% – and the five largest credit unions for 75.2% – of the sector's total assets. The ten largest credit unions managed 90.8% of the sector's total assets. The Herfindahl index calculated from the total assets of the credit unions sector rose from 0.148 to 0.168 in 2007. This indicates a marked increase in the concentration of this sector.

Receivables from clients (credit union members) are the main item for the majority of credit unions. This item accounted for almost 60% of the assets of the sector at the end of 2007 and is associated with one of the credit unions' main activities, i.e. lending. Loans increased by 26.3% in 2007, from CZK 4.1 billion to CZK 5.2 billion. Receivables from banks and credit unions are the second most significant item (more than one-third of the balance sheet). Other asset items are much less significant.

Liabilities to clients (credit union members), which accounted for almost 78% of total liabilities at the end of 2007 (a rise of 2.0 percentage points year on year), are a dominant and still increasing item of credit unions' liabilities. In 2007, they increased by almost 35%, from CZK 5.2 billion to CZK 7.0 billion. Confidence of clients (credit union members) was restored. Client numbers are rising, as are transaction numbers and volumes. Credit unions are expanding the range of services they offer. Equity capital (14.6% of the balance sheet), which consists of basic and other membership contributions, is the second most significant item on the liability side. In the case of some credit unions, part of the capital was not paid up. Other liability items are insignificant in terms of volume.

The credit unions sector posted a profit of CZK 83.2 billion in 2007. This was a better result than in 2006 (up by 1.0%). The end-2006 increase was more than double the end-2005 one. The bulk of credit unions' income is generated in the interest rate area, which is associated with lending. Similarly, the main part of costs relates to interest paid to clients, which is linked to the acceptance of deposits as the main financing source for credit unions' activities. Net interest income was CZK 286.1 million. Net income from fees and commissions is a complementary source of profit (CZK 36.9 million). Of the total of 19 credit unions, 17 were profit-making and 2 were loss-making at the end of 2007. In 2006, 17 credit unions had been profitable, while 3 had recorded a loss.

Until 30 June 2007, the principles for classifying loan receivables and for provisioning for these receivables by credit unions were stipulated in a Ministry of Finance decree.[69] Since 1 July 2007, they have been subject to Decree No. 123/2007, on

CHART III.2
Concentration of CU sector
(as of 31 December 2007; in %)

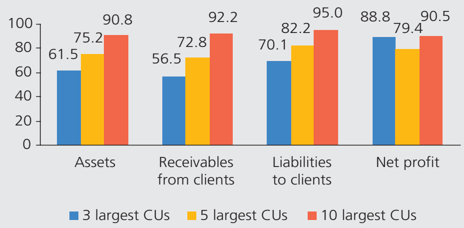


TABLE III.2
CU asset structure
(in CZK millions)

	2005	2006	2007
TOTAL ASSETS	4,048	6,857	9,003
Cash and deposits with CNB	77	162	128
Receivables from banks and CUs	982	2,334	3,215
Receivables from clients – CU members	2,722	4,133	5,219
Debt securities	35	0	0
Intangible assets	4	3	5
Tangible assets	78	106	145
Receivables from paid-up capital	73	51	96

TABLE III.3
CU liabilities and own capital
(in CZK millions)

	2005	2006	2007
TOTAL LIABILITIES	4,048	6,857	9,003
Liabilities to banks and CUs	130	288	341
Liabilities to clients – CU members	3,133	5,218	7,031
Reserves	1	1	0
Equity capital	689	1,175	1,318
of which Paid-up equity capital	616	1,124	1,222
Reserve funds and other funds created from profit	25	40	74
Retained profits (accumulated losses)	-7	7	40
Profit (loss) for accounting period	39	82	83

TABLE III.4
CU sector performance
(in CZK millions)

	2005	2006	2007
Interest income and similar income	274	496	595
Interest expenses and similar expenses	-164	-266	-309
Income from fees and commissions	50	55	44
Expenses from fees and commissions	-30	-40	-7
Other operating income	31	126	13
Other operating expenses	-19	-130	-16
Administrative expenses	-90	-118	-202
Depreciation, creation and use of provisions and reserves for fixed assets	-1	6	-8
Impairment	-9	-12	-17
Income tax	-5	-11	-6
Profit (loss) for accounting period	39	82	83

69 Decree of the Ministry of Finance No. 319 of 29 July 2005, stipulating the principles for classifying loan receivables and for provisioning for these receivables by credit unions.

TABLE III.5
Classification of CU receivables
(in CZK millions)

	2005	2006	2007
TOTAL RECEIVABLES	3,704	6,514	8,559
standard receivables	3,626	6,388	8,252
watch receivables	48	31	186
substandard receivables	19	67	81
doubtful receivables	3	9	32
loss receivables	9	19	8
Sum of provisions	13	21	36
Ratio of classified receivables to total volume (in %)	2.12	1.94	3.59

prudential rules for banks, credit unions and investment firms. The data reported by individual credit unions show that the credit portfolio of credit unions is of relatively high quality. Default receivables (substandard, doubtful, loss) amounted to CZK 121.3 billion at the end of 2007, i.e. roughly 1.4% of credit unions' total receivables. The category of standard receivables (CZK 8.3 billion) is the largest in terms of volume, accounting for 96.4% of all loans granted by credit unions.

The regulatory capital of credit unions and its structure differ from that of banks. Under Decree No. 123/2007 Coll., the capital of credit unions is composed of the sum of paid-up equity capital entered and not entered in the Commercial Register, the risk fund, the reserve fund and other funds created from profit and retained earnings net of accumulated losses, the loss of the current accounting period and intangible assets. The settlement duty and subordinated debt can also be included in capital to the extent laid down in the Act and subject to fulfilment of the set criteria.

As in the case of banks, the amount of regulatory capital forms the basis for the regulatory limits derived from it. The capital requirement for credit unions was increased in previous years to the present CZK 35 million required by law. The regulatory capital of the credit unions sector increased by CZK 190.2 billion (16.3%) during 2007, to CZK 1,357.8 billion. This is capital adjusted for the purposes of the capital adequacy calculation. One credit union accepted and repaid subordinated debt in 2007 (no credit union had previously reported subordinated debt). Reserve funds and retained earnings increased by CZK 66.7 million (142.0%) year on year.

All credit unions were compliant with the stipulated minimum capital ratio of 8% at the end of 2007 (a ratio below 10% was reported by one credit union).

4. THE CAPITAL MARKET

4.1 INVESTMENT SERVICES PROVIDERS

Investment services providers worked intensively during 2007 to comply with the requirements of the Directive on Markets in Financial Instruments (MiFID). However, MiFID had still to be implemented into Czech law when this directive took effect on 1 November 2007. The CNB was therefore forced to flexibly introduce a number of measures on this date. Since the start of 2007, investment services providers have also been adapting to the new capital adequacy framework (Basel II), introduced by Act No. 120/2007 Coll., which took effect on 1 July 2007 (with some provisions taking effect on 1 January 2008).

4.1.1 Investment firms

No new investment firm licences were granted in 2007. Two such licences expired under the legislation owing to changes in objects of business. At the end of 2007, 44 investment firms licensed by the CNB (13 of them banks) and 14 foreign entities from EU countries providing investment services in the Czech Republic via a branch (11 of them banks) were operating actively. Six domestic investment companies managing assets of clients under contract held investment firm licences at the end of 2007. By the end of 2007, 518 non-banks and 201 banks had provided notification of their intention to provide investment services in the Czech Republic under the single European licence without establishing an organisational unit.

As of 31 December 2007, investment firms[70] had concluded 1.3 million contracts with clients (a year-on-year increase of 14.8%), of which almost 210,000 were active clients.[71] Client assets amounted to CZK 1,998.9 billion.

Investment firms carried out trades for their clients totalling CZK 9,406.8 billion[72] in 2007, a year on year rise of 24.9%. Of this total, share trades amounted to CZK 5,415.8 billion (an annual increase of 58.6%), bond trades to CZK 2,976.0 billion (an annual increase of 27.1%), money market instrument trades to CZK 682.0 billion (an annual decline of 30.3%) and unit trades to CZK 332.9 billion (an annual decline of 58.1%).

In 2007, investment firms carried out trades for their own account amounting to CZK 16,406.3 (an annual increase of 5.5%), of which share trades accounted for CZK 2,638.0 billion (an annual increase of 17.4%), bond trades for CZK 2,384.1 billion (an annual decline of 4.8%) and money market instrument trades for CZK 11,384 billion (an annual increase of 5.5%). The structures of trades for clients and trades for own account can be compared in Charts IV.4 and IV.5 (excluding derivatives trades).

At the end of 2007, the CNB registered 31 non-bank investment firms licensed by it. Their own capital totalled CZK 4,012.7 billion. Most investment firms had capital in the range of CZK 10–20 million or over CZK 100 million. A more detailed

70 Entities licensed by the CNB and branches of entities registered in another Member State of the European Union and authorised to provide investment services in the Czech Republic.

71 An active client is one that requested an investment service at least once in the period under review.

72 The total trading volume excluding derivatives transactions.

CHART IV.1
Number of investment firms
(at end of period)

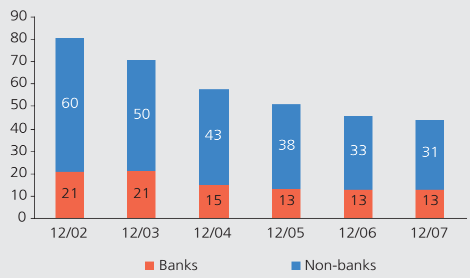


CHART IV.2
Number of foreign entities authorised to provide investment services in the Czech Republic under the single European licence
(at end of period)

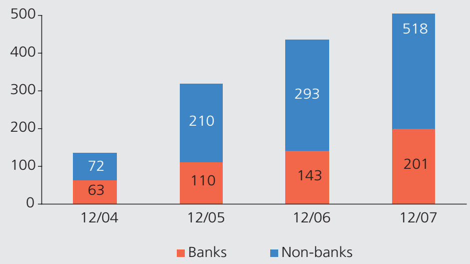


CHART IV.3
Volume of client assets managed by investment firms
(in CZK billions)

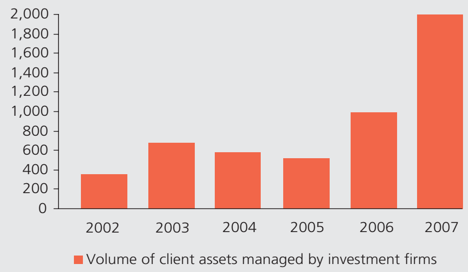


CHART IV.4
Structure of trades for clients
(as of 31 December 2007)

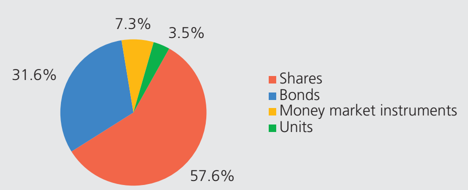


CHART IV.5
Structure of trades for own account
(as of 31 December 2007)

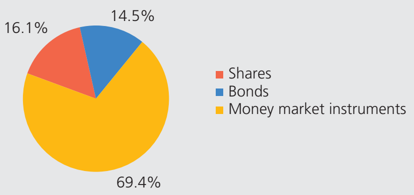


CHART IV.6
Non-bank investment firms by own capital
(as of 31 December 2007)

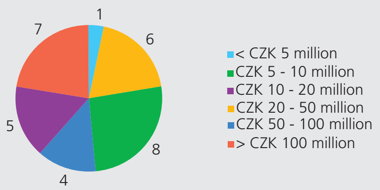


CHART IV.7
Concentration in non-bank investment firm sector
(as of 31 December 2007; in %)

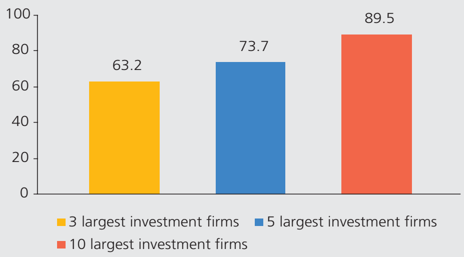
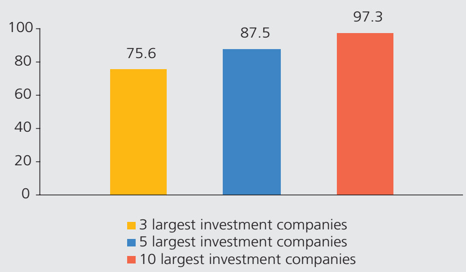


CHART IV.8
Concentration in investment company sector by volume of assets in mutual funds
(as of 31 December 2007; in %)



breakdown of non-bank investment firms by own capital is given in Chart IV.6. The average return on equity of non-bank investment firms was 22.2% in 2007.

Non-bank investment firms administered client assets amounting to CZK 393.1 billion at the end of 2007. They had concluded 74,300 contracts with clients, of which 31,800 were active clients.

The concentration of trades for clients (excluding derivatives) carried out by non-bank investment firms is shown in Chart IV.7.

4.1.2 Other supervised entities – brokers and investment intermediaries

Decree No. 59/2007 Coll., which redefined the types of activities which require broker examinations, the types of broker specialisations and the method of taking the broker examination, took effect in mid-April 2007.

A total of 1,917 entities holding a broker's licence under Article 14(1) of the Capital Market Undertakings Act were registered at the end of 2007. In 2007, the CNB issued or extended 117 broker's licences and withdrew such licences in 21 cases. Thirty-nine rounds of broker examinations took place, with 394 participants.

In all, 10,628 investment intermediaries were registered under Article 30 of the Capital Market Undertakings Act at the beginning of 2007. During 2007, a total of 2,792 investment intermediary registration certificates were issued and 55 were cancelled. The CNB thus registered 13,365 investment intermediaries as of 31 December 2007.

4.2 COLLECTIVE INVESTMENT

The interest in setting up new investment companies, open-end mutual funds, real estate funds and funds for qualified investors initiated by the May 2006 amendment to the Collective Investment Act continued into 2007. Another important factor for collective investment was an amendment to the Act on Banks, effective from 1 July 2007, allowing bank investment companies to acquire real estate companies into real estate funds.

4.2.1. Overview of collective investment undertakings

The number of active investment funds, which had been zero at the end of 2006, increased to seven in 2007. These are newly established funds intended for qualified investors.

There were 13 active investment companies (excluding those in liquidation or bankruptcy or those whose licences have been revoked) at the start of 2007. The CNB licensed six new investment companies during the year.[73] At the end of 2007, 18 investment companies licensed by the CNB were active on the market. These companies managed 121 open-end mutual funds, of which 38 were standard and 83 specialised.

At the end of 2007, the CNB registered 37 foreign investment companies and 20 specialised funds from EU Member States. A total of 1,479 (sub-)funds in

73 One licence took effect in 2008.

64 foreign investment companies or SICAVs from seven EU countries had made valid notifications of the offering of UCITS funds' securities to the public in the Czech Republic by 31 December 2007. However, the number of securities actually offered was considerably lower. The geographical structure of notified (sub-)funds is shown in Chart IV.9.

4.2.2. Volume of assets managed by mutual funds

Total assets in open-end mutual funds increased by CZK 17.0 billion, or 10.8%, to CZK 174.2 billion in 2007. The structure of total investments in open-ended mutual funds is shown in Chart IV.10. The structure of the total investments is shown from different points of view in Charts IV.11 to IV.13.

4.3 PENSION FUNDS

4.3.1. Number of licensed entities

A total of 11 pension funds (excluding pension funds in liquidation or bankruptcy) had been active on the private pension scheme market at the end of 2006. ČSOB Penzijní fond Progres, a.s., a member of the ČSOB group, and Hornický penzijní fond Ostrava, a.s. merged on 31 December 2006. Ten pension funds were active on the market at both the start and the end of 2007.

4.3.2 Licensing and authorisation activities

In June 2007, the CNB granted a licence to establish and operate the pension fund AEGON Penzijní fond, a.s. In November 2007, the CNB authorised the merger of Zemský penzijní fond, a.s., with the successor pension fund ČSOB Penzijní fond Progres, a.s., a member of the ČSOB group, on 31 December 2007.

4.3.3 Structure of pension fund assets

The total assets managed by pension funds amounted to CZK 167.2 billion at the end of 2007, despite market conditions causing a partial decline in the value of the assets. This is an increase of CZK 21.3 billion compared to a year earlier, explained mainly by an inflow of newly received planholders' funds. The growth in pension fund assets and profit over the past five years is shown in Chart IV.14. Concentration in the pension fund sector is relatively high and has remained broadly unchanged in recent years. Its evolution over the past three years is shown in Chart IV.16. Chart IV.15 illustrates the allocation of pension fund investments by asset type. In terms of the rate of growth of total investments, it is worth mentioning that accrued expenses in pension funds' assets increased further, from CZK 2.9 billion to CZK 3.5 billion.

As with other sectors, own funds (consisting of invested capital, share premium, reserve funds and other funds created from profit, capital funds, valuation differences, retained earnings/accumulated losses and profit/loss for the current period) are an important indicator for pension funds, reflecting the interest of shareholders in the prudent management of the institution. The 2007 data show a decline in the own capital of the pension fund sector as a whole – the book value of own capital fell in absolute terms from CZK 8.7 billion as of 31 December 2006 to CZK 3.9 billion as of 31 December 2007. This decrease is due mainly to valuation differences in response to the deterioration in market conditions.

The valuation differences item, which declined from plus CZK 1.2 billion to minus CZK 4.4 billion, accumulates gains and losses on holdings of financial instruments which are not reflected in the pension fund's profit and loss account. In large

CHART IV.9
Structure of notified (sub-)funds by country
(as of 31 December 2007)

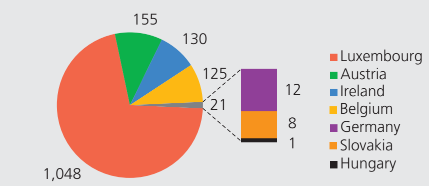


CHART IV.10
Structure of total investments in mutual funds by fund type
(as of 31 December 2007)

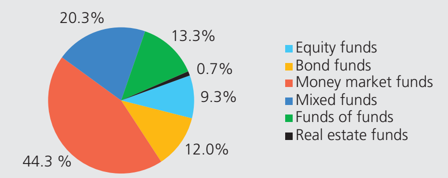


CHART IV.11
Total investments in mutual funds by fund type
(at end of period)

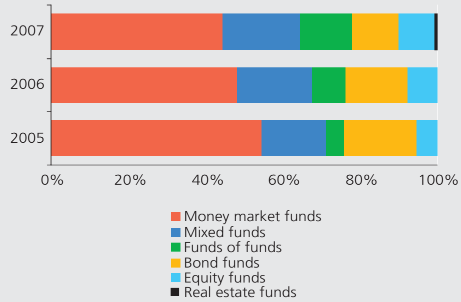


CHART IV.12
Total investments in domestic and foreign funds
(as of 31 December 2007; source: CCMA)

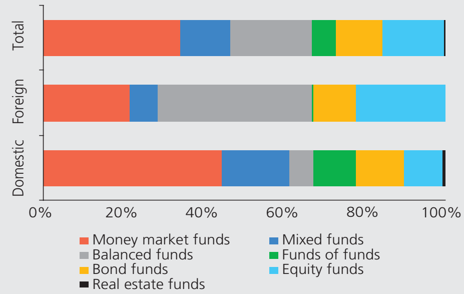


CHART IV.13
Assets in domestic and foreign funds offered to the public in Czech Republic
(in CZK billions; source: CCMA)

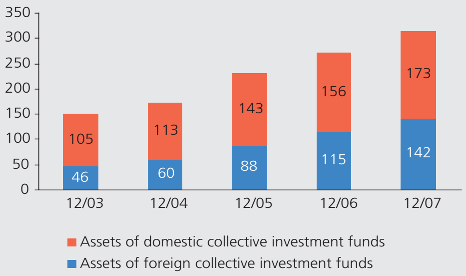


CHART IV.14
Total assets and profit of pension funds
(in CZK billions)

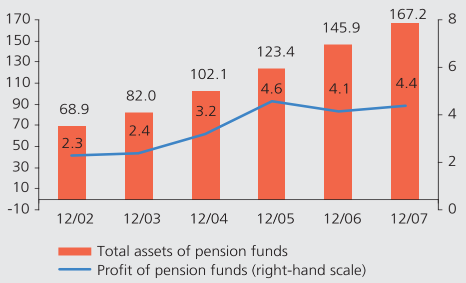


CHART IV.15
Structure of pension fund assets
(as of 31 December 2007)

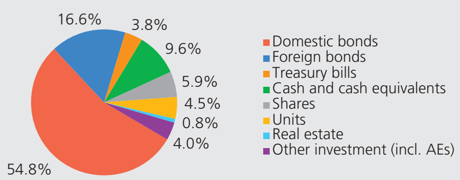
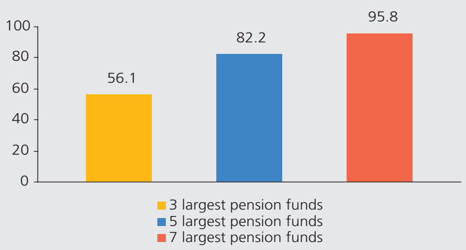


CHART IV.16
Concentration in pension fund sector by volume of contributions received
(as of 31 December 2007; in %)



measure it reflects any deterioration in the value of the fund's assets. In other words, any market risk (associated with current developments on financial markets, for example a change in interest rates[74]) arising from holdings of financial instruments materialises here. With standard risk management, it is necessary to predict the relevant market fluctuations and to create reserves of an appropriate size in good times to cover risk.

