FINANCIAL MARKET SUPERVISION REPORT

2008

CZECH NATIONAL BANK

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CZECH
NATIONAL BANK

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CONTENTS

Under the powers vested in it by law and in accordance with its mission[1], the Czech National Bank 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 an efficient financial market based on well-functioning financial institutions are a prerequisite for sound economic development. 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, on increasing its transparency and competitiveness and its credibility in the eyes of the public, and on supporting entrepreneurship. The CNB strives to be seen as a competent, dynamic and flexible open institution recognised by the market, the public and specialists for working to exacting standards and for taking a professional, sensitive, yet effective approach to financial market regulation and 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 of financial institutions and other institutions making up the infrastructure of the financial market. The CNB also uses other tools of integrated regulation and supervision, including remedial measures and, where appropriate, penalties where it uncovers shortcomings, and also the collection, processing 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. If unexpected events occur outside or inside the financial sector, the CNB exercises its right to require the information needed to monitor the current situation in the financial sector and, after assessing that information, makes decisions regarding necessary measures.

In connection with the integration of financial market supervision, 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.

This report is also intended to inform the public about financial market supervisory activities and financial market developments in the previous year.

The report consists of two parts. Part A deals with financial market supervision in 2008, 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 credit institutions, the capital market and the insurance sector) in 2008.

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 on 11 June 2009.

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.*

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 Arbitrator of the Czech Republic (who replaced his predecessor Otakar Schlossberger on 2 January 2008),
- Klára Hájková, Deputy Finance Minister (who replaced Milan Šimáček on 1 October 2008) and Jiří Król, Executive Director of the Financial Market Analysis and Development Department (this position was held by Klára Cetlová until 1 May 2008 and then by Libuše Horáková until 30 September 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 Committee should meet at least twice a year. In the previous period (i.e. since it issued its opinion on the Financial Market Supervision Report for 2007) it met on 29 October 2008 and 17 March 2009. Between its meetings, the Committee deals with operational and routine matters in compliance with its Rules of Procedure by electronic communication.

The Committee is regularly (twice a year) informed by the CNB of the main financial market supervisory activities (pursuant to Article 45c(3) of the Act on the Czech National Bank) and also issues its opinion on the Financial Market Supervision Report.

The Committee also discussed the proposals approved by the Government for the preparation of a new act on private pension insurance/saving, which defines one of the key items of the second stage of the pension reform. When evaluating the draft, the Committee emphasised that intelligibility and clarity for all system participants (i.e. clients, providers, the state) should be one of the core aspects of the new act.

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.

From the second half of 2008 onwards, the CNB's management informed the FMC regularly and in detail about the current situation in the Czech financial market in the context of the financial crisis and on measures taken in the financial market supervision area. In this regard, the Committee also discussed in detail the European Commission's report on the reform of supervision (the de Larosière report), which may have a strong effect on the functioning of the Czech financial market.

Consumer protection and promotion of financial literacy are other significant topics addressed by the Committee on a regular basis. On 1 September 2008, a Consumer Protection Department was established at the CNB and the Committee was informed about its work. This issue also covers the activities of the Financial Arbitrator; in the past period the Committee was also informed about his activities in 2003–2008.

Over its three years of life, the Financial Market Committee has become 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 2008

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. The draft report was discussed by the Committee in two parts (first Part A and then Part B). The Committee members were able to 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.

The Committee members studied in detail the financial sector's performance last year and stated that, notwithstanding the highly dramatic events in global financial markets, the situation on the domestic market was relatively stable. Nevertheless, the Committee also said that the Czech financial system had not avoided some problems. The banking sector had experienced a temporary drop in liquidity and default loans had started to rise at the year-end, largely due to the decline in economic growth caused by the crisis. According to the Committee, the other segments hit most seriously by foreign developments were mutual and pension funds.

To sum up, the Financial Market Committee, being aware that the final version of the Financial Market Supervision Report for 2008 must also be approved by the CNB Bank Board, acknowledges this draft report and has no reservations about its content.

Prague, 4 June 2009

On behalf of the Financial Market Committee:

Jiří Rusnok, Chairman

Following the integration of supervisory activities into the CNB in April 2006, the Czech National Bank started to perform supervision as a fully functionally integrated supervisory authority on 1 January 2008. 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. The databases of all reporting financial entities were unified in this period. In the second half of 2008, the CNB, as a supervisory authority, closely monitored selected areas of financial institutions' activities on a daily basis in connection with the crisis in global financial markets.

At the end of 2008, the CNB was supervising 21 banks and building societies, 17 credit unions, 35 insurance undertakings, 10 pension funds, 8 depositories, 142 open-end mutual funds, 27 non-bank investment firms and almost 3,000 non-bank foreign exchange entities. To a limited extent, the CNB was also supervising 16 branches of foreign banks and monitoring the activities of 17 branches of insurance undertakings from the EU and 1 branch of an insurance undertaking 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. Broker licensing and keeping a register of investment and insurance intermediaries are also part of CNB regulation and supervision. The CNB also administers the Central Credit Register, 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).