The profit of pension funds increased by CZK 0.3 billion to CZK 4.4 billion in the same period. However, the sector's real asset performance was negative, owing to the decline in valuation differences item.

4.3.4 Volume of planholders' funds

The funds of pension planholders, i.e. their deposits including state contributions, employers' contributions and related income, amounted to around CZK 162.4 billion at the end of 2007. This represented an increase of CZK 26.3 billion compared to 2006, due mainly to the balance of funds newly received by pension funds in 2007 (CZK 37.0 billion) and funds paid out (CZK 14.6 billion). Yields of CZK 3.7 billion on funds saved in 2006 was also credited to planholders' accounts in 2007. The average volume of funds per planholder thus increased from CZK 37,700 to almost CZK 41,000. There were 3.9 million pension planholders at the end of 2007.

4.4 REGULATED MARKETS

4.4.1 Trading on regulated markets

The total number of share issues traded on the PSE in the fifteenth year of its renewed operation was the same at the end of 2007 as at the end of 2006 – 32. During the year, two issues were admitted to trading on the PSE and two issues were delisted at the issuer's request due to a squeeze-out. The evolution of the number of issues of shares and bonds traded on the stock exchange since 2001 is shown in Chart IV.19. Trading in shares increased by 19.3% year on year, from CZK 848.9 billion to CZK 1,013.0 billion.

The number of bond issues traded on the PSE increased from 110 in 2006 to 132 in 2007. However, the total volume of bond trades declined by 15% compared to 2006, from CZK 598.9 billion to CZK 508.9 billion. The annual volumes of bond trades have been on a downward trend since 2002. The structure of bond trades in 2007 is shown in Chart IV.21.

Derivatives trading on the PSE recorded a relatively small volume of CZK 3.1 billion. The offer of derivatives at the end of 2007 comprised two issues of warrants, six issues of futures and 39 issues of investment certificates. The monthly derivatives trading volumes are shown in Chart IV.22.

The number of share issues traded on the main RM-S market in the period under review fell from 53 to 50. The total trading volume recorded a significant rise, from CZK 3.9 billion to CZK 7.7 billion. Share trading accounted for almost all this figure. Bond trading totalled just CZK 20.8 million, while unit trading amounted to CZK 14 million.

74 Pension funds hold most of their assets in interest-rate sensitive instruments.

The share of the RM-S market in the total trading volume on the regulated markets increased slightly, accounting for about 0.5% in 2007 compared to 0.3% in 2006.

By comparison with the previous year, the total annual trading volume on the two markets rose by around CZK 78 billion. The rise in the total volume was due entirely to increased share trading. The share of bonds fell to 33.4% of the total trading volume in 2007. In 2006, bond trading had accounted for 41.3% of the total.

The PSE's PX index closed 2007 at 1,815.1 points, compared to 1,588.9 points at the end of 2006. Its year-on-year growth was thus 14.2%. The PX index broke through 1,800 points on 17 April 2007 and reached a record high of 1,936.1 points on 29 October 2007. The monthly share trading volumes on the PSE and the 20-day historical volatility of the PX index are shown in Chart IV.23.

The RM-S index showed even stronger growth of 31.2%, rising from 2,595.3 points to 3,404.4 points. The evolution of the PX exchange index, the RM off-exchange index and the total volume of trading on regulated markets are shown in Chart IV.25.

The market capitalisation of shares traded on regulated markets recorded year-on-year growth on both the PSE and the OTC market organised by RM-S. The market capitalisation of share issues on the PSE was CZK 1,841.6 billion on 31 December 2007, up by 11.6% compared to the end of 2006. The market capitalisation of shares traded on the RM-S market rose from CZK 1,621.9 billion to CZK 4,306.4 billion, or 165.5%. This was due mainly to the launch of trading in foreign issues in September 2007.

4.4.2 Trading off the regulated markets

Securities transactions executed off the regulated markets[75] totalled CZK 3,547 billion in 2007. This represents a year-on-year increase of 11.1%. UNIVYC transactions rose by 11.5% to CZK 3,544.3 billion. Transactions settled through the Czech Securities Centre increased by 15.6% to CZK 3 billion.

4.5 SECURITIES ISSUES

Two basic types of approval procedures are conducted in the area of securities issues. The first is the approval of documents connected with new securities issues, bond issue conditions, securities prospectuses and combinations thereof for the purpose of offers to the public and admission of securities to trading on the regulated market. The second type is approval procedure for the granting of consent to the publication of takeover bids and other public share-purchase contract offers relating to listed participating securities, and also the granting of prior consent to squeeze-out decisions made by general meetings. Detailed lists are given in part C – Annexes.

75 Transactions executed off the regulated markets are transactions where, in the case of securities transfers executed at the Prague Securities Centre, the counterparties state the price paid for the transfer. In the case of UNIVYC transactions, such transactions are commercial transfers and non-commercial transactions involving the transfer of money.

CHART IV.17
Planholders' funds
(in CZK billions)

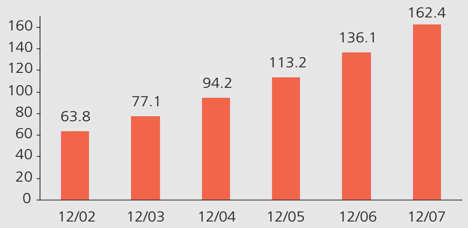
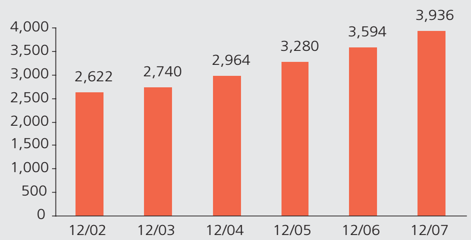


CHART IV.18
Number of planholders
(in thousands)



Source: Ministry of Finance CR

CHART IV.19
Number of issues on PSE

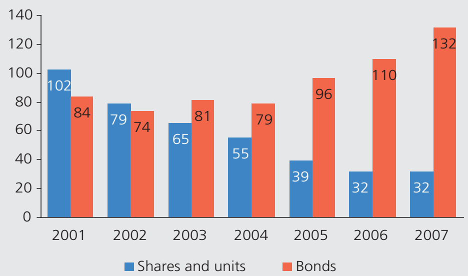


CHART IV.20
Monthly trading volumes on PSE and PX index
(in CZK billions)

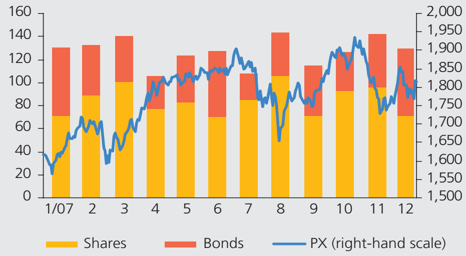


CHART IV.21
Structure of bond trades on PSE
(as of 31 December 2007; in CZK millions)

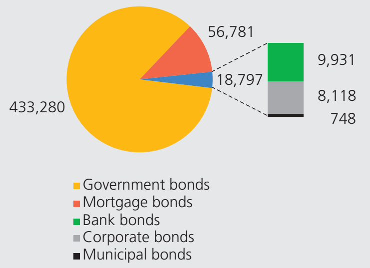


CHART IV.22
Monthly derivatives trading volumes on PSE
(in CZK millions)

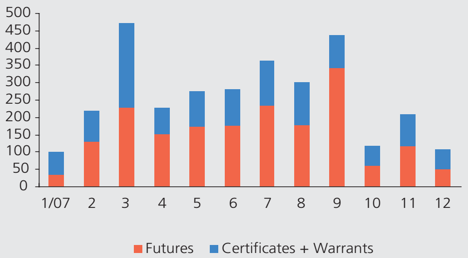


CHART IV.23
Historical volatility of PX index (20D) and monthly share trading volumes
(in % and CZK billions)

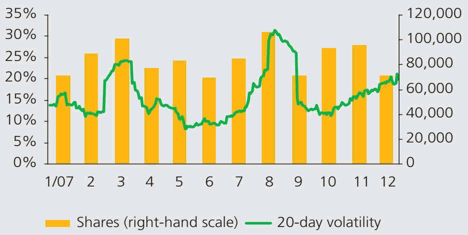
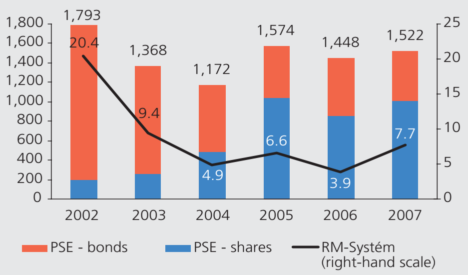


CHART IV.24
Trading volumes on regulated markets
(in CZK billions)



4.5.1 New listed issues

In 2007, issue conditions were approved and 38 issues of listed bonds totalling CZK 112.1 billion were newly issued. Three new share issues were admitted to trading on the regulated market in the Czech Republic. Two cases involved admission at the request of the issuer based on a prospectus notification approved by a regulator in another EU Member State. One case involved admission not requested by the issuer based on an exemption laid down in Article 44(4) of the Capital Market Undertakings Act. One already admitted issue was increased due to an increase in the issuer's equity capital. Notifications of 40 issues of investment certificates listed on the PSE were made during 2007. Of these, 39 were issued by two Austrian banks and one by a British bank.

4.5.2 Publicly offered unlisted securities

In 2007, the CNB approved prospectuses for offers to the public of five unlisted shares aimed at increasing equity. Two bond programmes with a maximum volume of CZK 160 billion were also approved.

4.5.3 Takeover bids and public share-purchase contract offers

The CNB approved four takeover bids in the period under review. One public contract offer was approved following a decision of the bidder's General Meeting to delist shares. There were no voluntary takeover bids in the period under review.

4.5.4 Squeeze-outs

When assessing applications for prior consent to consideration amounts in squeeze-outs, the CNB granted final consent in 43 cases, refused applications in 10 cases and discontinued proceedings in two cases in 2007.

4.5.5 Issuers of listed securities

As of 31 December 2007, the CNB supervised 85 issuers of listed securities, 17 of which were foreign.

Information from all 85 issuers was inspected on an ongoing basis. At the start of 2007, the CNB issued methodological instructions concerning the content of companies' annual reports. Despite that, the most frequent shortcomings in the annual reports were again inadequate descriptions of the principles of remuneration of senior officers and supervisory board members and missing statements on conflicts of interests. An inspection of the reports for the first half of 2007 revealed shortcomings consisting of incorrect reference periods in financial statements and insufficient descriptions of the issuer's activity over the past six months. The issuers were notified of the shortcomings in their annual and half-yearly reports and administrative proceedings were opened in four cases.

In 2007, after assessing the specific circumstances, the CNB allowed one issuer registered abroad to fulfil its disclosure duty in the Czech Republic in English.

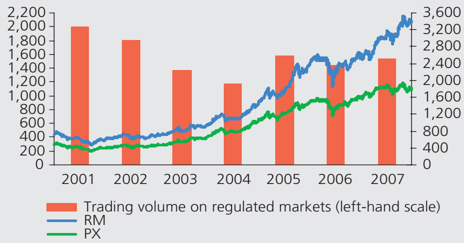
In 2007, the CNB conducted 7 administrative proceedings concerning requests of listed securities issuers - who are obliged to compile both financial statements and consolidated financial statements - for permission to publish only one of these in their annual reports.

The CNB evaluated whether an annual report containing only financial statements (or only consolidated financial statements) would still provide investors with a true and fair picture of the issuer's financial condition, business activities and financial results. The proceedings were discontinued in one case and the CNB decided to approve the other requests.

CHART IV.25

Trading volumes on markets; PX and RM indices

(at end of period; in CZK billions)



5. THE INSURANCE MARKET

5.1 NUMBER OF INSURANCE UNDERTAKINGS

As of 31 December 2007, there were 34 domestic insurance undertakings, 17 branches of EU insurance undertakings and one branch of an insurance undertaking from outside the EU/EEA operating on the Czech insurance market. The number of domestic insurance undertakings does not include the Czech Insurers' Bureau.[76] The number of domestic insurance undertakings increased by one compared to the previous year. In 2007, DIRECT Pojišťovna, a. s. was granted a new licence to provide selected types of non-life insurance. This domestic insurance undertaking specialises in providing insurance products in the area of motor third party liability insurance and vehicle accident insurance.

As in 2006, AXA životní pojišťovna a. s. provided insurance also through its branches in Slovakia and Norway. As of 31 December 2007, a total of 15 domestic insurance undertakings were authorised to carry on insurance business in other EU or EEA countries under the freedom to provide services. In 2006, the figure had been 14.

2007 saw continuing development of insurance business of undertakings from other EU or EEA countries through branches or under the freedom to provide services. The number of branches of insurance undertakings from EU countries increased by two compared to 2006. In 2007, new notifications were submitted for ACE European Group Ltd, organizační složka, INTER PARTNER ASSISTANCE, organizační složka and QBE Insurance (Europe) Limited, organizační složka. Two branches, HDI Industrie Versicherung AG, organizační složka and GERLING - Konzern Všeobecná pojišťovací akciová společnost, organizační složka, merged into a successor entity HDI-Gerling Industrie Versicherung AG, organizační složka. Most branches (a total of four) were established in the Czech Republic by Austrian insurance undertakings. Insurance undertakings from the United Kingdom, Germany and Slovakia each have three branches. The number of branches from third countries remained unchanged in 2007. The only entity in this category is a branch of a Swiss insurance undertaking (Elvia Reiseversicherungs-Gesellschaft AG - organizační složka).

The number of insurance undertakings and branches thereof from other EU or EEA countries offering insurance in the Czech Republic under the freedom to provide services continues to rise. There were 478 such entities at the end of 2007, up by 77 year on year. This number was made of 378 insurance undertakings and 100 branches of insurance undertakings. These undertakings are active mainly on the non-life insurance market, where they are helping to increase competition. More than 100 notified entities are from the United Kingdom. It is followed by Ireland,

TABLE V.1
Structure of market by type of insurance undertaking

	2005	2006	2007
NUMBER OF DOMESTIC INSURANCE UNDERTAKINGS	33	33	34
of which:			
non-life	15	15	16
life	3	3	3
both life and non-life	15	15	15
NUMBER OF BRANCHES OF INSURANCE UNDERTAKINGS FROM EU AND THIRD COUNTRIES	12	16	18
of which:			
non-life	8	11	13
life	2	3	3
both life and non-life	2	2	2
TOTAL NUMBER OF INSURANCE UNDERTAKINGS a)	45	49	52
of which:			
non-life	23	26	29
life	5	6	6
both life and non-life	17	17	17

a) excluding insurance undertakings from Member States operating in the Czech Republic under the freedom to provide services

76 The Czech Insurers' Bureau was founded by Act No. 168/1999 Coll., on Vehicle Liability Insurance, as amended, as a professional organisation of insurers licensed to provide motor third party liability insurance. Its main tasks include providing frontier insurance, guaranteeing and providing compensation for personal injury or death caused by the operation of an unidentified vehicle for which an unidentified person is responsible, and providing compensation for damage caused by the operation of a vehicle without liability insurance and other types of compensation under the aforementioned Act. Detailed information on the activity and financial performance of the Czech Insurers' Bureau is available at http://www.ckp.cz.

Germany and France, each with more than 30 notifications.[77] The number of notified entities from EU or EEA countries can be expected to rise further.

Insurance market entities were divided into four categories for the purposes of the analyses in the following sections. The first three categories – large, medium-sized and small insurance undertakings – are made up of domestic insurance undertakings and are subdivided according to their share in total premiums written on the Czech insurance market. The fourth category comprises branches of insurance undertakings and includes a branch from a third country in addition to those from other EU countries.[78]

The first group (large insurance undertakings) consists of five domestic insurers whose shares in total gross premiums written on the Czech market exceed 5%. These insurance undertakings offer a broad range of life insurance and non-life insurance products. With the exception of one insurer, premiums written are higher in the non-life insurance market segment, reflecting the ratio of non-life to life insurance on the market as a whole. Four insurance undertakings are also authorised to carry on cross-border provision of insurance services in selected EU or EEA countries. The entities in this category belong to large international financial groups with a strong capital base. In 2007, a joint venture agreement was signed by the Czech financial group PPF, owner of Česká pojišťovna, a.s., and the Italian group Generali, operating in the Czech Republic through Generali pojišťovna, a.s. The new Generali PPF Holding, which opened for business in January 2008, is one of the largest insurance groups in Central and Eastern Europe.

The second category (medium-sized insurance undertakings) is made up of six entities having market shares in premiums written of between 1% and 5%. As in the case of large insurers, these undertakings are universal insurers, operating on both the non-life and life insurance markets. Unlike large insurance undertakings, medium-sized insurers have higher premiums written in life insurance and non-life insurance is prevalent only in two of them. Three insurers also provide insurance on a cross-border basis in EU or EEA countries. Four undertakings are controlled by foreign shareholders, while two are controlled by domestic shareholders.

The group of small insurance undertakings contains 23 domestic insurers with market shares of less than 1%. Three of these insurers focus on life insurance, while 16 specialise in non-life insurance and four are universal insurers. The range of insurance products offered is relatively narrow and specialised. It includes, for example, accident and sickness insurance, general liability insurance, credit and guarantee insurance, legal protection insurance and travel insurance. As regards life insurance, their products are focused increasingly on investment life insurance. A total of 13 insurers are controlled by foreign capital, while 10 insurers are controlled by domestic owners. Eight undertakings offer products on a cross-border basis in other EU or EEA countries.

The fourth category consists of branches of foreign insurance undertakings. It comprises 18 entities that specialise primarily in non-life insurance and have

CHART V.1
Number of insurance undertakings by group

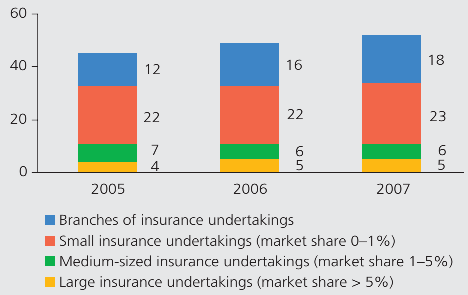
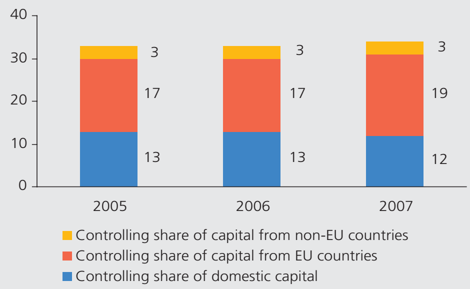


CHART V.2
Ownership structure of domestic insurance undertakings



77 A detailed overview of the numbers of notified insurance undertakings and branches broken down by EU and EEA country is given in Annex 5. A complete up-to-date list of insurance undertakings authorised to carry on insurance business under the freedom to provide services, including their specialisations, is available on the CNB website.

78 A list of the individual insurers assigned to these categories is given in Annex 4.

Table V.2
Ownership structure of domestic insurance undertakings by share in registered capital as of 31 December 2007

COUNTRY	AMOUNT OF PARTICIPATION (CZK thous.)	SHARE IN TOTAL REGISTERED CAPITAL (%)
Czech Republic	5,337,534	29.0
Netherlands[a)]	4,712,000	25.6
Austria	4,288,224	23.3
Belgium	1,218,300	6.6
Italy	566,000	3.1
France	546,427	3.0
United Kingdom	435,900	2.4
Germany	372,100	2.0
USA	370,000	2.0
Switzerland	243,100	1.3
Slovenia	235,000	1.3
Denmark	55,500	0.3
TOTAL CAPITAL	18,380,085	100.0

a) including direct shareholder of Česká pojišťovna, a.s.

Chart V.3
Domestic insurance undertakings by origin of capital as of 31 December 2007
(in %)

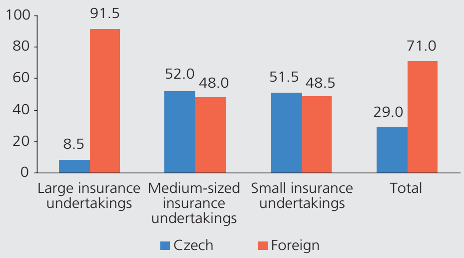


Chart V.4
Gross premiums written
(in CZK billions)

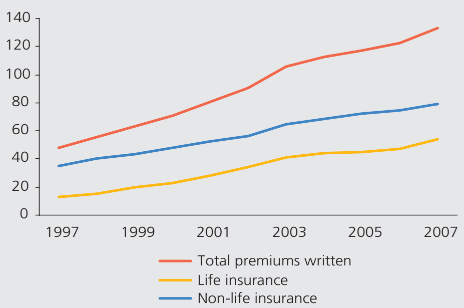
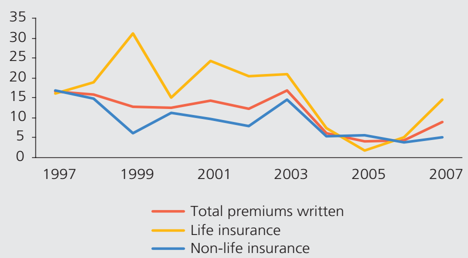


Chart V.5
Rate of growth of premiums written
(in %)



insignificant market shares. However, ING Životní pojišťovna N.V., pobočka pro Českou republiku, has a specific position on the market, ranking second by premiums written in life insurance and sixth in the whole insurance market. Three branches of insurance undertakings specialise in life insurance and 13 in non-life insurance, while two are universal.

Unlike in the previous year, no domestic insurance undertaking moved into a different category in 2007. DIRECT pojišťovna, a.s was a new arrival in the group of small insurers. While the structure of domestic insurance undertaking categories is stabilised, the number of branches of foreign insurance undertaking continues to increase gradually.[79]

5.2 OWNERSHIP STRUCTURE OF DOMESTIC INSURANCE UNDERTAKINGS

The ownership structure of domestic insurance undertakings is stable, with foreign capital predominating. However, the share of foreign capital is rising moderately. Last year it reached 71.0%, up by 1.1 percentage point on a year earlier. Foreign shareholders have a very strong position in the group of large insurance undertakings. As of 31 December 2007, they owned 91.5% of all shares, only 0.1 percentage point less than a year earlier. As in 2006, Czech capital dominates by a small margin in medium-sized and small insurance undertakings. While the share of Czech capital remained unchanged from the previous year in the case of medium-sized insurers, it fell by 5.4 percentage points to 51.5% for small insurers. This decline was due mainly to a change in the shareholder structure of Komerční úvěrová pojišťovna EGAP, a.s. and to the granting of a new licence to DIRECT Pojišťovna, a.s., which is wholly owned by a foreign shareholder. As of the end of 2007, a total of 22 out of the 34 domestic insurers were controlled by foreign owners, 17 of which were wholly foreign owned. In all, 11 insurance undertakings were wholly owned by Czech entities.

The total capital of domestic insurance undertakings remained broadly unchanged in terms of geographical structure. Registered capital increased by 3.7% in 2007. This increase was smaller than in the previous year (6.3%). The share of domestic shareholders decreased by 1.1 percentage points to 29.0%, thus converging towards the figures for shareholders from the Netherlands and Austria, who again held roughly one-quarter of the total share capital of the insurance sector last year. The large share of the Netherlands is due to the fact that a direct shareholder of Česká pojišťovna, a.s. has its registered office there. The high share of Austrian shareholders is related mainly to major interests in two large insurers. As in the previous year, shareholders from Belgium accounted for more than 5% of capital. Unlike in 2006, the list of owners from countries with small capital shares also included shareholders from Italy.

79 The indicators relating to the categories of insurance undertakings in 2005 and 2006 in the following sections are based on the numbers of insurance undertakings in these categories in 2007 (except branches).

5.3 PREMIUMS WRITTEN

Following a period of sluggish growth in gross premiums written, the Czech insurance market staged something of a recovery in 2007. The rate of growth of premiums written, which amounted to CZK 132.9 billion for the entire insurance market, roughly doubled from 4.3% in 2006 to 8.8% in 2007. In 2006 gross domestic product had increased at a faster pace than premiums written, but in 2007 the situation was just the opposite. The expansion of the insurance market was the strongest since 2004.

The positive trend in premiums written resulted from high growth in the life insurance area, where the rate of growth of premiums written stood at 14.6%, compared to only 5.1% a year earlier. Premiums written in life insurance totalled CZK 54.1 billion, of which single premiums accounted for CZK 14.4 billion. Single premiums rose by 34.2% compared to 2006, whereas regular premiums increased by 8.9%. The life insurance market showed a favourable trend thanks to the rising economic level of the Czech Republic and higher public knowledge and awareness of this insurance segment. A link with the growing number of mortgage loans and the increasing popularity of investment life insurance also played a role.

In 2007, the share of life insurance in total premiums written increased by 2 percentage points year on year to a record high of 40.7%. Although this is a positive trend, the share is still lower than on the insurance markets of advanced EU countries.

In the area of non-life insurance, premiums written rose by 5.2% to CZK 78.8 billion. This represented a moderate increase of 1.4 percentage points in the rate of growth. Premiums written have been recording broadly stable moderate growth rates since 2004. The moderate dynamics are due to relatively high competition on the non-life insurance market, which is pushing down premium rates in some cases. The ever-growing number of branches of foreign insurance undertakings and entities from EU or EEA countries providing insurance in the Czech Republic under the freedom to provide services is also playing a significant role in the rise in competition. These entities mostly specialise in non-life insurance, focusing on business risks. According to incomplete data, the share of premiums written by entities from EU or EEA countries in the Czech insurance market was around 1% in 2006. Data for 2007 are not yet available, but another slight increase in this share can be expected.

Insurance penetration, measured as the ratio of gross premiums written to GDP at current prices, is an important insurance market indicator. In 2007, the rate of growth of premiums written was again lower than nominal GDP growth. Consequently, insurance penetration fell by 0.1 percentage point to 3.7%. As with the share of life insurance in total premiums written, this indicator for the Czech insurance market also lags behind that for advanced Western European countries, where insurance penetration is at higher levels.

Owing to growing competition, concentration is gradually decreasing on the Czech insurance market, which is historically quite highly concentrated (as measured by gross premiums written). In the categories analysed (the three, five and ten largest insurers), a slight increase in market share – of 0.6 percentage point to 73.1% – was recorded only for the five largest life insurance undertakings. The other categories all recorded falls in market share for the individual market segments. The share of the three largest insurers in the overall insurance market fell most noticeably, by 3.5 percentage points to 59.1%. The second largest decrease – of 2.9 percentage points – was recorded for the same category in the non-life insurance market. The overall market share of the ten largest insurers declined by 1 percentage point to 90.0%. The non-life insurance market is more concentrated

CHART V.6
Shares of life insurance and non-life insurance in total premiums written

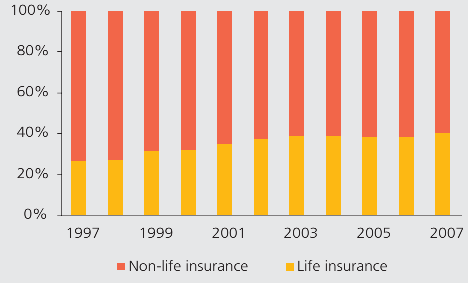


TABLE V.3
Total insurance penetration in the Czech Republic

	Amount (CZK billions) 2005	2006	2007	Change (%) 2007/2006
Premiums written	117	122	133	9.0
GDP (at current prices)	2,970	3,232	3,558	10.1
		%		
Premiums written/GDP	3.9	3.8	3.7	x

CHART V.7
Shares of premiums written in GDP
(in %)

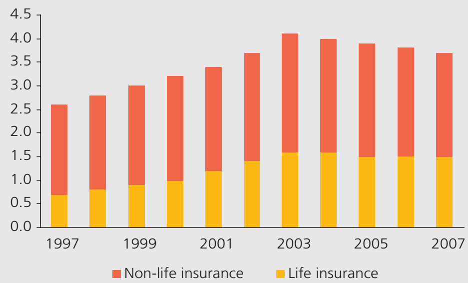


CHART V.8
Concentration in insurance market by premiums written as of 31 December 2007
(in %)

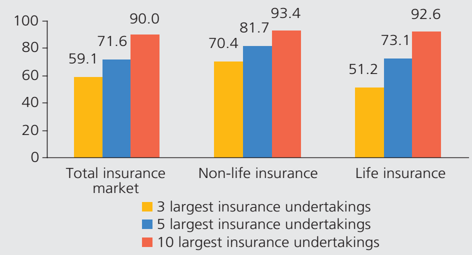


Table V.4
Premiums written by insurance group

	Amount (CZK millions) 2005	2006	2007	Share (%) 2007
TOTAL PREMIUMS WRITTEN	117,077	122,121	132,900	100.0
Large insurance undertakings	89,657	90,530	95,167	71.6
Medium-sized insurance undertakings	15,464	18,077	21,252	16.0
Small insurance undertakings	5,717	6,760	7,637	5.7
Branches of insurance undertakings	6,239	6,754	8,844	6.7
PREMIUMS WRITTEN – NON-LIFE INSURANCE	72,123	74,888	78,759	100.0
Large insurance undertakings	61,178	62,511	64,307	81.7
Medium-sized insurance undertakings	5,865	6,187	6,927	8.8
Small insurance undertakings	4,440	5,375	5,956	7.6
Branches of insurance undertakings	640	815	1,569	2.0
PREMIUMS WRITTEN – LIFE INSURANCE	44,954	47,233	54,141	100.0
Large insurance undertakings	28,479	28,019	30,860	57.0
Medium-sized insurance undertakings	9,599	11,890	14,325	26.5
Small insurance undertakings	1,277	1,385	1,681	3.1
Branches of insurance undertakings	5,599	5,939	7,275	13.4

Chart V.9
Shares of classes of life insurance in premiums written

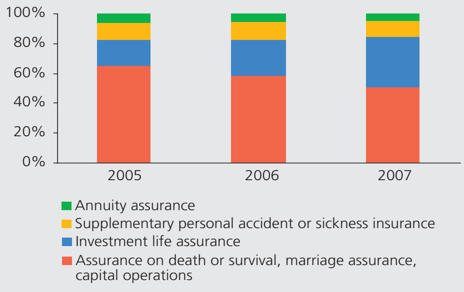


Table V.5
Premiums written by insurance class

Insurance classes	Amount (CZK millions) 2005	2006	2007	Change (%) 2007/2006
TOTAL LIFE INSURANCE	44,954	47,233	54,141	14.6
Assurance on death or survival, marriage assurance, capital operations	29,490	27,684	27,514	-0.6
Annuity assurance	2,779	2,768	2,577	-6.9
Investment life assurance	7,550	11,357	18,390	61.9
Supplementary personal accident and sickness insurance	5,135	5,424	5,660	4.4
TOTAL NON-LIFE INSURANCE	72,123	74,888	78,759	5.2
Liability insurance for damage arising out of use of motor vehicle	21,994	22,454	23,376	4.1
Insurance against damage to or loss of property	17,626	17,873	17,722	-0.8
Insurance against damage to or loss of land vehicles	15,322	15,507	16,214	4.6
General liability insurance for damage[a)]	9,291	9,734	10,425	7.1
Accident and sickness insurance	3,140	3,337	3,724	11.6
Other non-life insurance	4,750	5,983	7,298	22.0

a) including mandatory employer liability insurance for damage due to accidents at work or occupational disease.

than the life insurance market. However, concentration is decreasing at a slower pace on the life insurance market.

As in the previous year, large insurance undertakings, which have a stronger position in the non-life insurance market, recorded a decrease in their market share in premiums written of 2.5 percentage points to 71.6% for the entire Czech insurance market. By contrast, the market shares of medium-sized and small insurers continued to grow moderately in both the life and non-life insurance markets. Medium-sized insurers are particularly strong in life insurance (26.5%), where the share of small insurers is only 3.1%. In non-life insurance, by contrast, both categories have almost equal market shares of around 8%. Like small insurers, branches of foreign insurance undertakings account for just over 5% of the total insurance market. The share of branches in the life insurance market has risen to 13.4%, owing mainly to ING Životní pojišťovna N. V., pobočka pro Českou republiku, while their share in the non-life insurance market is very low at 2%.

A very important instrument for mitigating the risks arising from large losses is reinsurance, which is used by insurers primarily in non-life insurance in situations where higher claims limits could jeopardise their financial stability and solvency. Non-life insurance premiums ceded to reinsurers were CZK 21.8 billion at the end of 2007, representing 27.7% of premiums written. This ratio fell by 3.8 percentage points compared to the previous year, following a decline of 13.5 percentage points a year earlier. Life insurance premiums ceded to reinsurers totalled CZK 1.4 billion, accounting for only 2.5% of total life insurance premiums written. In 2006, this ratio had been 2.8%.

Turning to life insurance products, the upward trend in investment life insurance strengthened, at the expense of standard products, the share of which in premiums written declined as in the previous year. With the exception of supplementary personal accident or sickness insurance, premiums written from traditional products are gradually falling in absolute terms as well. Compared to the previous year, the rate of growth of investment life insurance increased by 11.5 percentage points to 61.9% and its share in the life insurance market rose to 34.0%. This confirms the tendency of clients to decide more on the investment of the saving part of premiums, despite the higher risk this entails. The growth in the importance of investment life insurance can be expected to continue. Moreover, insurers are introducing new products and promoting general awareness of this type of insurance.

The most important category of the non-life insurance market is still motor third party liability insurance (29.7%), followed by insurance against damage to or loss of property (22.5%) and vehicle accident insurance (20.6%). These insurance segments are experiencing a gradual moderate decline in market share. However, insurance against damage to or loss of property also recorded a decrease in premiums written in absolute terms in 2007. By contrast, the market shares of other insurance products are gradually rising. Accident insurance, credit insurance and travel insurance recorded significant growth in premiums written of over 20%. Premiums written for insurance products covering financial losses rose by a full 63%. As regards non-life insurance, the largest shares will continue to be recorded by motor third party liability insurance, vehicle accident insurance and property insurance. However, a slight increase in the shares of specialised insurance products can be expected.[80]

80 Annex 22 contains a breakdown of gross premiums written by life and non-life insurance.

5.4 CLAIM SETTLEMENT COSTS

The rate of growth of claim settlement costs rose by 2.6 percentage points to 8.5% in 2007. In this section, claim settlement costs are given on a gross basis, including the reinsurer's share. In 2006 life insurance claim settlement costs had fallen by 4.5%, whereas in 2007 they recorded a relatively large rise of 33.8%. One of the factors behind this rise was the phasing-out of short-term single-payment insurance policies with a saving component signed by clients at the start of the new millennium. By contrast, non-life insurance claim settlement costs fell by 4.1%, due to lower losses caused by natural disasters, while in 2006 they had risen by 12%. In 2006, heavy snow and subsequent floods in the spring caused by melting snow and torrential rain led to roughly 95,000 insurance losses, resulting in claim settlement costs of CZK 3.3 billion. A gale in winter 2007 also caused large losses, although they were lower than those recorded in 2006. Insurers recorded roughly 77,000 insurance losses with estimated claim settlement costs of CZK 2.1 billion linked with the gale.[81]

The share of reinsurers in claim settlement costs roughly corresponds to their share in premiums written. In non-life insurance reinsurers' share in the costs increased slightly, by 0.4 percentage point to 25.1%, while in life insurance their share declined by 0.4 percentage point to 1.3%. Claim settlement costs totalling CZK 9.1 billion were ceded to reinsurers in non-life insurance, whereas in life insurance the figure was only CZK 317 million. Both figures represent a slight decline compared to the previous year.

The shares of the groups of insurance undertakings in total claim settlement costs saw some shifts, especially in the groups of large and medium-sized insurers. Compared to a year earlier, the share of large insurers in claim settlement costs fell by 7 percentage points to 74.8% and that of medium-sized insurers rose by 5.8 percentage points to 16.1%. This trend was even more visible in life insurance, where the share of large insurers was down by 10.1 percentage points and that of medium-sized insurers went up by 10.8 percentage points. By comparison with 2006, the shares of the individual groups of insurers in premiums written in both life and non-life insurance are more closely linked with their shares in claim settlement costs. These costs declined only in the case of large insurance undertakings on the non-life insurance market.

81 Source: Czech Insurance Association.

CHART V.10
Shares of classes of non-life insurance in premiums written

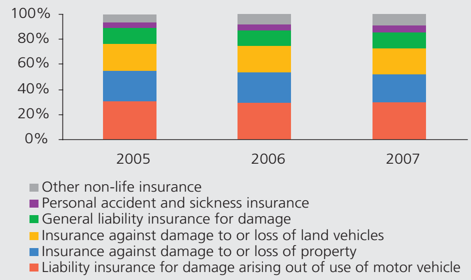


TABLE V.6
Claim settlement costs by insurance group

	Amount (CZK millions) 2005	2006	2007	Share (%) 2007
TOTAL CLAIM SETTLEMENT COSTS	53,560	56,735	61,533	100.0
Large insurance undertakings	44,811	46,415	46,044	74.8
Medium-sized insurance undertakings	4,744	5,855	9,888	16.1
Small insurance undertakings	1,837	1,936	2,240	3.6
Branches of insurance undertakings	2,168	2,529	3,361	5.5
CLAIM SETTLEMENT COSTS – NON-LIFE INSURANCE	33,830	37,898	36,337	100.0
Large insurance undertakings	29,887	33,392	31,188	85.8
Medium-sized insurance undertakings	2,271	2,724	2,991	8.2
Small insurance undertakings	1,626	1,664	1,842	5.1
Branches of insurance undertakings	46	118	316	0.9
CLAIM SETTLEMENT COSTS – LIFE INSURANCE	19,730	18,837	25,196	100.0
Large insurance undertakings	14,924	13,023	14,856	59.0
Medium-sized insurance undertakings	2,473	3,131	6,897	27.4
Small insurance undertakings	211	272	398	1.6
Branches of insurance undertakings	2,122	2,411	3,045	12.1

CHART V.11
Claim settlement costs
(in CZK billions)

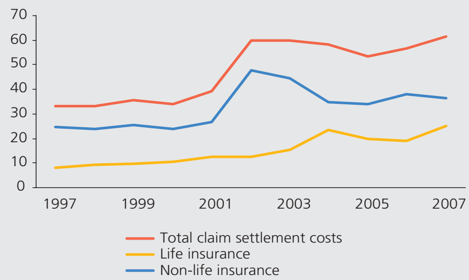


Table V.7
Shares of individual insurance groups in total assets

	Amount (CZK millions) 2005	2006	2007	Share % 2007
TOTAL ASSETS	310,511	322,776	345,021	100.0
Large insurance undertakings	212,473	211,381	223,244	64.7
Medium-sized insurance undertakings	44,782	53,289	58,702	17.0
Small insurance undertakings	22,333	24,207	26,926	7.8
Branches of insurance undertakings	30,923	33,899	36,149	10.5

Chart V.12
Shares of insurance undertakings in total assets by type

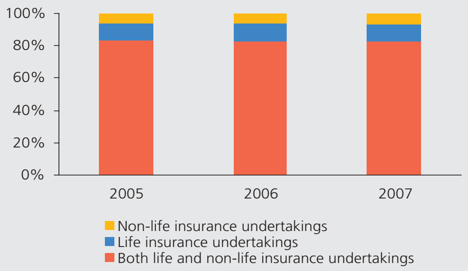


Table V.8
Assets of insurance undertakings

	Amount (CZK millions) 2005	2006	2007	Share % 2007
TOTAL ASSETS	310,511	322,776	345,021	100.0
Financial placements (investment)	265,917	272,002	283,691	82.2
of which:				
real estate	9,315	8,770	4,807	1.4
participating interests	25,980	11,314	11,476	3.3
shares, variable-yield securities	33,102	30,378	28,453	8.2
bonds and other fixed-income securities	164,473	191,827	203,424	59.0
deposits at financial institutions	27,730	26,380	26,856	7.8
other financial placements	5,317	3,333	8,675	2.5
Financial placements of unit-linked life insurance	12,420	18,581	26,900	7.8
Debtors (receivables)	18,951	18,371	19,772	5.7
Other assets	13,223	13,822	14,658	4.2

5.5 ASSETS OF INSURANCE UNDERTAKINGS

The total assets of insurance undertakings rose by 6.9% to CZK 345.0 billion in 2007. This was almost double the growth rate for the previous year, when the lower asset growth had been due mainly to transactions among large insurers relating to sales of holdings in subsidiaries. Large insurers, whose total assets had declined by 0.5% in 2006, recorded a year-on-year increase in assets of 5.6%. This was the lowest increase among the groups of insurance undertakings analysed. By contrast, the total assets of small insurers recorded the largest rise (of 11.2%). From the long-term perspective, a gradual moderate decline is apparent in the share of large insurers in the sector's total assets, accompanied by a gradual rise in the share of medium-sized insurers. The shares of small insurers and foreign insurance undertaking branches have remained broadly stable over the past few years.

From the point of view of specialisation, entities carrying on both life and non-life insurance continued to hold a dominant share in total assets. Their share was 82.5% at the end of 2007, down by 0.2 percentage point year on year. The share of life insurers remained virtually unchanged at 11.1%. Non-life insurers recorded an increase in share of 0.3 percentage point to 6.4%, due to the establishment of new small entities specialising in non-life insurance. While in 2006 total assets had risen fastest in the category of life insurers (11.3%), non-life insurers recorded the strongest total asset growth in 2007 (12.8%).

Financial placement (investment)[82] is the most important item in insurance undertakings' assets. It rose by 4.3% in 2007, up by 2 percentage points on a year earlier. However, its share in the total assets of the insurance sector is falling gradually, mainly in favour of financial placements of unit-linked life insurance, which expanded by 44.8% in 2007, to 7.8% of total assets. This is in line with the rapidly rising popularity of investment life insurance. The decline of the ratio of investments to total assets of 3.4 percentage points over the last two years was due significantly to sales of participating interests in subsidiaries in 2006 and extensive sales of real estate in 2007. Both cases concerned operations in the group of large insurers. In addition to real estate, whose share in total assets dropped by 1.3 percentage points in 2007, a gradual decline in the share of equity is visible. There were no major changes in the shares of other selected financial placement items in total assets; debt securities remained the most important item. In 2007, the value of receivables and other assets grew at roughly the same pace as the total assets of insurance undertakings, so their shares remained almost unchanged.

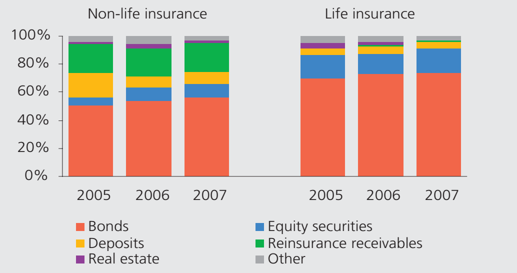
To ensure that insurance undertakings can fulfil their obligations, Act No. 363/1999 Coll., on Insurance, as amended, stipulates the permissible structure of investments arising from technical provisions. Insurance undertakings must also comply with limits for the individual financial placement items as laid down in Implementing Decree No. 303/2004 Coll., as amended. As technical provisions for life insurance are of a longer-term nature, longer maturity bonds dominate investments arising from technical provisions for life insurance, and equity securities also have a large share. By contrast, investments arising from technical provisions for non-life insurance is made up of more liquid items, such as deposits and treasury bills. Reinsurance receivables, including reinsurers' share in technical provisions, also have a significant share.

82 Financial placement (investment) is defined differently than financial placement of assets arising from technical provisions. Financial placement (investment) excludes reinsurance receivables.

The structure of investments arising from non-life insurance technical provisions is dominated by bonds (73.9%) and equity securities (17.3%).[83] Compared to 2006, the shares of the individual categories were almost unchanged, except for real estate, which fell by 2.1 percentage points to 0.5%, and equity securities, whose share in total investment of assets arising from life insurance technical provisions rose by 3.1 percentage points.

As in the case of life insurance, investments arising from non-life insurance technical provisions are dominated by bonds (56.3%), followed by reinsurance receivables (20.4%). By contrast, reinsurance receivables have only a negligible share in investments arising from life insurance technical provisions. The shares of the financial placement categories remained almost the same as last year, except for bonds, which have being showing steady growth of about 3 percentage points in recent years.

CHART V.13
Investments arising from technical provisions



5.6 LIABILITIES OF INSURANCE UNDERTAKINGS

In addition to shareholders' equity, insurance undertakings' liabilities consist mainly of technical provisions, followed by liabilities arising from direct insurance operations and reinsurance operations. Equity increased by 1.5% last year, up by 1 percentage point on in 2006. The share of equity in total liabilities is falling gradually. In 2007, it decreased by 0.9 percentage point to 17%. Share capital, which rose by 3.7%, remains the most important component of equity (31.3%). Owing to the good results of insurance undertakings in 2006, retained earnings increased by 61.4% and reserve funds rose by 35.4%. Nonetheless, total equity rose only slightly due to a decline in other capital funds of 38.1% chiefly as a result of revaluation of selected assets. The preliminary profit of insurance undertakings fell by around 10%.

The most important item in insurance undertakings' liabilities is technical provisions, which represent the future obligations of insurance undertakings arising from insurance or reinsurance activities which are either likely to be incurred or certain to be incurred but uncertain as to amount and as to the date on which they will arise. The types of technical provisions and their creation and application are laid down in Act No. 363/1999 Coll., on Insurance, as amended, and in Implementing Decree No. 303/2004 Coll., as amended. Technical provisions are reported gross of reinsurers' share in technical provisions or net of the reinsurers' share. The technical provision for unit-linked life insurance is a specific item. It is linked with investment life insurance and is the source of financial placement of life insurance where the investment risk is borne by the policy holder. In 2007, the share of net technical provisions (excluding provisions for unit-linked life insurance) in total liabilities fell by 0.7 percentage point year on year, to 66.8%. As in previous years, the growth in the financial placement of unit-linked life insurance was accompanied by a commensurate increase in the provision for unit-linked life insurance of 2.1 percentage points to 7.8% of total liabilities.

In 2007, gross technical provisions, including the provision for unit-linked life insurance, increased at a rate of 8.2%, which is 0.8 percentage point slower than a year earlier. While in 2006 gross technical provisions for life insurance had risen faster, the situation in 2007 was exactly the opposite. Gross technical provisions for

TABLE V.9
Liabilities of insurance undertakings

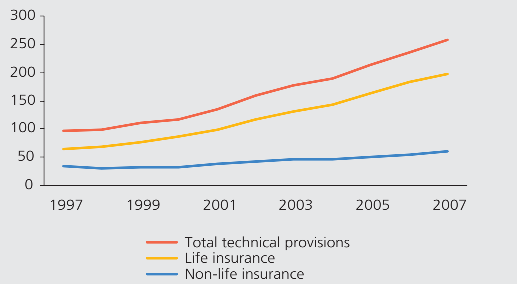
	Amount (CZK millions) 2005	2006	2007	Share % 2007
TOTAL LIABILITIES	310,511	322,776	345,021	100.0
Shareholder's equity	57,466	57,757	58,629	17.0
Technical provisions[a)]	200,511	217,879	230,326	66.8
Provision for unit-linked life insurance	12,053	18,546	26,903	7.8
Creditors (liabilities)	26,874	18,995	19,461	5.6
Other liabilities	13,607	9,599	9,702	2.8

a) net amount

TABLE V.10
Technical provisions

	Amount (CZK millions) 2005	2006	2007	Change % 2007/2006
TOTAL GROSS TECHNICAL PROVISIONS	238,373	259,794	281,108	8.2
of which:				
non-life insurace	72,448	75,893	82,705	9.0
life insurance	165,925	183,901	198,403	7.9
TOTAL NET TECHNICAL PROVISIONS	212,564	236,424	257,228	8.8
of which:				
non-life insurace	49,599	53,512	59,808	11.8
life insurance	162,965	182,912	197,420	7.9

CHART V.14
Net technical provisions
(in CZK billions)



83 The investment structure also includes items of financial placements of unit-linked life insurance.

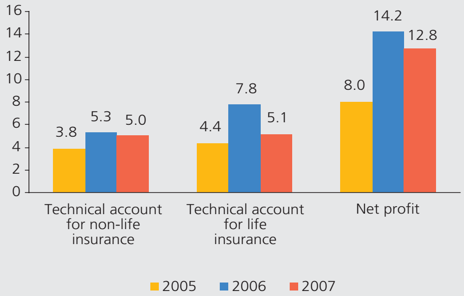
TABLE V.11
Net technical provisions by insurance group

	Amount (CZK millions) 2005	2006	2007	Share % 2007
TOTAL NET TECHNICAL PROVISIONS	212,564	236,424	257,228	100.0
Large insurance undertakings	146,004	159,307	170,389	66.2
Medium-sized insurance undertakings	35,899	43,776	49,166	19.1
Small insurance undertakings	7,878	8,246	9,627	3.7
Branches of insurance undertakings	22,783	25,095	28,046	10.9
NET TECHNICAL PROVISIONS – NON-LIFE INSURANCE	49,599	53,512	59,808	100.0
Large insurance undertakings	39,945	43,361	47,898	80.1
Medium-sized insurance undertakings	3,983	4,786	5,546	9.3
Small insurance undertakings	5,399	5,120	5,793	9.7
Branches of insurance undertakings	272	245	571	1.0
NET TECHNICAL PROVISIONS – LIFE INSURANCE	162,965	182,912	197,420	100.0
Large insurance undertakings	106,059	115,946	122,491	62.0
Medium-sized insurance undertakings	31,916	38,990	43,620	22.1
Small insurance undertakings	2,479	3,126	3,834	1.9
Branches of insurance undertakings	22,511	24,850	27,475	13.9

TABLE V.12
Net technical provisions by type of insurance undertaking

	2005	2006	2007
Type of insurance undertaking	Net TPs in non-life insurance (CZK millions)		
non-life insurance	5,378	4,976	5,814
both life and non-life	44,221	48,536	53,994
TOTAL	49,599	53,512	59,808
Type of insurance undertaking	Net TPs in life insurance (CZK millions)		
non-life insurance	24,574	27,479	30,690
both life and non-life	138,391	155,433	166,730
TOTAL	162,965	182,912	197,420

CHART V.15
Profits of insurance undertakings
(in CZK billions)



non-life insurance rose 4.2 percentage points faster than in 2006 and growth in provisions for life insurance slowed by 2.9 percentage points. The share of gross technical provisions for life and non-life insurance in total technical provisions was virtually unchanged. The share of technical provisions for non-life insurance increased by 0.2 percentage point to 29.4%. As in the previous year, the rate of growth of net technical provisions was higher than that of gross technical provisions, owing to a decline in the share of reinsurers. The individual trends in the growth of net technical provisions for life and non-life insurance are analogous to those in the case of gross technical provisions. The share of net technical provisions for non-life insurance in total net technical provisions increased by 0.7 percentage point to 23.3%.

The shares of small insurance undertakings and branches of insurance undertakings in net technical provisions are relatively stable. As in the case of premiums written, the share of large insurers in total technical provisions is gradually declining. This decline is very moderate in the case of provisions for non-life insurance. The share of large insurers in net technical provisions for non-life insurance fell by 1.4 percentage points in 2007. The share of medium-sized insurance undertakings in net technical provisions is rising gradually at the expense of large insurers. Again, this rise is moderate for non-life insurance. Growth in net technical provisions was fastest in the category of small insurers (16.7%) and slowest in the category of large insurers (7.0%). As for branches of insurance undertakings, their net technical provisions for non-life insurance increased by a full 133%, but the absolute size of these provisions is negligible in terms of the market as a whole.

Undertakings carrying on both life and non-life insurance have a dominant share in technical provisions for both life and non-life insurance. Their share in net technical provisions fell by 0.4 percentage point to 90.3% for non-life insurance and by 0.5 percentage point to 84.5% for non-life insurance. In recent years, however, the shares in net technical provisions of the categories of insurers grouped according to their specialisation have been broadly stable.

The other important liabilities items recorded no major changes in their ratios to total liabilities. The share of the creditors (liabilities) item dropped by 0.3 percentage point to 5.6%, owing mainly to a decline of 9.9% in liabilities arising out of reinsurance. Direct insurance and reinsurance operations accounted for 72.7% of the total liabilities of insurance undertakings. The share of other liabilities in the balance sheet total fell by 0.2 percentage point to 2.8% in 2007.

5.7 ECONOMIC RESULTS OF INSURANCE UNDERTAKINGS

Like the previous year, 2007 was a successful year for the Czech insurance market. Insurance undertakings made a profit of CZK 12.8 billion, down by 10.1% compared to 2006, when net profit had been affected by one-off income from sales of ownership interests in the group of large insurance undertakings. The solid profitability of the insurance sector is in line with the favourable economic developments in the Czech Republic. The partial decline in profit compared to the previous period was due chiefly to the technical account for life insurance,[84] which

84 The profit and loss account of insurance undertakings consists of a technical account for non-life insurance, a technical account for life insurance and a non-technical account, which comprises income and expenses not related to life or non-life insurance.

decreased by 34.5% to CZK 5.1 billion. The technical account for non-life insurance declined moderately, by 5.5% to CZK 5.0 billion.

Looking at the individual groups of insurance undertakings, large insurers have a dominant share in net profit. Compared to the previous year, the shares of large and medium-sized insurers in the total profit decreased; this decrease was stronger for large insurers (2.5 percentage points). The share of small insurers grew by 2.7 percentage points and that of branches of insurance undertakings was virtually unchanged. By comparison with 2006, net profit fell in all categories of insurers except small insurance undertakings, whose profit rose by 30.9% in 2007.

Owing to the decline in net profit, the key profitability and efficiency indicators deteriorated slightly across the entire insurance market. The ratio of net profit to earned premiums saw the largest fall (of 2.9 percentage points).[85] However, the selected indicators for the whole insurance market are still better than in 2005 and are close to those observed in 2004, when the insurance market recorded total profit of CZK 10.9 billion.

The profitability and efficiency indicators for the area of non-life insurance recorded no major changes. However, a steady improvement is apparent in the ratio of claim settlement costs to premiums earned. By contrast, the ratio of net operating expenses to earned premiums is worsening slightly owing to a decline in reinsurance commissions. Among the selected indicators for life insurance, the ratio of claim settlement costs, including change in technical provisions, to earned premiums rose by 6.5 percentage points, due mainly to rising costs. With regard to profitability on the technical accounts, a sizeable decline in the ratio of the technical account for life insurance to earned premiums was also recorded. There were no significant changes in the other life insurance indicators.

5.8 SOLVENCY OF INSURANCE UNDERTAKINGS

Solvency is the ability of an insurance/reinsurance undertaking to meet liabilities from insurance/reinsurance activities by means of its own funds. Insurance undertakings are required to maintain own funds equal to at least the required solvency margin over the entire duration of their activities. The solvency margin is calculated pursuant to Decree No. 303/2004 Coll., implementing certain provisions of Act No. 363/1999, on Insurance, as amended. An important regulatory requirement contained in the Decree is separate calculation of solvency for life insurance and non-life insurance. Two separate calculations are therefore performed for undertakings carrying on both life and non-life insurance.

Domestic insurance undertakings submit an annual solvency report to the CNB within 30 days of the preparation of the audit report. As of the cut-off date for this publication, solvency reports as of 31 December 2007 had been submitted by 14 non-life insurers, 3 life insurers and 12 insurers carrying on both life and non-life insurance. All these insurance undertakings reported that they were compliant with the required solvency margin and therefore their financial stability and their ability to meet their obligations was not at risk. The share of these insurers in the total premiums written of domestic insurers that submit solvency reports is 97.3% on the non-life insurance market and 95.7% on the life insurance market.

Table V.13
Profit by insurance group

	Amount (CZK millions)			Share %
	2005	2006	2007	2007
TOTAL NET PROFIT	8,021	14,209	12,778	100.0
Large insurance undertakings	6,366	11,215	9,768	76.4
Medium-sized insurance undertakings	711	1,191	1,035	8.1
Small insurance undertakings	119	846	1,107	8.7
Branches of insurance undertakings	825	957	868	6.8

Table V.14
Selected profitability and efficiency indicators (%)

	2005	2006	2007
Net profit/assets (RoA)	2.6	4.4	3.7
Net profit/shareholder's equity (RoE)	14.0	24.6	21.8
Net profit/earned premiums	9.2	14.8	11.9
NON-LIFE INSURANCE			
Proft on technical account for non-life insurance/earned premiums	8.6	10.7	9.2
Claims incurred, including change in TPs/earned premiums	61.3	59.1	56.1
Net operating costs/earned premiums	25.2	26.3	27.8
Acquisition costs for insurance contracts/earned premiums	21.6	21.1	21.3
Administrative expenses/earned premiums	17.5	16.9	16.4
LIFE INSURANCE			
Proft on technical account for life insurance/earned premiums	10.3	17.0	9.7
Claims incurred, including change in TPs/earned premiums	45.3	41.1	47.6
Net operating costs/earned premiums	23.2	22.9	22.7
Acquisition costs for insurance contracts/earned premiums	14.4	13.1	13.6
Administrative expenses/earned premiums	10.3	10.5	9.8

Table V.15
Aggregate solvency – non-life insurance (CZK thousands)*

	2005	2006	2007
ASM	29,760,201	30,935,740	33,469,043
RSM	7,696,291	8,400,454	8,539,130

ASM – available solvency margin
RSM – required solvency margin
* 2007 data are missing for 3 undertakings offering both life and non-life insurance and for 2 non-life insurance undertakings

Table V.16
Aggregate solvency – life insurance (CZK thousands)*

	2005	2006	2007
ASM	23,970,073	24,784,809	22,858,641
RSM	7,003,784	7,882,583	8,054,284

ASM – available solvency margin
RSM – required solvency margin
* 2007 data are missing for 3 undertakings offering both life and non-life insurance

85 Earned premiums and claim settlement costs, including change in technical provisions, are net of reinsurance.

Table V.17
ASM/RSM ratios – non-life insurance*

Number of insurance undertakings	2005	2006	2007
< 100%	1	0	0
100%–150%	1	2	2
150%–200%	2	2	1
200%–250%	3	2	1
250%–300%	1	2	6
300%–400%	2	2	0
400%–500%	3	2	0
> 500%	17	18	16
TOTAL	30	30	26

* 2007 data are missing for 3 undertakings offering both life and non-life insurance and for 2 non-life insurance undertakings

Table V.18
ASM/RSM ratios – life insurance*

Number of insurance undertakings	2005	2006	2007
< 100%	0	0	0
100%–150%	4	3	2
150%–200%	1	1	3
200%–250%	2	2	3
250%–300%	2	3	2
300%–400%	2	3	2
400%–500%	3	2	0
> 500%	4	4	3
TOTAL	18	18	15

* 2007 data are missing for 3 undertakings offering both life and non-life insurance

Tables V.15 and V.16 show the aggregate available solvency margins (ASM) and required solvency margins (RSM) of all domestic insurance undertakings over the past three years, separately for life insurance and non-life insurance. The aggregate ASM is roughly 3.9 times the RSM in non-life insurance and 2.8 times the RSM in life insurance. In the periods under review, this ratio is relatively stable in non-life insurance but is declining slightly in life insurance.

Tables V.17 and V.18 show the numbers of insurance undertakings according to percentage ASM/RSM ratios, divided into life insurance and non-life insurance. The solvency of undertakings carrying on both life and non-life insurance is incorporated into the respective tables for life and non-life insurance. However, taking into account the minimum amount of the guarantee fund (insurance undertakings are obliged to keep their own funds above this level), one insurance undertaking failed to record adequate solvency in 2005. However, it subsequently complied with the ASM by increasing its capital funds. As in previous years, most of the ASM/RSM ratios exceeded 500% in non-life insurance, while life insurance showed a more even distribution. The band above 500% consists mainly of smaller insurance undertakings, which have comparatively smaller ratios of premiums written to shareholders' equity.

AKAT	Czech Capital Market Association
AMA	Advanced Measurement Approaches
AML	anti-money laundering
ASA	Alternative Standardized Approach
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
bn	billion
b.p.	basis point
BSC	Banking Supervision Committee
BSCEE	Group of Banking Supervisors from Central and Eastern Europe
CCA	Czech Consolidation Agency
CCR	Central Credit Register
CDO	collateralized debt obligations
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CERTIS	Czech Express Real Time Interbank Gross Settlement System
CESR	Committee of European Securities Regulators
CESR-Fin	CESR operational group for accounting and auditing
CESR-Pol	CESR operational group for market integrity
CESR-Tech	CESR expert group for IT projects
ČKP	Czech Insurers' Bureau
CNB	Czech National Bank
Coll.	Collection of Laws of the Czech Republic
COREP	Common Reporting
CPLG	Core Principles Liaison Group
CRD	Capital Requirements Directive
ČSOB	Československá obchodní banka (a commercial bank)
CU	credit union
CZK	Czech koruna
CZSO	Czech Statistical Office
DIF	Deposit Insurance Fund
EBC	European Banking Committee
EC	European Community
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EEA	European Economic Area
EEC	European Economic Community
EFC	Economic and Financial Committee
EU	European Union
EUR	euro

FESE	Federation of European Securities Exchanges
FINREP	Guidelines on Financial Reporting
FSC	Financial Services Committee
FV	fair value
GDP	gross domestic product
HI	Herfindahl Index (measuring of market concentration)
HUF	Hungarian forint
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICS	internal control system
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards
ILG	International Liaison Group
IMF	International Monetary Fund
IOPS	International Organisation of Pension Supervisors
IOSCO	International Organization of Securities Commissions
IRB	Internal Ratings Based
IWCFC	Interim Working Committee on Financial Conglomerates
KYC	know-your-customer
MiFID	Markets in Financial Instruments Directive
MoF	Ministry of Finance of the Czech Republic
MoU	Memorandum of Understanding
MTPL	motor third party liability insurance
NBS	National Bank of Slovakia
OECD	Organisation for Economic Cooperation and Development
P/L	profit/loss
PLN	Polish zloty
PSE	Prague Stock Exchange (Burza cenných papírů Praha, a. s.)
PX	PSE stock exchange index
QA	quick assets
QIS	Quantitative Impact Study
RM-S	RM-Systém, a. s. (an OTC market operator)
RoA	return on assets
RoE	return on equity
SDNS	Non-bank Data Collection System
SICAV	Société d'investissement à capital variable (investment company with variable capital)
SKK	Slovak koruna
SON	Subgroup on Operational Networking

SPAD	Share and Bond Market Support System
STA	Standardized Approach
SVYT	Transaction Settlement System
TREM	Transaction Reporting Exchange Mechanism
UCITS	Undertakings for Collective Investment in Transferable Securities
UNIVYC	UNIVYC, a. s. (a universal settlement system)
USD	US dollar
WGCR	Working Group on Credit Registers
WGDB	Working Group on Developments in Banking
WGMA	Working Group on Macroprudential Analysis
WGOND	Working Group on National Discretions

Czech National Bank	www.cnb.cz

1. CZECH

Association of Credit Unions of the Czech Republic	www.asociacedz.cz
Association of Czech Insurance Brokers	www.acpm.cz
Association of Financial Intermediaries and Financial Advisers of the Czech Republic	www.afiz.cz
Association of Pension Funds of the Czech Republic	www.apfcr.cz
Chamber of Auditors of the Czech Republic	www.kacr.cz
Chamber of Independent Loss Adjusters	www.kslpu.cz
Czech Association of Investment Firms	www.caocp.cz
Czech Banking Association	www.czech-ba.cz
Czech Capital Market Association	www.akatcr.cz
Czech Chamber of Independent Loss Adjusters	www.ckslpu.com
Czech Insurance Association	www.cap.cz
Czech Insurers' Bureau	www.ckp.cz
Czech Republic - official website	www.czech.cz
Czech Society of Actuaries	www.actuaria.cz
Czech Statistical Office	www.czso.cz
Czechinvest	www.czechinvest.cz
Deposit Insurance Fund of the Czech Republic	www.fpv.cz
Financial Arbiter of the Czech Republic	www.finarbitr.cz
Ministry of Finance of the Czech Republic	www.mfcr.cz
Prague Securities Centre	www.scp.cz
Prague Stock Exchange	www.pse.cz
RM-Systém, a. s.	www.rmsystem.cz
Securities Brokers Guarantee Fund	www.gfo.cz
UNIVYC	www.univyc.cz

2. INTERNATIONAL

Bank for International Settlements	www.bis.org
Committee of European Banking Supervisors	www.c-ebs.org
Committee of European Insurance and Occupational Pensions Supervisors	www.ceiops.org
Committee of European Securities Regulators	www.cesr-eu.org
European Central Bank	www.ecb.int
European Commission	www.ec.europa.eu
European Commission, DG Internal Market and Services	ec.europa.eu/internal_market
European Fund and Asset Management Association	www.efama.org
European Insurance and Reinsurance Federation	www.cea.assur.org
Eurostat	ec.europa.eu/eurostat
Federation of European Securities Exchanges	www.fese.be
International Association of Insurance Supervisors	www.iaisweb.org
International Capital Market Association	www.icma-group.org
International Monetary Fund	www.imf.org
International Organization of Securities Commissions	www.iosco.org
Organisation for Economic Co-operation and Development	www.oecd.org
World Bank	www.worldbank.org
World Federation of Exchanges	www.world-exchanges.org

ANNEXES

Annex 1

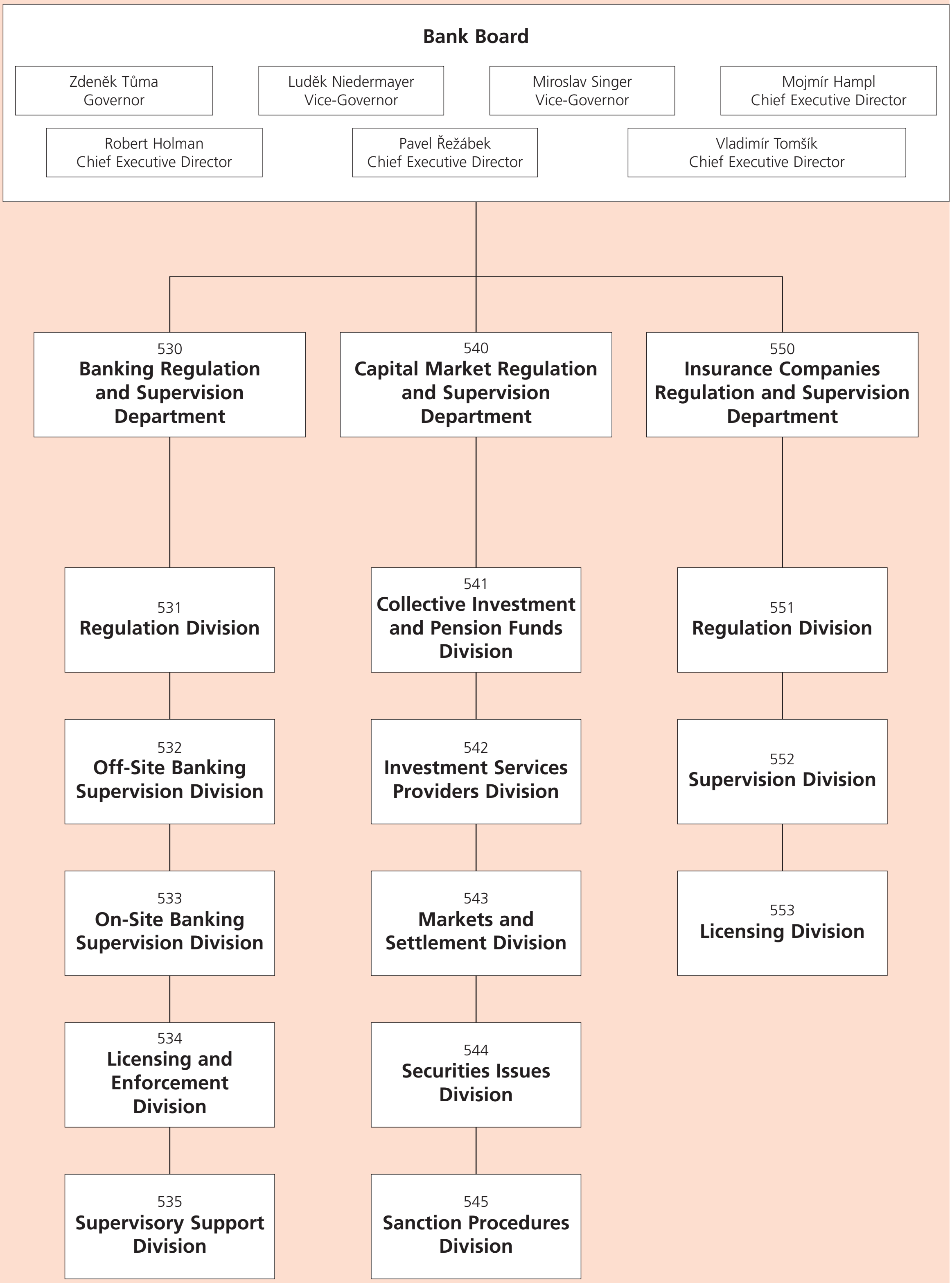
Main indicators of monetary and economic developments in the Czech Republic

		2003	2004	2005	2006	2007
Gross domestic product 1) 2)	Volume (in CZK billions)	2,367.8	2,474.0	2,631.7	2,799.0	2,979.8
	Increase (in per cent)	3.6	4.5	6.4	6.4	6.5
Output – percentage increase 2)	Industry	5.8	9.9	8.1	11.6	10.0
	Construction	11.2	4.5	3.7	13.8	4.1
Prices 3)	Inflation rate (in per cent)	0.1	2.8	1.9	2.5	2.8
Unemployment 4)	Unemployment rate (in per cent)	9.9	9.2	9.0	8.1	6.6
Foreign trade	Exports (in CZK billions, current prices)	1,370.9	1,722.7	1,868.6	2,144.6	2,472.4
	Imports (in CZK billions, current prices)	1,440.7	1,749.1	1,830.0	2,104.8	2,387.4
	Balance (in CZK billions, current prices)	-69.8	-26.4	38.6	39.8	85.0
Average wage 2)	Nominal (in per cent)	6.6	6.6	5.3	6.4	7.3
	Real (in per cent)	6.5	3.7	3.3	3.8	4.4
Balance of payments	Current account (in CZK billions)	-160.6	-147.5	-48.5	-100.8	-89.0
	Financial account (in CZK billions)	157.1	177.3	154.8	104.9	104.5
Exchange rate 5)	CZK/USD	28.23	25.70	23.95	22.61	20.31
	CZK/EUR	31.84	31.90	29.78	28.34	27.76
Average interbank	7-day	2.30	2.23	1.97	2.18	2.87
deposit rate (PRIBOR)	3-month	2.28	2.36	2.01	2.30	3.09
in per cent 5)	6-month	2.28	2.48	2.05	2.42	3.21
Discount rate	(in per cent) 6)	1.00	1.50	1.00	1.50	2.50
Lombard rate	(in per cent) 6)	3.00	3.50	3.00	3.50	4.50
2W repo rate	(in per cent) 6)	2.00	2.50	2.00	2.50	3.50
PX capital market index 6)		659.1	1,032.0	1,473.0	1,447.5	1,815.1

Source: CZSO (macroeconomic indicators), PSE, CNB
1) Initial calculation performed at current prices. For the purposes of monitoring developments net of price changes there follows conversion to average prices of the previous year, from which figures at constant 2000 prices are obtained by chain-linking.
2) Percentage increase on a year earlier
3) Inflation rate, average
4) Average registered unemployment rate; based on existing methodology since 2004
5) Annual averages from monthly averages
6) End-of-period figures; on 20 March 2006, the Prague Stock Exchange's PX 50 and PX-D indices were replaced by a single index called the PX. Calculation of both the original indices was terminated on Friday, 17 March 2006. The new main PX index carried on from the PX 50 and took over its history.

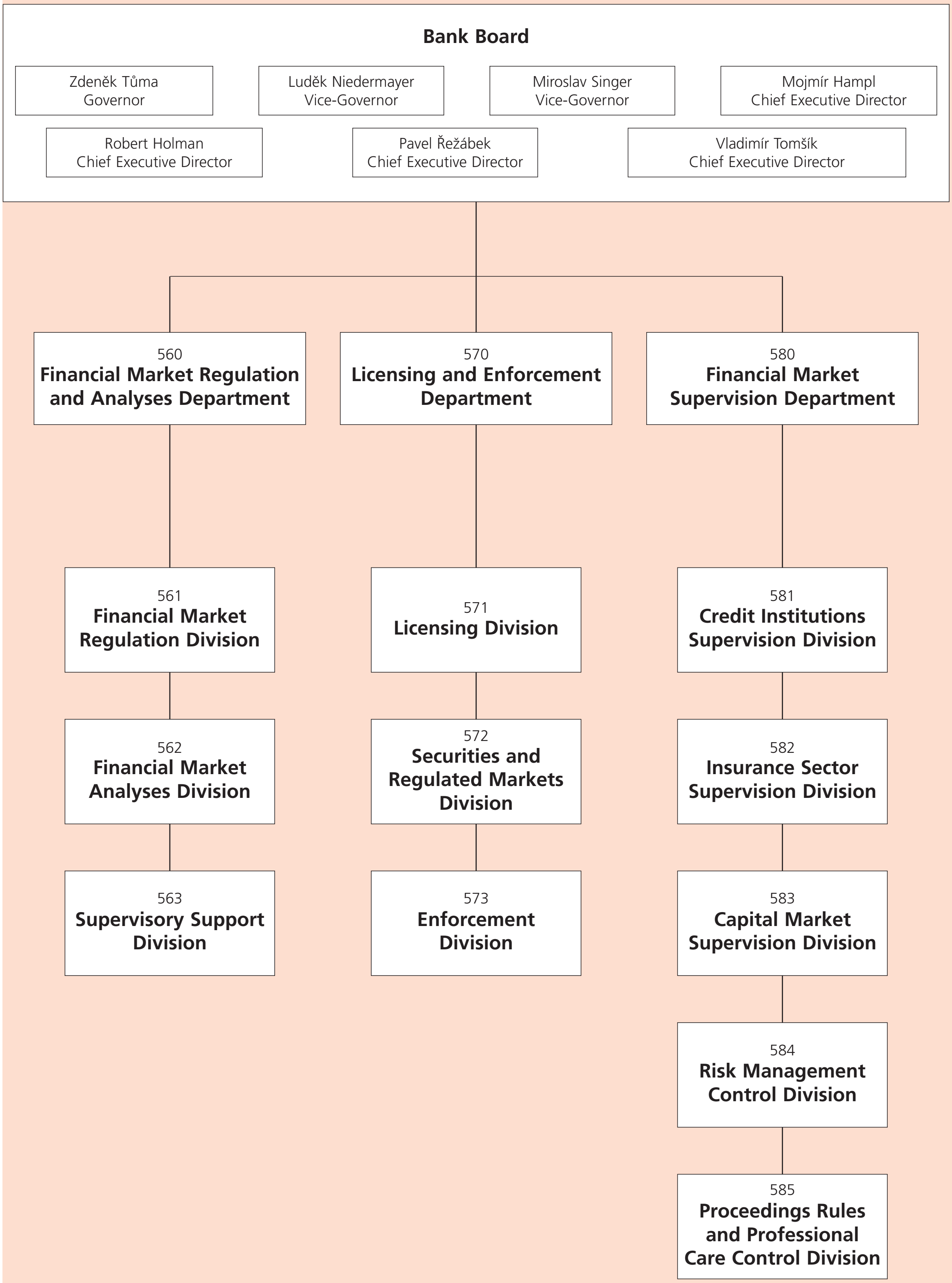
Annex 2a

Organisational structure of CNB Financial Market Supervision
(as of 31 December 2007)



Annex 2b

Organisational structure of CNB Financial Market Supervision
(as of 1 January 2008)



Vice-Governor Luděk Niedermayer's term of office ended on 26 February 2008. Effective from 1 March 2008, the Czech President appointed Mojmír Hampl as Vice-Governor of the CNB and Eva Zamrazilová as Chief Executive Director and Member of the Bank Board of the CNB.

Annex 3

Breakdown of banks into groups

(as of 31 December 2007)

I.	**Large banks**	**IV.**	**Foreign bank branches**
1	Česká spořitelna, a. s.	1.	ABN AMRO Bank N.V.
2	Československá obchodní banka, a. s.	2.	Bank of Tokyo-Mitsubishi UFJ (Holland) N.V. Prague Branch, organizační složka
3.	Komerční banka, a. s.	3.	BRE Bank S.A., organizační složka podniku
4.	UniCredit Bank Czech Republic, a. s.	4.	CALYON S.A., organizační složka
		5.	COMMERZBANK Aktiegesellschaft, pobočka Praha
II.	**Medium-sized banks**	6.	Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka
1.	Citibank, a. s.	7.	Fortis Bank SA/NV, pobočka Česká republika
2.	Českomoravská záruční a rozvojová banka, a. s.	8.	HSBC Bank plc – pobočka Praha
3.	GE Money Bank, a. s.	9.	ING Bank N.V.
4.	Hypoteční banka, a. s.	10.	Oberbank AG pobočka Česká republika
5.	Raiffeisenbank a. s.	11.	PRIVAT BANK AG der Raiffeisenlandesbank Oberösterreich, pobočka Česká republika
III.	**Small banks**	12.	Raiffeisenbank im Stiftland eG pobočka Cheb, odštěpný závod
1.	Banco Popolare Česká republika, a. s.	13.	Všeobecná úverová banka a. s., pobočka Praha
2.	BAWAG Bank CZ a. s.	14.	Waldviertler Sparkasse von 1842 AG
3.	Česká exportní banka, a. s.		
4.	eBanka, a. s.	**V.**	**Building societies**
5.	J&T BANKA, a. s.	1.	Českomoravská stavební spořitelna, a. s.
6.	PPF banka a. s.	2.	HYPO stavební spořitelna a. s.
7.	Volksbank CZ, a. s.	3.	Modrá pyramida stavební spořitelna, a. s.
8.	Wüstenrot hypoteční banka a. s.	4.	Raiffeisen stavební spořitelna a. s.
		5.	Stavební spořitelna České spořitelny, a. s.
		6.	Wüstenrot – stavební spořitelna a. s.

On 1 January 2008, Citibank, a. s. was converted into a branch of the Irish bank Citibank Europe plc.

Annex 4

Breakdown of insurance undertakings into groups

(as of 31 December 2007)

I. Large insurance undertakings

1. Allianz pojišťovna, a.s.
2. Česká pojišťovna a.s.
3. ČSOB Pojišťovna, a.s., člen holdingu ČSOB
4. Generali Pojišťovna a.s.
5. Kooperativa, pojišťovna, a.s., Vienna Insurance Group

II. Medium-sized insurance undertakings

1. Česká podnikatelská pojišťovna, a.s., Vienna Insurance Group
2. Komerční pojišťovna, a.s.
3. Pojišťovna České spořitelny, a.s.
4. PRVNÍ AMERICKO – ČESKÁ POJIŠŤOVNA, a.s., angl. FIRST AMERICAN CZECH INSURANCE COMPANY
5. UNIQA pojišťovna, a.s.
6. AXA životní pojišťovna a.s.

III. Small insurance undertakings

1. AEGON Pojišťovna, a. s.
2. AIG CZECH REPUBLIC pojišťovna, a.s.
3. Aviva životní pojišťovna, a.s.
4. Cestovní pojišťovna ADRIA Way družstvo
5. Česká pojišťovna ZDRAVÍ a.s.
6. D.A.S. pojišťovna právní ochrany, a.s.
7. DIRECT Pojišťovna, a.s.
8. Euler Hermes Čescob, úvěrová pojišťovna, a.s.
9. Evropská Cestovní Pojišťovna, a.s.
10. Exportní garanční a pojišťovací společnost, a.s.
11. HALALI, všeobecná pojišťovna, a.s.
12. Hasičská vzájemná pojišťovna a.s.
13. Komerční úvěrová pojišťovna EGAP, a.s.
14. MAXIMA pojišťovna, a.s.
15. ING pojišťovna, a.s.
16. POJIŠŤOVNA CARDIF PRO VITA, a.s.
17. Pojišťovna Slavia a.s.
18. Pojišťovna VZP, a.s.
19. Servisní pojišťovna a.s.
20. Triglav pojišťovna, a.s.
21. VICTORIA VOLKSBANKEN pojišťovna, a.s.
22. Vitalitas pojišťovna, a.s.
23. Wüstenrot, životní pojišťovna, a.s.

IV. Branches of foreign insurance undertakings

1. ACE European Group Ltd, organizační složka
2. AIG EUROPE, S.A., pobočka pro Českou republiku
3. Atradius Credit Insurace N. V., organizační složka
4. CG Car-Garantie Versicherungs-Aktiengesellschaft organizační složka pro Českou republiku
5. Coface Austria Kreditversicherung AG, organizační složka
6. DEUTSCHER RING Lebensversicherungs-AG, pobočka pro Českou republiku
7. Elvia Reiseversicherungs – Gesellschaft AG – organizační složka
8. HDI Hannover Versicherung AG, organizační složka
9. HDI-Gerling Industrie Versicherung AG, organizační složka
10. ING Životná poisťovňa, a.s., pobočka pro Českou republiku
11. ING Životní pojišťovna N.V., pobočka pro Českou republiku
12. INTER PARTNER ASSISTANCE, organizační složka
13. Niederösterreichische Versicherung AG, organizační složka
14. Österreichische Hagelversicherung – Versicherungsverein auf Gegenseitigkeit, organizační složka
15. QBE Insurance (Europe) Limited, organizační složka
16. QBE poisťovňa, a.s., pobočka
17. Wüstenrot pojišťovna, pobočka pro Českou republiku
18. XL INSURANCE COMPANY LIMITED, organizační složka

Annex 5

Numbers of foreign financial undertakings providing financial services in the Czech Republic under the freedom to provide services (without establishing a branch) as of 31 December 2007

Home country of head office of financial institution	Banks	Insurance undertakings	Funds	Investment companies	Non-bank investment service providers
Belgium	2	11	125	2	1
Bulgaria	-	1	-	-	-
Denmark	1	9	-	-	1
Estonia	-	2	-	-	-
Finland	2	6	-	-	1
France	15	33	-	2	6
Gibraltar	3	5	-	-	1
Ireland	9	71	130	-	8
Iceland	2	-	-	-	-
Italy	5	19	-	-	-
Cyprus	2	-	-	-	10
Liechtenstein	3	9	-	-	3
Lithuania	1	4	-	-	-
Latvia	-	1	-	-	-
Luxembourg	12	21	1,048	11	2
Hungary	5	8	1	2	-
Malta	3	4	-	-	1
Germany	34	33	12	5	9
Netherlands	9	28	-	-	18
Norway	2	2	-	-	6
Poland	1	12	-	-	-
Portugal	-				
Austria	35	29	155	10	19
Romania	-	1	-	-	-
Greece	-	-	8	-	1
Slovakia	2	9	-	3	6
Slovenia	-	4	-	-	1
Spain	2	16	-	-	-
Sweden	1	17	-	1	-
UK	47	123	-	1	424
Total	**198**	**478**	**1,479**	**37**	**518**

Annex 6

Banking sector balance sheet

(including foreign bank branches; CZK thousands)

	31 December 2005	31 December 2006	31 December 2007		
	Data adjusted for provisions and reserves	Data adjusted for provisions and reserves	Data not adjusted for provisions and reserves	Provisions and reserves	Data adjusted for provisions and reserves
Total balance sheet assets	2,954,369,396	3,151,809,889	3,846,159,145	98,691,800	3,747,467,345
Cash and balances with central banks	516,013,616	398,691,727	344,529,976	0	344,529,976
Cash	31,169,894	33,543,566	36,414,163		36,414,163
balances with central banks	484,843,722	365,148,161	308,115,813	0	308,115,813
Financial assets held for trading	157,584,152	225,237,653	362,883,869		362,883,869
Derivatives held for trading (positive FV)	50,271,951	69,256,948	84,950,660		84,950,660
Equity instruments held for trading	10,433,611	11,798,080	3,516,308		3,516,308
Debt instruments held for trading	96,878,590	144,182,625	150,770,487		150,770,487
Loans and advances held for trading			123,646,413		123,646,413
Loans and advances held for trading to credit institutions			119,181,229		119,181,229
Loans and advances held for trading to clients			4,412,665		4,412,665
Other loans and advances held for trading (not divided by sector)			52,519		52,519
Financial assets designated at FV through P/L			66,247,278		66,247,278
Equity instruments designated at FV through P/L			10,308,356		10,308,356
Debt instruments designated at FV through P/L			55,102,494		55,102,494
Loans and advances designated at FV through P/L			836,426		836,426
Loans and advances designated at FV through P/L to credit institutions			0		0
Loans and advances designated at FV through P/L to clients			836,426		836,426
Other loans and advances designated at FV through P/L (not divided by sector)			0		0
Available-for-sale financial assets	180,873,066	234,237,474	284,543,365	41,533	284,501,832
Available-for-sale equity instruments	1,069,760	1,361,367	1,928,395	41,533	1,886,862
Available-for-sale debt instruments	179,803,306	232,876,107	282,614,970		282,614,970
Available-for-sale loans and advances			0		0
Available-for-sale loans and advances to credit institutions			0		0
Available-for-sale loans and advances to clients			0		0
Other available-for-sale loans and advances (not divided by sector)			0		0
Loans and receivables	1,645,503,472	1,845,021,180	2,252,446,193	36,652,003	2,215,794,190
Debt instruments	43,154,027	29,310,392	41,978,114	0	41,978,114
Loans and advances	1,602,349,445	1,815,710,788	2,210,468,079	36,652,003	2,173,816,076
Loans and advances to credit institutions	422,943,100	375,363,320	342,149,059	90,560	342,058,499
Loans and advances to clients	1,167,297,786	1,423,835,988	1,838,436,235	36,017,866	1,802,418,369
Other loans and advances (not divided by sector)	12,108,559	16,511,480	29,882,782	543,575	29,339,207
Held to maturity investments	334,822,553	320,654,258	326,854,077	10,561	326,843,516
Debt instruments held to maturity	334,822,553	320,654,258	317,087,511	0	317,087,511
Loans and advances held to maturity			9,766,566	10,561	9,756,005
Loans and advances held to maturity to credit institutions			2,400,855	0	2,400,855
Loans and advances held to maturity to clients			7,365,710	10,561	7,355,149
Other loans and advances held to maturity (not divided by sector)			0	0	0
Derivatives – hedge accounting (positive FV)	11,301,270	12,524,174	10,914,042		10,914,042
Derivatives – hedge accounting of FV (positive FV)			107,722		107,722
Derivatives – hedge accounting of cash flows (positive FV)			8,072,083		8,072,083
Derivatives – hedge accounting of net investments in foreign units (positive FV)			0		0
Derivatives – hedge accounting of interest rate risk – FV (positive FV)			618,560		618,560
Derivatives – hedge accounting of interest rate risk – cash flows (positive FV)			2,115,678		2,115,678
FV changes of the hedged items in portfolio hedge of interest rate risk	745,297	1,829,044	0		0
Tangible assets	37,000,164	34,290,161	73,415,377	40,039,104	33,376,273
Property, plant and equipment	37,000,164	34,290,161	72,581,064	39,479,180	33,101,884
Investment property			834,315	559,925	274,390
Intangible assets	11,940,831	12,302,599	33,110,687	20,131,927	12,978,760
Goodwill	2,910,490	2,868,927	3,058,725	253,650	2,805,075
Other intangible assets	9,030,341	9,433,673	30,051,962	19,878,276	10,173,686
Investments in associates, subsidiaries and joint ventures	36,287,589	45,578,049	66,955,991	467,777	66,488,214
Tax assets	2,479,039	1,490,900	3,819,142		3,819,142
Current tax assets	126,325	184,171	770,610		770,610
Deferred tax assets	2,352,714	1,306,729	3,048,530		3,048,530
Other assets	19,818,347	19,952,667	18,132,522	11,647	18,120,875
Noncurrent assets and disposal groups classified as held for sale			2,306,627	1,337,244	969,383

Annex 6

Banking sector balance sheet (continued)

(including foreign bank branches; CZK thousands)

	31 December 2005	31 December 2006	31 December 2007		
	Data adjusted for provisions and reserves	Data adjusted for provisions and reserves	Data not adjusted for provisions and reserves	Provisions and reserves	Data adjusted for provisions and reserves
Total balance sheet liabilities	2,954,369,397	3,151,809,890			3,747,467,346
Liabilities, total	2,734,539,947	2,917,979,105			3,490,620,059
Deposits, loans and other financial liabilities vis-à-vis central banks	29,056,715	30,570			11,205
Financial liabilities held for trading	60,423,997	75,812,685			98,512,834
Derivatives held for trading (negative FV)	46,335,558	64,831,614			76,455,558
Short positions	14,088,439	10,981,071			9,726,088
Deposits, loans and other financial liabilities held for trading					12,331,187
Deposits, loans and other financial liabilities held for trading from credit institutions					6,346,106
Deposits, loans and other financial liabilities held for trading from clients					5,985,081
Other financial liabilities held for trading (not divided by sector)					0
Debt certificates (incl. bonds intended for repurchase in short term)					0
Financial liabilities designated at FV through P/L					149,771,816
Deposits, loans and other financial liabilities designated at FV through P/L					142,680,888
Deposits, loans and other financial liabilities designated at FV through P/L from credit institutions					103,192,023
Deposits, loans and other financial liabilities designated at FV through P/L from clients					39,477,271
Other financial liabilities designated at FV through P/L (not divided by sector)					11,594
Debt certificates (including bonds) designated at FV through P/L					7,090,927
Subordinated liabilities designated at FV through P/L					0
Financial liabilities measured at amortised cost	2,575,103,433	2,762,080,302			3,156,839,396
Deposits, loans and other financial liabilities measured at amortised cost	2,315,130,825	2,468,001,279			2,774,976,129
Deposits, loans and other financial liabilities measured at amortised cost from credit institutions	380,633,925	348,321,415			325,693,749
Deposits, loans and other financial liabilities measured at amortised cost from clients	1,919,550,825	2,102,215,944			2,414,430,447
Other financial liabilities measured at amortised cost (not divided by sector)	14,946,075	17,463,920			34,851,938
Debt certificates (including bonds) measured at amortised cost	247,976,984	267,784,229			346,631,395
Subordinated liabilities measured at amortised cost	11,995,624	26,294,794			35,231,870
Financial liabilities associated with transferred assets					0
Derivatives – hedge accounting (negative FV)	4,071,418	4,974,242			9,171,900
Derivatives – hedge accounting of FV (negative FV)					1,914,104
Derivatives – hedge accounting of cash flows (negative FV)					3,200,653
Derivatives – hedge accounting of net investments in foreign units (negative FV)					0
Derivatives – hedge accounting of interest rate risk – FV (negative FV)					967,124
Derivatives – hedge accounting of interest rate risk – cash flows (negative FV)					3,090,019
FV changes of the hedged items in portfolio hedge of interest rate risk	1,052,695	1,193,294			0
Provisions	12,764,018	11,023,215			11,614,428
Provisions for restructuring					139,766
Provisions for taxes and litigation	372,771	319,869			3,630,039
Provisions for pensions and similar liabilities	1,858	404			101,898
Provisions for off-balance-sheet items	4,320,193	4,118,242			4,152,330
Provisions for disadvantageous contracts					366,327
Other provisions	8,069,196	6,584,698			3,224,069
Tax liabilities	2,624,109	1,278,700			1,097,973
Current tax liabilities	817,818	328,938			1,032,596
Deferred tax liabilities	1,806,291	949,762			65,377
Other liabilities	49,443,562	61,586,097			63,600,517
Equity of credit unions payable on demand					
Liabilities included in disposal groups classified as held for sale					0
Equity, total	219,829,452	233,830,801			256,847,287
Issued capital	69,826,875	70,732,975			74,276,659
Paid-up capital	69,420,846	70,326,946			73,870,630
Non-paid-up capital	406,029	406,029			406,029
Share premium	12,929,645	13,588,498			23,140,396
Other equity	1,079,012	4,234,516			42,444
Equity component of financial instruments					24
Other equity instruments	1,079,012	4,234,516			42,420
Revaluation reserves and other valuation differences	6,815,182	6,109,041			-3,501,696
Valuation differences from tangible assets	17,343	15,994			0
Valuation differences from intangible assets					0
Hedge accounting of net investments in foreign units	-192,748	-198,205			51,112
Hedge accounting of cash flows	4,221,004	4,070,839			-1,556,536
Valuation differences from available-for-sale financial assets	2,769,586	2,220,411			-2,011,110
Valuation differences from noncurrent assets and discontinued operations classified as held for sale					0
Other valuation differences					14,837
Reserves	31,998,662	34,036,008			35,184,324
Retained earnings	58,047,741	67,270,533			80,677,531
Treasury shares (minus)	6,865	150,379			150,379
Net income from current year	39,139,200	38,009,609			47,178,005

Annex 7

Banking sector profit and loss account

(including foreign bank branches; CZK thousands)

	31 December 2005	31 December 2006	31 December 2007
Financial and operating income and expenses	111,135,239	116,864,367	134,511,125
Interest income	107,143,629	124,114,384	156,436,942
Interest on cash balances with central banks	10,345,738	12,558,482	11,330,934
Interest on financial assets held for trading			9,215,564
Interest on financial assets designated at FV through P/L			2,549,048
Interest on available-for-sale financial assets			8,951,488
Interest on loans and receivables	67,553,037	80,317,897	103,160,737
Interest on held to maturity investments	23,533,133	24,650,479	12,717,345
Profit on interest rate derivatives – hedge accounting	5,711,721	6,587,526	8,320,050
Interest on other assets			191,776
Interest expenses	43,100,407	52,567,121	71,741,726
Interest on deposits, loans and other financial liabilities vis-à-vis central banks	15,957	51,004	12,415
Interest on financial liabilities held for trading	229,551	214,963	536,839
Interest on financial liabilities designated at FV through P/L			5,281,766
Interest on financial liabilities measured at amortised cost	39,079,258	47,671,050	56,919,158
Loss on interest rate derivatives – hedge accounting	3,775,641	4,630,104	6,600,626
Interest on other liabilities			2,390,922
Expenses on equity payable on demand			0
Dividend income	2,189,410	1,675,508	5,886,359
Dividend income on financial assets held for trading			19,135
Dividend income on financial assets designated at FV through P/L			553,676
Dividend income on available-for-sale financial assets			183,902
Dividend income from associates	2,189,410	1,675,508	5,129,645
Fee and commission income	38,899,100	41,092,657	44,786,659
Fees and commissions from financial instrument transactions for clients	583,481	758,742	1,712,971
Fees and commissions for arranging issues	168,379	325,972	57,314
Fees and commissions for procuring financial instruments	276,002	341,591	1,548,739
Fees and commissions for consulting activities	139,100	91,179	106,919
Fees and commissions from clearing and settlement			554,975
Fees and commissions for asset management	146,618	173,183	207,627
Fees and commissions for custody of values	783,802	786,166	741,303
Fees and commissions from commitments and guarantees			2,463,726
Fees and commissions from payments	26,327,620	26,941,178	25,666,276
Fees and commissions from structured financing			24,745
Fees and commissions from securitisation			0
Fees and commissions from other services	11,057,571	12,433,390	13,415,039
Fee and commission expenses	7,068,140	8,174,518	8,935,532
Fees and commissions for financial instrument transactions	411,968	463,955	569,490
Fees and commissions for asset management			0
Fees and commissions for custody of values			45,200
Fees and commissions for securitisation			35,400
Fees and commissions for clearing and settlement			320,049
Fees and commissions for other services	6,656,171	7,710,561	7,965,387
Realised gains (losses) on financial assets & liabilities not measured at FV through P/L, net	144,521	44,711	-158,362
Gains (losses) on available-for-sale financial assets	594,505	371,795	45,553
Gains (losses) on loans and receivables	-464,766	-359,696	-637,638
Gains (losses) on held to maturity investments	14,782	32,612	33,201
Gains (losses) on financial liabilities measured at amortised cost			163,340
Gains (losses) on other liabilities			237,181

Annex 7

Banking sector profit and loss account (continued)

(including foreign bank branches; CZK thousands)

	31 December 2005	31 December 2006	31 December 2007
Gains (losses) on financial assets and liabilities held for trading, net	9,522,989	6,510,735	4,519,971
Gains (losses) on equity instruments and equity derivatives	358,612	-109,017	-86,566
Gains (losses) on interest rate instruments (including interest rate derivatives)	258,706	-559,505	885,145
Gains (losses) on foreign currency instruments (including foreign currency derivatives)	8,893,820	6,945,038	3,406,100
Gains (losses) on credit instruments (including credit derivatives)	3,361	-883	266,892
Gains (losses) on commodities and commodity derivatives	8,487	235,103	48,399
Gains (losses) on other instruments, including hybrid instruments			0
Gains (losses) on financial assets and liabilities designated at FV through P/L, net			-2,191,009
Gains (losses) from hedge accounting, net	-118,820	-389,873	-534,849
Exchange differences, net	840,978	4,211,622	7,759,458
Gains (losses) on derecognition of assets other than held for sale, net	153,696	1,673,608	252,557
Other operating income	5,006,112	2,507,451	2,201,125
Other operating expenses	2,477,821	3,834,799	3,770,469
Administration costs	51,785,559	55,652,001	59,712,774
Staff expenses	26,223,481	28,976,240	30,960,073
Wages and salaries	18,472,552	20,387,646	21,498,144
Social and health insurance	6,540,564	7,233,961	7,186,392
Pensions and similar expenses			461,025
Temporary employee expenses			148,892
Remunerations – equity instruments			5,973
Other staff expenses	1,210,363	1,354,637	1,659,646
Other administration costs	25,562,073	26,675,765	28,752,704
Advertising costs	3,507,843	3,582,171	4,179,620
Consultancy costs	1,245,759	915,070	1,403,956
IT costs			4,757,712
Outsourcing costs	3,986,401	4,111,454	4,238,390
Rent	3,344,551	3,584,352	3,461,055
Other administration costs	13,477,523	14,482,717	10,711,962
Depreciation	8,986,540	8,357,275	7,904,186
Depreciation of property, plant and equipment	5,467,694	4,773,627	4,188,835
Depreciation of real estate investments			0
Depreciation of intangible assets	3,518,846	3,583,648	3,715,347
Provisions	-1,704,035	-1,335,718	1,113,191
Impairment	2,870,863	5,162,699	6,524,995
Impairment on financial assets not measured at FV through P/L	3,272,131	5,295,779	6,932,494
Impairment on financial assets at acquisition price	0	56	0
Impairment on available-for-sale financial assets			115
Impairment on loans and receivables	3,272,131	5,295,723	6,932,379
Impairment on held to maturity investments	0	0	0
Impairment on non-financial assets	-401,268	-133,080	-407,499
Impairment on property, plant and equipment	263,055	-148,388	-144,566
Impairment on real estate investments			0
Impairment on goodwill	57,493	61,317	554
Impairment on intangible assets	-31,850	11,221	13,419
Impairment on shares in associates and joint ventures	-689,966	-57,230	-276,905
Impairment on other non-financial assets			0
Negative goodwill immediately recognised in P/L			0
Share of P/L of associates and joint ventures	76,074	113,576	0
Profit or loss from noncurrent assets and disposal groups			27,138
Total profit or loss before tax from continuing operations	49,272,402	49,141,674	59,283,117
Tax expense	10,133,202	11,132,068	12,105,111
Profit or loss from continuing operations after taxation			47,178,004
Profit or loss from discontinued operations after taxation			0
Total profit or loss after taxation	39,139,200	38,009,609	47,178,004

Annex 8

Insurance sector balance sheet

(total excluding the Czech Insurers' Bureau; CZK thousands)

	31 December 2005	31 December 2006	31 December 2007		
	Data adjusted for provisions and reserves	Data adjusted for provisions and reserves	Data not adjusted for provisions and reserves	Provisions and reserves	Data adjusted for provisions and reserves
Total assets	310,511,484	322,775,777	368,741,051	23,719,781	345,021,269
Receivables for subscribed share capital	300,000	0	74,200	0	74,200
Long-term intangible assets	4,294,501	3,599,956	10,321,327	7,475,817	2,845,509
Establishment expenses	6,600	4,905	47,720	34,698	13,021
Goodwill	2,289,222	1,586,563	3,606,955	2,701,353	905,602
Financial placement (investment)	265,917,108	272,002,162	283,693,351	2,313	283,691,038
Land and buildings (real estate),	9,314,767	8,769,670	4,808,901	2,313	4,806,588
Financial placements in third-party companies	25,980,388	11,314,491	11,475,985	0	11,475,985
Other financial placements	230,599,203	251,824,767	267,407,908	0	267,407,908
Deposits with ceding undertakings	22,750	93,235	558	0	558
Financial placement of unit-linked life assurance	12,419,621	18,581,168	26,900,129	0	26,900,129
Debtors	18,951,359	18,371,095	31,613,229	11,840,939	19,772,290
Receivables arising out of direct insurance operations	8,317,389	9,737,247	14,590,895	4,383,734	10,207,162
Receivables arising out of reinsurance operations	6,897,050	4,328,883	4,709,653	111,326	4,598,328
Other receivables	3,736,921	4,304,966	12,312,680	7,345,881	4,966,801
Other assets	4,180,707	4,707,664	8,677,314	4,397,526	4,279,787
Long-term tangible assets other than land, buildings (real estate) and stocks	2,163,315	1,943,936	6,613,310	4,397,017	2,216,294
Cash at financial institutions and cash	2,015,936	2,762,864	2,053,165	509	2,052,656
Other assets	1,456	865	10,837	0	10,837
Temporary accounts of assets	4,448,188	5,513,728	7,461,497	3,185	7,458,312
Interest and annuities	116,185	82,743	105,926	0	105,926
Deferred acquisition costs for insurance contracts	3,107,604	3,819,113	5,503,194	3,185	5,500,009
Other temporary accounts of assets	1,224,398	1,611,873	1,852,376	0	1,852,376

Annex 8

Insurance sector balance sheet (continued)

(total excluding the Czech Insurers' Bureau; CZK thousands)

	31 December 2005	31 December 2006	31 December 2007		
	Net	Net	Gross	Reinsurers' share in TPs	Net
Total liabilities	310,511,484	322,775,777			345,021,269
Shareholders' equity	57,466,192	57,756,716			58,629,481
Share capital	16,674,140	17,729,181			18,380,085
Share premium account	880,720	880,720			880,720
Revaluation reserve fund	0	-150			62
Other capital funds	13,544,700	12,222,850			7,570,966
Reserve fund and other profit funds	4,765,647	5,764,756			7,804,313
Profit or loss brought forward	13,579,823	6,950,603			11,215,352
Profit or loss for the current financial year	8,021,161	14,208,755			12,777,983
Subordinated debt	2,500,000	0			251,973
Technical provisions	200,511,113	217,878,853	254,205,250	23,879,420	230,325,831
Provision for unearned premiums	14,065,071	15,712,686	22,188,727	4,442,007	17,746,720
Life assurance provision	136,557,752	151,218,765	160,944,944	47,540	160,897,404
Outstanding claims provision	31,613,864	33,683,667	56,536,818	18,964,334	37,572,484
Provision for bonuses and rebates	1,165,093	1,227,531	1,330,601	70,238	1,260,363
Equalisation provision	4,404,943	4,575,313	4,907,881	0	4,907,881
Provision for the fulfilment of the commitments					
from the technical interest rate applied	7,589,392	6,039,689	2,583,429	0	2,583,429
Non-life insurance provision	164,535	191,896	242,434	54	242,381
Provisions for the fulfilment of the commitments					
from the guarantee of the CIB	4,668,681	4,947,100	5,470,416	355,246	5,115,170
Other provisions	281,783	282,208	0	0	0
Technical provision for unit-linked life assurance	12,053,208	18,545,544	26,902,537	0	26,902,537
Provision for other risks and losses	1,406,899	2,115,300			1,680,915
Provision for pensions and similar liabilities	14,653	7,235			6,111
Tax provision	1,103,765	1,768,072			1,089,546
Other provisions	288,482	339,993			585,258
Passive reinsurance deposits	3,541,524	210,755			181,957
Creditors	26,874,363	18,995,461			19,460,790
Liabilities arising out of direct insurance	6,493,164	6,611,621			7,850,602
Liabilities arising out of reinsurance	10,462,490	6,980,805			6,292,392
Debenture loans	0	0			0
Liabilities to financial institutions	1,025,364	528,248			13,431
Other liabilities	8,893,345	4,874,789			5,304,363
Guarantee fund of the Czech Insurers' Bureau	0	0			0
Temporary accounts of liabilities	6,158,185	7,273,146			7,587,785
Accrued expenses and revenues	3,454,131	3,553,591			3,020,798
Other temporary accounts of liabilities	2,704,054	3,719,555			4,566,987

Annex 9

Insurance sector profit and loss account

(total excluding the Czech Insurers' Bureau; CZK thousands)

Technical account for non-life insurance	31 December 2005	31 December 2006	31 December 2007
Result of technical account for non-life insurance	3,835,541	5,314,336	5,021,443
Earned premiums, net of reinsurance	44,774,469	49,819,282	54,642,034
Premiums written, net of reinsurance	44,882,067	51,318,485	56,919,961
Change in provision for unearned premiums, net of reinsurance	-107,597	-1,499,204	-2,277,926
Allocated investment return transferred from the non-technical account	1,364,216	1,053,777	855,664
Other technical income, net of reinsurance	2,077,804	2,578,700	1,558,648
Claims incurred including change in provision, net of reinsurance	-27,467,942	-29,445,372	-30,643,119
Claims incurred, net of reinsurance	-23,790,032	-28,546,050	-27,204,392
Change in provision for claims, net of reinsurance	-3,677,910	-899,323	-3,438,726
Change in other technical provisions, net of reinsurance	71,609	-218,221	-204,501
Bonuses and rebates, net of reinsurance	-592,030	-761,691	-1,254,269
Operating expenses, net amount	-11,293,636	-13,105,858	-15,197,904
Acquisition expenses for insurance contracts	-9,668,616	-10,646,810	-11,764,781
Change in deferred acquisition expenses	-105,946	159,277	140,792
Administrative expenses	-7,837,643	-8,422,699	-8,946,428
Reinsurance commissions and profit participation	6,318,569	5,804,377	5,372,515
Other technical expenses, net of reinsurance	-4,918,644	-4,434,349	-4,402,523
Change of equalisation provision	-180,306	-171,935	-332,583

Technical account for life assurance	31 December 2005	31 December 2006	31 December 2007
Result of technical account for life assurance	4,394,911	7,848,599	5,139,591
Earned premiums, net of reinsurance	42,837,976	46,137,629	53,069,993
Premiums written, net of reinsurance	42,757,848	45,918,354	52,775,875
Change in provision for unearned premiums, net of reinsurance	80,128	219,276	294,118
Income from financial placements	29,741,508	19,568,521	21,647,789
Income from participating interests	139,816	206,741	140,090
Income from other financial placements	7,748,152	8,522,853	9,539,683
Change in value of financial placements – income	87,759	1,518,301	155,877
Gains on the realisation of financial placements	21,765,781	9,320,625	11,812,139
Unrealised gains on financial placements	5,002,060	4,465,583	-843,361
Other technical income, net of reinsurance	835,299	732,638	887,068
Claims incurred including change in provision, net of reinsurance	-19,421,040	-18,946,591	-25,286,617
Claims incurred, net of reinsurance	-19,298,066	-18,512,908	-24,878,696
Change in provision for claims, net of reinsurance	-122,975	-433,684	-407,922
Change in other technical provisions, net of reinsurance	-19,245,456	-17,772,107	-14,329,742
Change in balance of life assurance provision, net of reinsurance	-12,208,536	-13,657,677	-9,938,015
Change in balance of other technical provisions (except life assurance provision), net of reinsurance	-7,036,921	-4,114,430	-4,391,72

Annex 9

Insurance sector profit and loss account (continued)

(total excluding the Czech Insurers' Bureau; CZK thousands)

Technical account for life assurance	31 December 2005	31 December 2006	31 December 2007
Bonuses and rebates, net of reinsurance	-46,971	-69,445	-227,292
Operating expenses, net amount	-9,917,687	-10,562,777	-12,036,601
Acquisition expenses for insurance contracts	-6,234,345	-6,591,900	-8,554,984
Change in deferred acquisition expenses	64,793	546,536	1,356,192
Administrative expenses	-4,421,727	-4,854,848	-5,181,190
Reinsurance commissions and profit participation	673,592	337,434	343,381
Expenses related to financial placements	-21,804,409	-11,379,758	-12,330,052
Administration expenses on financial placements, including interest	-1,362,046	-1,378,447	-1,230,365
Change in value of financial placements – expenses	-2,777,316	-59,076	-205,085
Realisation expenses on financial placements	-17,665,046	-9,942,234	-10,894,602
Unrealised losses on financial placements	-2,156,248	-3,284,444	-4,475,803
Other technical expenses, net of reinsurance	-1,010,357	-647,480	-639,367
Transfer of income from financial placement to the non-technical account	-419,764	-393,171	-296,425

Non-technical account	31 December 2005	31 December 2006	31 December 2007
Profit or loss for the accounting period	8 021 162	14 208 755	12 777 983
After-tax profit or loss on ordinary activities	7 782 606	14 189 282	12 888 420
Result of technical account for non-life insurance	3 835 541	5 314 336	5 021 443
Result of technical account for life assurance	4 394 911	7 848 599	5 139 591
Income from financial placements	7 288 969	10 360 539	11 710 490
Transferred income from financial placements from technical account for life assurance	419 764	393 171	296 425
Expenses related to financial placements	-4 737 742	-5 512 570	-5 292 851
Transfer of income from financial placements to non-life technical account	-1 364 133	-1 053 777	-855 664
Other income	1 070 675	2 508 613	1 632 827
Other expenses	-570 991	-1 817 387	-1 700 079
Income tax on ordinary activities	-2 554 388	-3 852 240	-3 063 764
Extraordinary profit or loss	280 805	73 842	76 879
Extraordinary income	333 330	86 718	608 600
Extraordinary expenses	-52 525	-12 876	-531 722
Income tax on extraordinary activities	4 701	-9 070	-6 897
Other taxes	-46 950	-45 301	-180 418

Annex 10

Pension fund sector balance sheet
(CZK thousands)

	31 December 2005 Data adjusted for provisions and reserves	31 December 2006 Data adjusted for provisions and reserves	31 December 2007 Data adjusted for provisions and reserves
Total assets	123,416,677	145,939,162	167,196,988
Cash and deposits with central banks	604	932	517
Receivables from banks and credit unions	10,133,528	9,333,972	16,069,253
Receivables from banks and credit unions payable on demand	4,105,569	4,670,052	7,963,206
Other receivables from banks and credit unions	6,027,959	4,663,920	8,106,047
Receivables from non-banking institutions	5,467	11,341	17,191
Receivables from non-banking institutions payable on demand	0	0	0
Other receivables from non-banking institutions	5,467	11,341	17,191
Debt securities	99,106,151	115,791,688	126,786,662
Debt securities issued by government institutions	72,805,108	90,269,006	98,589,778
Debt securities issued by other entities	26,301,043	25,522,682	28,196,884
Shares, units and other interests	9,230,837	14,434,241	17,383,424
Shares	7,425,219	9,616,022	9,921,865
Units and other interests	1,805,618	4,818,219	7,461,559
Substantial interests	0	0	0
Substantial interests in banks	0	0	0
Substantial interests in other entities	0	0	0
Controlling interests	0	0	0
Controlling interests in banks	0	0	0
Controlling interests in other entities	0	0	0
Long-term intangible assets	144,098	122,828	129,679
Establishment expenses	0	0	1,266
Goodwill	5,663	328	0
Other long-term intangible assets	138,435	122,500	128,413
Long-term tangible assets	993,776	1,437,951	1,423,636
Land and buildings for operations	166,845	151,234	151,708
Other long-term tangible assets	826,931	1,286,717	1,271,928
Receivables from state budget – state contribution	811,059	919,219	1,005,907
Other assets	721,451	1,006,975	905,711
Receivables from subscribed registered capital	0	0	0
Deferred revenues and accrued expenses	2,269,706	2,880,015	3,475,008
Acquisition expenses for pension plans	2,217,241	2,870,269	3,449,765
Other deferred revenues and accrued expenses	52,465	9,746	25,243

Annex 10

Pension fund sector balance sheet (continued)

(CZK thousands)

	31 December 2005	31 December 2006	31 December 2007
Total liabilities	123,416,677	145,939,162	167,196,988
Liabilities to banks and credit unions	0	0	0
Liabilities to banks and credit unions payable on demand	0	0	0
Other liabilities to banks and credit unions	0	0	0
Liabilities to non-banking institutions	5,105	3,350	5,366
Liabilities to non-banking institutions payable on demand	0	0	0
Other liabilities to non-banking institutions payable on demand	5,105	3,350	5,366
Planholders' money	113,107,511	136,404,900	162,445,096
Planholders' contributions	86,068,910	104,543,054	147,296,154
Planholders' own contributions	75,541,445	90,589,522	108,484,661
Contributions paid by employer	10,400,306	13,749,580	16,682,180
Contributions paid by third parties for planholder	127,159	203,952	257,019
State contributions	16,503,900	18,990,951	21,872,294
Financial means for pension payments	148,207	187,710	232,880
Revenues on planholders' contributions	9,426,911	11,987,887	14,201,685
Unallocated planholders' contributions	575,888	517,258	578,670
Payables from eligible unpaid lump sums	383,695	178,040	135,707
Liabilities to state budget – state contribution	51,261	74,291	75,010
Liabilities to state budget – tax liabilities	79,847	70,280	29,089
Other liabilities	610,539	595,578	653,303
Deferred revenues and accrued expenses	13,857	13,374	11,501
Reserves	58,718	59,641	62,909
Reserves for pensions and similar payables	56,536	58,016	59,843
Reserves for taxes	0	0	0
Other reserves	2,182	1,625	3,066
Subordinated liabilities	0	0	0
Registered capital	1,063,438	1,063,438	1,133,438
Paid up capital	1,063,438	1,063,438	1,133,438
Own shares	0	0	0
Share premium account	148,771	148,771	148,771
Reserve funds and other funds created from profit	1,114,493	1,465,388	1,697,912
Statutory reserve funds and risk funds	851,317	1,117,164	1,349,389
Other reserve funds	0	0	0
Other funds created from profit	263,176	348,224	348,523
Pension reserves fund	114,059	173,325	168,623
Revaluation reserve fund	0	0	0
Capital funds	381,146	364,693	392,578
Valuation differences	2,059,445	1,207,103	-4,413,301
Valuation differences from assets and liabilities	2,067,649	1,158,327	-4,401,458
Valuation differences from hedging derivatives	-8,204	48,776	-11,843
Valuation differences from recalculated shares	0	0	0
Other valuation differences	0	0	0
Retained profits (accumulated losses) from previous periods	154,868	343,833	561,672
Profit or loss for the accounting period	4,567,678	4,124,522	4,393,644

Annex 11

Pension fund sector profit and loss account

(CZK thousands)

	31 December 2005	31 December 2006	31 December 2007
Interest income and similar income	3,324,647	3,847,184	4,752,800
Interest on debt securities	3,133,429	3,618,374	4,428,952
Interest on other assets	191,218	228,810	323,848
Interest expenses and similar expenses	3,616	175	80
Interest expenses from debt securities	3,589	0	1
Costs of other liabilities	27	175	79
Income from shares and other equity instruments	144,505	365,256	456,097
Income from shares and other equity instruments representing substantial interests	0	0	0
Income from shares and other equity instruments representing controlling interests	0	0	0
Other income from shares and other equity instruments	144,505	365,256	456,097
Income from fees and commissions	1,422	2,257	2,433
Fee and commission expenses	942,891	1,094,950	1,284,557
Expenses associated with care for safety and administration of securities	360,878	340,021	306,314
Expenses associated with sale or other disposal of securities	8,774	14,356	22,102
Expenses for pension plans	550,324	716,775	933,213
Other fee and commission expenses	22,915	23,798	22,928
Profit or loss from financial operations	3,034,649	1,989,331	1,514,355
Other operating income	111,834	190,242	166,031
Other operating expenses	60,148	26,128	12,497
Administrative expenses	901,532	999,626	1,110,961
Personnel expenses	314,921	333,377	344,143
Social security and health insurance	78,804	78,954	81,821
Wages and remuneration – employees and statutory bodies	225,088	242,437	248,981
Other social expenses	11,029	11,986	13,341
Other administrative expenses	586,611	666,249	766,818
Release of provisions and reserves for tangible and intangible assets	0	0	0
Depreciation, creation and use of reserves and provisions for tangible and intangible assets	87,224	153,092	73,623
Depreciation of tangible assets	38,294	98,272	38,213
Creation and use of reserves and provisions for tangible assets	1,614	2,414	572
Depreciation of intangible assets	29,203	34,298	22,007
Creation and use of reserves and provisions for intangible assets	18,113	18,109	12,831
Release of provisions and reserves for receivables and guarantees, income from written-off receivables	0	7,875	309
Depreciation, creation and use of provisions and reserves for receivables and guarantees	3,574	2,456	5,281
Release of provisions for controlling and substantial interests	0	0	0
Losses from transfers of controlling and substantial interests, creation and use of provisions	15	23	0
Release of other reserves, including pension reserves	5,379	7,909	7,273
Creation and use of other reserves, including pension reserves	30,057	12,517	13,105
Shares in profit (loss) of controlling or substantial interests	0	0	0
Pre-tax profit or loss from ordinary activities for the financial year	4,593,381	4,128,156	4,399,463
Income tax	25,703	3,634	5,819
After-tax profit or loss for the financial year	4,567,678	4,124,522	4,393,644

Annex 12

Investment company sector balance sheet

(CZK thousands)

	31 December 2005 Data adjusted for provisions and reserves	31 December 2006 Data adjusted for provisions and reserves	31 December 2007 Data adjusted for provisions and reserves
Total assets	2,152,605	2,945,977	2,599,549
Cash	279	652	653
Receivables from banks	417,357	670,754	769,933
Receivables from banks payable on demand	243,843	494,284	484,818
Receivables from banks other than those payable on demand	173,514	176,470	285,115
Receivables from non-banking institutions	7,500	83,706	20,752
Receivables from non-banking institutions payable on demand	7,500	20,000	17,000
Receivables from non-banking institutions other than those payable on demand	0	63,706	3,752
Debt securities	820,720	939,426	1,009,445
Debt securities issued by government institutions	0	0	0
Debt securities issued by other entities	820,720	939,426	1,009,445
Shares, units and other interests	499,779	542,808	292,850
Shares	0	65	15,691
Units	499,779	542,743	277,159
Other interests	0	0	0
Substantial interests and controlling interests	19,290	0	0
Long-term intangible assets	29,343	31,619	32,982
Establishment expenses	0	437	300
Goodwill	0	0	0
Other long-term intangible assets	29,343	31,182	32,682
Long-term tangible assets	116,203	126,587	118,305
Land and buildings for operations	96,911	99,574	94,872
Other long-term tangible assets	19,292	27,013	23,433
Other assets	216,654	310,247	288,243
Receivables from subscribed registered capital	865	7,000	0
Deferred revenues and accrued expenses	24,615	233,178	66,386

Investment company sector balance sheet (continued)

(CZK thousands)

	31 December 2005	31 December 2006	31 December 2007
Total liabilities	2,152,605	2,945,977	2,599,549
Liabilities to banks	5,000	0	0
Liabilities to banks payable on demand	0	0	0
Liabilities to banks other than those payable on demand	5,000	0	0
Liabilities to non-banking institutions	0	43,360	38,825
Liabilities to non-banking institutions payable on demand	0	9,945	735
Liabilities to non-banking institutions other than those payable on demand	0	33,415	38,090
Other liabilities	208,067	444,810	253,325
Deferred revenues and accrued expenses	47,500	36,771	25,000
Reserves	4,676	3,968	5,104
Reserves for pensions and similar liabilities	918	356	1,003
Tax reserves	0	0	0
Other reserves	3,758	3,612	4,101
Subordinated liabilities	0	0	0
Registered capital	616,960	816,340	712,540
Paid-up capital	616,960	809,340	712,540
Own shares	0	0	0
Share premium account	388,110	388,187	388,187
Reserve funds and other funds created from profit	135,715	152,111	145,150
Statutory reserve funds and risk funds	123,264	135,025	131,713
Other reserve funds	0	0	0
Other funds created from profit	12,451	17,086	13,437
Revaluation reserve fund	0	0	0
Capital funds	43,645	54,640	45,640
Valuation differences	1,633	-16	1,969
Valuation differences from assets and liabilities	1,633	176	1,972
Valuation differences from hedging derivatives	0	0	0
Valuation differences from recalculated shares	0	0	0
Other valuation differences	0	-192	-3
Retained profits (accumulated losses) from previous periods	427,280	500,208	493,076
Profit or loss for the accounting period	274,019	505,598	490,733

Annex 13

Investment company sector profit and loss account

(CZK thousands)

	31 December 2005	31 December 2006	31 December 2007
Interest income and similar income	20,944	55,652	37,500
Interest on debt securities	15,246	36,029	26,745
Interest on other assets	5,698	19,623	10,755
Interest expenses and similar expenses	1,244	72	116
Income from shares and other equity instruments	6,785	437	3,046
Income from shares and other equity instruments representing substantial and controlling interests	0	0	0
Other income from shares and other equity instruments	6,785	437	3,046
Income from fees and commissions	1,532,722	2,604,254	1,793,445
Fee and commission expenses	759,613	1,351,234	792,670
Profit or loss from financial operations	17,839	-5,931	4,801
Other operating income	92,335	172,856	123,178
Other operating expenses	66,243	113,565	78,219
Administrative expenses	427,319	668,870	482,888
Personnel expenses	201,972	357,217	248,097
Wages and salaries of employees	148,370	265,626	182,727
Social security and health insurance of employees	51,223	86,951	62,761
Other social expenses	2,379	4,640	2,609
Other administrative expenses	225,347	311,653	234,791
Release of provisions and reserves for tangible and intangible assets	4,273	747	1,883
Depreciation, creation and use of reserves and provisions for tangible and intangible assets	45,121	24,440	18,976
Depreciation of tangible assets	37,347	11,167	8,259
Release of provisions and reserves for receivables and guarantees, income from written-off receivables	15	309	62
Depreciation, creation and use of provisions and reserves for receivables and guarantees	15	300	259
Release of provisions for controlling and substantial interests	0	0	0
Losses from transfers of controlling and substantial interests, creation and use of provisions	0	0	0
Release of other reserves	0	300	1,268
Creation and use of other reserves	837	506	1,255
Shares in profit (loss) of controlling or substantial interests	-600	0	612
Pre-tax profit or loss from ordinary activities for the financial year	356,431	679,915	572,536
Extraordinary income	0	1,124	143
Extraordinary expenses	27	5	5
Pre-tax profit or loss from extraordinary activities for the financial year	-27	-5,152	21,315
Income tax	82,385	89,929	48,836
After-tax profit or loss for the financial year	274,019	517,454	468,820

Annex 14

Listed bonds issued in 2007

(in CZK)

Issue date	ISIN	Issuer	Maximum size
16 February 2007	CZ0002000946	Raiffeisenbank a.s.	2,000,000,000
21 February 2007	CZ0002000961	Hypoteční banka, a.s.	2,000,000,000
15 March 2007	CZ0003701278	Česká spořitelna, a.s.	1,110,000,000
22 March 2007	CZ0002000979	Hypoteční banka, a.s.	1,000,000,000
22 March 2007	CZ0003701286	Česká spořitelna, a.s.	2,250,000,000
30 March 2007	CZ0000000211	ECM Real Estate Investments AG	3,500,000,000
24 May 2007	CZ0002001019	Hypoteční banka, a.s.	1,000,000,000
24 May 2007	CZ0002000995	Česká spořitelna, a.s.	1,000,000,000
28 June 2007	CZ0002001068	Česká spořitelna, a.s.	800,000,000
3 July 2007	CZ0002001084	Česká spořitelna, a.s.	1,500,000,000
17 August 2007	CZ0002001134	Česká spořitelna, a.s.	3,000,000,000
27 August 2007	CZ0003501520	ČEZ, a.s.	10,000,000,000
12 September 2007	CZ0002001175	Raiffeisenbank a.s.	2,000,000,000
13 September 2007	CZ0002001183	Hypoteční banka, a.s.	2,000,000,000
25 September 2007	CZ0002001159	Volksbank CZ, a.s.	700,000,000
26 September 2007	CZ0002001209	Wüstenrot hypoteční banka a.s.	1,250,000,000
10 October 2007	CZ0003701393	ČSOB, a.s.	2,000,000,000
12 October 2007	CZ0002001191	Česká spořitelna, a.s.	2,000,000,000
25 October 2007	CZ0002001266	Hypoteční banka, a.s.	2,000,000,000
31 October 2007	CZ0000000229	PPF Co2 B.V.	12,000,000,000
5 November 2007	CZ0002001274	Česká spořitelna, a.s.	1,000,000,000
8 November 2007	CZ0002001282	Česká spořitelna, a.s.	2,000,000,000
8 November 2007	CZ0002001290	Česká spořitelna, a.s.	1,000,000,000
14 November 2007	CZ0002001316	eBanka, a.s.	2,000,000,000
15 November 2007	CZ0002001308	Hypoteční banka, a.s.	1,500,000,000
29 November 2007	CZ0002001415	Česká spořitelna, a.s.	1,000,000,000
7 December 2007	CZ0002001423	Česká spořitelna, a.s.	5,000,000,000
12 December 2007	CZ0002001696	eBanka, a.s.	1,500,000,000
12 December 2007	CZ0002001662	Raiffeisenbank a.s.	3,000,000,000
12 December 2007	CZ0002001670	Raiffeisenbank a.s.	5,500,000,000
13 December 2007	CZ0003701401	Česká pojišťovna, a.s.	500,000,000
14 December 2007	CZ0002001407	Česká spořitelna, a.s.	4,000,000,000
20 December 2007	CZ0002001928	Raiffeisenbank a.s.	4,000,000,000
20 December 2007	CZ0002001720	Hypoteční banka, a.s.	5,000,000,000
20 December 2007	CZ0002001712	Hypoteční banka, a.s.	5,000,000,000
20 December 2007	CZ0002001985	Wüstenrot hypoteční banka a.s.	3,750,000,000
21 December 2007	CZ0002001910	UniCredit Bank Czech Republic, a.s.	12,000,000,000
28 December 2007	CZ0003501579	Credium, a.s.	1,250,000,000
TOTAL			**112,110,000,000**

Annex 15

Listed share issues/tranches admitted in 2007

Issuer	ISIN	Face value	Volume
AAA Auto Group N.V.	NL0006033375	0.1 EUR	67,757,875 pcs
VGP N.V.	BE0003878957	-	18,583,050 pcs
Orco Property Group S.A.[1]	LU0122624777	-	1,500,000 pcs
Deutsche Telekom AG[2]	DE0005557508	-	4,294,967,295 pcs

1 share capital increase
2 admitted without the issuer applying, based on an exemption under Article 44(4) of Capital Market Undertakings Act

Annex 16

Listed investment certificate issues admitted as of 28 December 2007

Issuer	ISIN	Name
Österreichische Volksbanken-Aktiengesellschaft	AT000B054564	ALT ENERG GAR II
RAIFFEISEN CENTROBANK AG	AT0000489778	BRENT CRUDE OIL
Raiffeisen Centrobank AG	AT0000A07MT5	BRENT TS 107,5
RAIFFEISEN CENTROBANK AG	AT0000A04C39	BRENT TURBO LONG
RAIFFEISEN CENTROBANK AG	AT0000A03E87	CECE BANKING TL
Österreichische Volksbanken-Aktiengesellschaft	AT000B053517	CECE BONUS III
RAIFFEISEN CENTROBANK AG	AT0000A03EC7	CECE OIL&GAS TL
RAIFFEISEN CENTROBANK AG	AT0000A03EE3	CECE TELECOM TL
RAIFFEISEN CENTROBANK AG	AT0000A02961	CECE TL
Raiffeisen Centrobank AG	AT0000A07MN8	CECE TS 3450
RAIFFEISEN CENTROBANK AG	AT0000A00M07	CECEXT
Österreichische Volksbanken-Aktiengesellschaft	AT000B053939	CEZ DISCOUNT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054358	CROX INDEX CERT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054085	CSS INDEX CERT
RAIFFEISEN CENTROBANK AG	AT0000454186	CTX
Raiffeisen Centrobank AG	AT0000A05V43	CTX TS 3500
Raiffeisen Centrobank AG	AT0000A07Q89	ČEZ TS 1750
RAIFFEISEN CENTROBANK AG	AT0000A02XK2	ČEZ TURBO LONG
Österreichische Volksbanken-Aktiengesellschaft	AT000B054457	DAX REV BONUS II
RAIFFEISEN CENTROBANK AG	AT0000340146	DJ EURO STOXX 50
Österreichische Volksbanken-Aktiengesellschaft	AT000B054861	EUROPA BONUS CZK
RAIFFEISEN CENTROBANK AG	AT0000489398	GOLD
Raiffeisen Centrobank AG	AT0000A07MY5	GOLD TS 935
RAIFFEISEN CENTROBANK AG	AT0000A00BQ9	GOLD TURBO LONG
Österreichische Volksbanken-Aktiengesellschaft	AT000B054275	CHINA BONUS III
Österreichische Volksbanken-Aktiengesellschaft	AT000B053954	KB DISCOUNT
Barclays Bank PLC	XS0322226415	KOMODITY PLUS
Österreichische Volksbanken-Aktiengesellschaft	AT000B054721	PX INDEX CERT.
RAIFFEISEN CENTROBANK AG	AT0000A04GH9	PX TURBO LONG I.
RAIFFEISEN CENTROBANK AG	AT0000A04GJ5	PX TURBO LONG II.
RAIFFEISEN CENTROBANK AG	AT0000481221	RDX
RAIFFEISEN CENTROBANK AG	AT0000A04WA1	ROTX TL
RAIFFEISEN CENTROBANK AG	AT0000A04KP4	S-BOX DIMAX
RAIFFEISEN CENTROBANK AG	AT0000A04WF0	SETX TL
Österreichische Volksbanken-Aktiengesellschaft	AT000B054515	SRX INDEX CERT
Österreichische Volksbanken-Aktiengesellschaft	AT000B053947	TELEFONO2 DISCOUNT
Raiffeisen Centrobank AG	AT0000A05VC6	WHEAT TL 519
Raiffeisen Centrobank AG	AT0000A078Z5	WHEAT TS 10,4
RAIFFEISEN CENTROBANK AG	AT0000A04E86	ŽELEZNÁ RUDA TL

Annex 17

Bond programmes approved in 2007
(in CZK)

Issuer	Maximum volume	Duration
Komerční banka, a.s.	150,000,000,000	30 years
Česká pojišťovna, a.s.	10,000,000,000	10 years

Annex 18

Publicly offered unlisted shares
(in CZK)

Issuer/Offeror	Face value	Volume
Rybena CZ, a.s.	332.5	19,138,700
ČESKÁ INVESTIČNÍ A SPRÁVCOVSKÁ, a.s.	195.-	219,400,155
AWO-Plzeň a.s.	45.-	20,365,650
Otavské strojírny, a.s.	30.-	21,000,000
PLIVA – Lachema a.s.	1000.-	400,000,000

Annex 19

Mandatory takeover bid after gaining control over the target company or acquiring a 2/3 or 3/4 share of the voting rights in the target company

Bidder	Target company	Decision
Via Chem Group, a.s.	Spolek pro chemickou a hutní výrobu, akciová společnost	Halted 1x, Approved 1x
MUDr. Oldřich Šubrt	MEDICAMENTA, a.s.	Halted 1x, Approved 1x
ČKD PRAHA HOLDING, a.s.	ČKD PRAHA DIZ, a.s.	Approved
Glenmark holding S.A.	MEDICAMENTA, a.s.	Approved

Annex 20

Public contract offer following the decision of the bidder's General Meeting to delist shares

Bidder	Decision
Vodovody a kanalizace Hradec Králové, a.s.	Approved

Annex 21

Squeeze-outs

Bidder (Main shareholder)	Target company	Decision
LESS a.s.	Krušnohorské lesy, a.s.	Halted 1x, Approved 1x
CIMEX PRAHA a.s.	INTERHOTEL VORONĚŽ a.s.	Approved
Zemědělské zásob. a nákup Louny, a.s.	Zemědělské zásobování v Teplicích, a.s.	Approved
Calabrone s.r.o.	DELTA CENTER a.s.	Not approved
S.M.K., a.s.	EKOFOND a.s. v likvidaci	Approved
Stoklásek Lubomír	AGROSTROJ Pelhřimov, a.s.	Approved
Ing. Dobiáš Milan	HUTNÍ PROJEKT OSTRAVA, a.s.	Approved
H & S PROGRESS s.r.o.	VÚHŽ NEMO a.s.	Approved
H & S PROGRESS s.r.o.	VÚHŽ a.s.	Approved
Ing. Josef Brettl, CSc.	PRAGA Strašnice a.s.	Approved
KBC Bank, N.V.	Československá obchodní banka, a.s.	Approved
BRIXEN LIMITED	ZAT a.s.	Not approved
SEAFORD LIMITED	MORAVIA CANS a.s.	Approved
Ing. Jan Frídl	STS Přerov, a.s.	Approved
Dalkia Česká republika, a.s.	Elektrárna Kolín a.s.	Approved
EKO-LIMA, s.r.o.	MEVA a.s.	Not approved 2x, Approved 1x
KKCG Investments B.V.	Cestovní kancelář FISCHER, a.s.	Approved
CHRIŠTOF, spol. s r.o.	PRAKOM Brno, a.s.	Halted 1x, Approved 1x
Telor International Limited	HMZ, a.s.	Approved
HENDON a.s.	Jihostroj a.s.	Approved
ČKD PRAHA HOLDING, a.s.	ČKD PRAHA DIZ, a.s.	Approved
AGROFERT HOLDING, a.s.	Kostelecké uzeniny, a.s.	Approved
BRIXEN LIMITED	ZAT a.s.	Approved
JUDr. Ing. Zdeněk Zemek	Železárny Veselí, a.s.	Halted
Glenmark holding S.A.	MEDICAMENTA, a.s.	Approved
MMM Münchener Medizin Mechanik	BMT a.s.	Approved
BRE/Hospitality Czech, a.s.	Gestin Holding, a.s.	Approved
Ing. Tomáš Tvrzský	TELEMATIX SERVICES, a.s.	Not approved
ODS – Dopravní stavby Ostrava, a.s.	Beskydská svatební, a.s.	Halted 1x, Approved 1x
Petr Koutecký	Agroslužby Bruntál a.s.	Approved
S – Media a.s.	AZ Media a.s.	Not approved
SWECO Eastern Europe AB	HYDROREAL a.s.	Approved
SWECO Eastern Europe AB	HYDROPROJEKT CZ a.s.	2x Not approved
FINSERVUS (TRUSTEES) LIMITED	SIGMA GROUP a.s.	Approved
Conti Capital, a.s.	Kovopol a.s.	Approved
Dimension Financial Services N.V.	Dimension, a.s.	Approved
EXIMAT a.s.	Česká zbrojovka a.s.	Approved
AVE CZ odpadové hospodářství s.r.o.	Západočeské sběrné suroviny a.s.	Halted 1x, Approved 1x
Speditions Holding GmgH	Česká a slovenská kombinovaná doprava – INTRANS a.s.	Approved
Expandia Holding N.V.	JITONA a.s.	Approved

Annex 21

Squeeze-outs (continued)

Bidder (Main shareholder)	Target company	Decision
ELTODO, a.s.	ELTODO EG, a.s.	Halted 1x, Approved 1x
Stoklásek Lubomír	VUCHZ, a.s.	Approved
GASCONTROL, společnost s r.o.	Moravský Plynostav, a.s.	Approved
REGA Přerov a.s.	TOPOS PREFA Tovačov a.s.	Not approved
AGROSTROJ Pelhřimov, a.s.	Humpolecké strojírny Humpolec, a.s.	Approved
LUKROM, spol. s r.o.	Zemědělské zásobování a nákup Vyškov, a.s.	Approved
Čestmír Velíšek	LARM a.s.	Not approved
SAFINA, a.s.	Chemoprojekt, a.s.	Halted
Spěváček Lubomír	KERAMOST, akciová společnost	Not approved
GARDEA, a.s.	Chladící věže Praha, a.s.	Approved
PROMABYT SLOVAKIA, a.s.	ČSAD Vsetín a.s.	Approved
SEGFIELD INVESTMENTS LIMITED	První brněnská strojírna Brno DIZ, a.s.	Approved
Stoklásek Lubomír	Moravská Agra a.s. Velké Pavlovice	Approved
KOVOTEK, s.r.o.	PANAV, a.s.	Not approved
Ing. Tomáš Tvrzský	TELEMATIX SERVICES, a.s.	Not approved

Annex 22

Gross premiums written by classes of insurance in 2007

PART A	
CLASSES OF LIFE ASSURANCE	**Gross premiums written**
1. Assurance on death only, assurance on survival only, assurance on survival or earlier death, joint life assurance, money back term assurance	24,874,431
2. Marriage assurance or insurance of benefits for child maintenance	2,432,276
3. Annuity assurance	2,577,237
4. Assurance referred to in 1 through 3 which is linked to an investment fund	18,389,974
5. Capital operations	207,403
6. Personal accident and sickness insurance if supplementary to classes of insurance 1 through 5	5,659,513

PART B	
CLASSES OF NON-LIFE INSURANCE	**Gross premiums written**
1. Accident insurance	2,630,604
2. Sickness insurance	1,092,639
3. Insurance against damage to or loss of land vehicles other than railway rolling stock	16,214,049
4. Insurance against damage to or loss of railway rolling stock	14,261
5. Insurance against damage to or loss of aircraft	125,973
6. Insurance against damage to or loss of vessels	15,935
7. Insurance of goods in transit including luggage and other property irrespective of means oftransport used	468,776
8. Insurance against damage to or loss of property other than referred to in 3 through 7 above	10,969,215
9. Insurance against damage to or loss of property other than referred to in 3 through 7 above due to hailstorm or frost, or any other event (such as robbery, theft or damage caused by forest animals) unless these are included in class 8, inclusive of insurance against damage to or loss of farm animals caused by infection or by other causes	6,752,484
10. Liability insurance for damage arising out of use of land motor vehicle and its trailer, use of rail vehicle and the activity of the carrier	23,375,779
11. Liability insurance for damage arising out of ownership or use of aircraft, including carrier's liability	129,939
12. Liability insurance for damage arising out of ownership or use of inland or sea vessel, including carrier's liability	8,953
13. General liability insurance for damage other than referred to in classes 10 through 12	10,424,958
14. Credit insurance	3,133,975
15. Suretyship insurance	206,659
16. Insurance of miscellaneous financial losses	1,250,486
17. Legal expenses insurance	246,400
18. Assistance insurance to persons who get into difficulties while travelling or while away from their residence, including insurance of financial losses directly connected to the travelling (assistance services)	1,698,322

Annex 23

AN ECONOMETRIC MODEL FOR ANALYSIS AND PREDICTION OF THE EVOLUTION OF THE BANK CONSUMER CREDIT MARKET

The Czech Republic has been recording very dynamic growth in bank consumer credit in recent years. As of 31 December 2002 bank consumer credit amounted to CZK 44 billion, but by the end of 2007 it had more than tripled to CZK 138 billion. This represents year-on-year increases of between 20% and 40%. Consumer credit thus rose substantially faster in this period than households' nominal gross disposable income, which rose from CZK 1,342 billion in 2002 to CZK 1,753 billion in 2007, representing year-on-year percentage increases of less than 10%. See Chart 1.

From the point of view of both banking practice and banking supervision, consumer credit is one of the riskier forms of credit. This fact is reflected by a mostly double-digit proportion of classified loans and by generally double-digit interest rates in the period under review. See Chart 2.

Although the ratio of bank consumer credit to households' annual gross disposable income increased from 3% to 7% in 2002–2007, it remains low compared to the USA and some other advanced countries. However, the current very dynamic growth raises the question of what sort of long-term equilibrium is taking shape on the bank consumer credit market and what sort of growth in such credit can be expected in 2008. The growth raises also the question of what overall tendency is emerging as regards the quality of bank consumer credit, or the proportion of classified consumer credit, and the question of what interest rates will be charged on such credit. In the latter case, the main issue is whether market competition will lead to a general fall in interest rates below the level that adequately covers the credit risk.

It is clear that the volume and quality of bank consumer credit is determined above all by market participants themselves, based on their preferences and the information available to them. That said, an unbiased view on the bank consumer credit market from the perspective of aggregate figures is also meaningful, since it enables us to identify and quantify the trends and risks unfolding on the market as a whole. These trends and risks may not be as clear from the data for individual institutions as if we focus on the market as a whole and abstract from otherwise fundamental (from the point of view of banks' profitability and financial soundness and from the banking supervision point of view) microeconomic processes, be those processes quantitative, i.e. the construction, testing and validation of models for credit risk assessment, or qualitative, such as the functioning of risk management and internal control systems in individual banks. In this context, and with the aim of answering the above questions, certain macroeconomic variables have been identified which might help to explain the volume and quality of bank consumer credit on the aggregate level and, based on the literature,[1] a vector auto-regression model has been proposed for the variables identified.

Because we are asking about the long-term equilibrium on the bank consumer credit market, and because we want to use information contained in the data on

CHART 1
Year-on-year growth in households' disposable income and bank consumer credit
(in %)

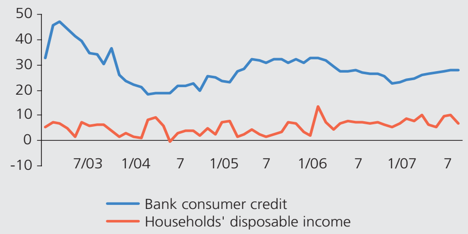
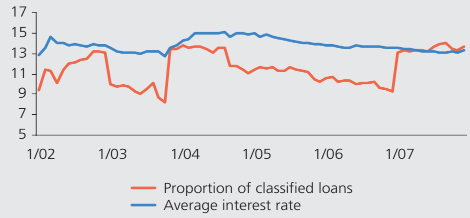


CHART 2
Proportion of classified loans and average interest rate on bank consumer credit
(in %)



1 Hoggarth, G., Sorensen, S., Zicchino, L. (2005): *Stress Tests of UK Banks Using a VAR Approach*, Bank of England Working Paper Series, November 2005, No. 282.

Calza, A., Manrique, M., Sousa, J. (2003): *Aggregate Loans to the Euro Area Private Sector*, ECB Working Paper Series, January 2003, No. 202.

the volume of this credit which is not clear from the growth figures alone, and finally also because we need to avoid the problem of spurious regression, we propose a vector auto-regression model in the form of vector error correction. The model is expressed by the following equation:

$$(1) \quad \triangle y_t = \mu + \Gamma(L) \triangle y_{t-1} + \alpha\beta' (y_{t-1}) + \varepsilon_t$$

where:

y_t is the vector of endogenous variables including nominal bank consumer credit in CZK billions (cl), households' nominal gross disposable income in CZK billions (hdy),[2] the average nominal interest rate on bank consumer credit in per cent (ispot) and the share of classified loans in bank consumer credit (dr), mostly involving seasonally adjusted monthly time series for the period January 2002 – September 2007

μ is a constant vector

Γ (L) is the matrix for the process with five lags

α is the vector of coefficients for the process of adjustment of the endogenous variables to equilibrium

β' is the vector of coefficients of the cointegration relationship.

The model contains one cointegration relationship expressed by the following equation:

$$(2) \quad cl = 1.9hdy + 0.315ispot - 1.16dr + 0.4trend - 174.25$$

In the macroeconomic modelling literature, the cointegration relationship is usually interpreted as an expression of long-term equilibrium, so we can say that equation (2) describes the long-term equilibrium on the Czech bank consumer credit market (see Chart 3). Equation (2) then supports the hypothesis that the growth in bank consumer credit recorded to date constitutes a sound, demand-driven credit expansion, because the equilibrium on the market is crystallising in the form of a direct correlation between the volume of such credit and households' disposable income and, conversely, an indirect correlation between the volume of such credit and the proportion of classified credit in it. As regards interest rates, the direct correlation between the average interest rate and the volume of credit is not consistent with the assumptions of economic theory concerning competitive markets. Nevertheless, it would be premature to draw any conclusions without conducting a deeper microeconomic analysis of the competitive environment on the market under analysis, and so we leave open the issue of the economic interpretation of this result for the time being.

The forecast based on the model tells us that in December 2008 bank consumer credit is likely to amount to around CZK 160 billion (baseline), within the range[3] of

CHART 3

Bank consumer credit and estimated equilibrium

(in CZK billions)

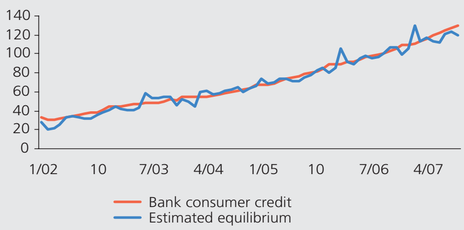
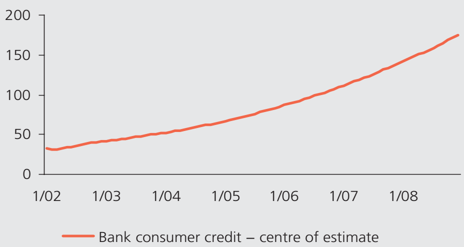


CHART 4

Estimated volume of bank consumer credit

(in CZK billions)



2 The monthly time series (hdy) was constructed from the quarterly time series (hdyq) using monthly data on mandatory social and health insurance (csins) via identity (3) on the basis of a strong (0.98) correlation between hdyq and csins.

$(3)\ HDY_{(t = 1...3)} = (HDYQ/ \Sigma\ CINSM_{(t = 1...3)})\ CINSM_{(t = 1...3)}$

3 The range for each forecast here is given by two standard deviations of the time series of the relevant endogenous variable for the period January 2002 - September 2007. This range is often interpreted as the 95% confidence interval.

CZK 100 billion to CZK 200 billion (see Chart 4). This result suggests a possible slight slowdown in the current rate of growth of the bank consumer credit market to 10%–20% year on year.

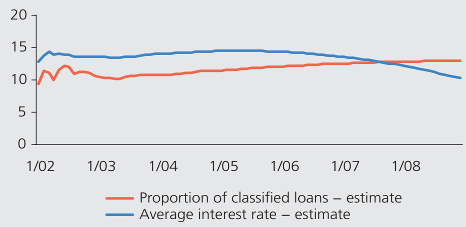
According to the forecast, the proportion of classified credit in bank consumer credit at the end of 2008 should be around 13% (baseline), within the range of 10–16%. As of the same date, interest rates should be around 11% (baseline), with an interval of 10–12.5% (see Chart 5). If we consider that in the first three quarters of 2007 classified credit accounted for 13.4% of bank consumer credit on average and the average interest rate was 13.3%, the forecast suggests that the coverage of the proportion of classified credit by the interest rates on such credit could decrease during 2008, and so elements of unsound credit expansion could emerge on the market. In addition, stress tests conducted using the model indicate that the quality of bank consumer credit could worsen quite significantly, amid a decline in its volume, especially if interest rates on such credit were to fall at the same time. It can be deduced from all of this that the risk of a deterioration in the quality of bank consumer credit rises mainly when the price competition on this market intensifies.

We should add that the model has its strengths and weaknesses from the econometric point of view. The weaknesses can be attributed mainly to the fact that high-quality data on bank consumer credit and on classified bank consumer credit have been available only since 2002. This fundamentally limits the scope for choosing the number of endogenous variables and lags that can be included in the model. From the methodological point of view, this implies that the model represents just the start of the research that will be used to analyse the evolution of the consumer credit market and, in the future, other credit market segments (research that will also include advanced statistical methods) and that the weaknesses will gradually be eliminated as the time series lengthen. From the objective point of view, it implies that results of the simulations conducted using the model must be taken with a pinch of salt.

CHART 5

Estimated quality of bank consumer credit and average interest rate on such credit

(in %)



Issued by:
CZECH NATIONAL BANK
Na Příkopě 28
115 03 Prague 1
CZECH REPUBLIC

Contact:
COMMUNICATIONS DEPARTMENT
Tel.:+420 22441 3494
Fax: +420 22441 2179

http://www.cnb.cz

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