The involvement of CNB staff in international and European structures remained an integral part of supervision in 2008. Following the integration of financial market supervision into the CNB, the supervisory departments, organised under a functional model, together formulate and communicate to international institutions single opinions on common issues. Exchange of information and cooperation with foreign partner supervisors is always beneficial to supervisory work.

The changes made to the financial market legislation in 2008 mostly related to the transposition of European directives regulating financial market undertakings. The Act on Banks, the Capital Market Undertakings Act, the Payment System Act, the Act on Certain Measures against Money Laundering and Terrorist Financing and the Act on Consumer Protection, for example, were all amended. More legislative changes are expected in 2009, in particular an amendment of the Capital Market Undertakings Act and new laws on insurance and pension saving. A statement of intent for a financial market supervision act is expected to be released in 2010.

The exercise of supervision in 2008 was again based on a combination of ongoing off-site surveillance of regulated entities and comprehensive or partial on-site inspections. Off-site surveillance focuses on comprehensive monitoring of the overall situation and, in particular, the financial condition of supervised entities based on all reported data and other 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 risks undertaken and verification of the effectiveness of internal control systems. In 2008, both off-site surveillance and on-site examinations were subject to close monitoring owing to the financial market crisis.

The global financial crisis continued into 2008. The Czech financial markets proved to be very resilient to these problems again in 2008, and the direct impacts of the global market volatility were assessed as negligible. The CNB regularly monitored the situation in the markets and in the banking sector. An extraordinary daily reporting duty, concentrating mainly on liquidity and deposit volumes, was introduced. This regular monitoring revealed no major adverse signs in the period under review.

As regards the number of banks and their ownership, the Czech banking sector has been unchanged for several years now. At the end of 2008, a total of 37 banks and foreign bank branches were operating on the market. In addition, 252 banks from EU countries were allowed to provide banking services in the Czech Republic under the freedom to provide services and the relevant notification. The CNB received 57 such notifications during 2008. About 97% of the banking sector's assets are directly or indirectly controlled by foreign entities.

The assets of the banking sector rose more moderately in 2008 – by 7.9% to CZK 4,045.5 billion. Loans provided to clients continued to grow. Loans to non-financial corporations increased by 14.1% to CZK 848.1 billion. Loans to individuals continued growing, albeit at a much lower rate (20.9%). The total value of these loans exceeded CZK 800 billion. Loans for house purchase, which rose by 20.1% and exceeded CZK 614 billion, accounted for almost 76% of all loans provided to households. Mortgage loans increased further in 2008 (by more than CZK 63 billion) to account for more than 49% of all loans to households. Consumer credit showed the fastest growth, reaching CZK 169.1 billion, but its annual growth rate also moderated to 22.8%.

Of all the standard banking sector risks, credit risk is still the most significant as regards the structure of bank transactions. Loans are divided into default receivables and non-default receivables based on an assessment of their quality. Performing loans, assessed as standard loans, made up a large majority of the investment portfolio (almost 94%) at the end of 2008. The increase of 37.1% in the value of all default loans to CZK 71.7 billion in 2008 was due to lower economic growth at the end of 2008 and a reduced ability of both non-financial corporations and households to repay their obligations. Half of the default loans consisted of loans in default for more than a year, although their share in total default loans decreased year on year.

Domestic banks still focus mainly on the domestic market. The share of transactions with non-residents and the share of foreign currency activities are relatively low. The banking sector's exposure to country and foreign exchange risk remains limited. 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 recorded no major liquidity problems and still has enough liquid funds. Sufficient primary funds are available to finance the loans of the banking sector.

The capital adequacy of the Czech banking sector is also sufficient. It edged up to 12.3% in 2008. Total regulatory capital increased by 9.0% to CZK 231.0 billion. Tier 1 increased thanks mainly to retained earnings. 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 95% of total regulatory capital. By contrast, the capital requirements of the banking sector grew at a lower rate (2.1%). In 2008, banks made capital savings thanks to the implementation of Basel II, which entails a new approach to the identification of risk and corresponding new methods of risk measurement.

In 2008, the Czech banking sector was successful as regards profit generation. The decline in economic growth had not yet been fully reflected in banks' profits by the end of 2008. The banking sector generated an unconsolidated net profit of CZK 45.7 billion, down by only CZK 1.3 billion compared to the previous record year. The main source of the growth in net profit was an increase in profit from financial activities. Turning to the individual categories, interest profit showed a strong increase in 2008, accounting for more than 70% of total profit from financial activities. Profit from fees and commissions rose by less than 1%, to CZK 36.1 billion. Administrative costs rose by 3.4% to CZK 61.7 billion. At CZK 8.4 billion, aggregate income tax decreased by CZK 3.8 billion year on year.

At the end of 2008, the credit union sector consisted of 17 active credit unions. The number of credit union members fell to 35,921 in 2008, i.e. by around 13%. The sector has seen relatively rapid growth in recent years. In 2008, the sector's assets increased by 34.8% to CZK 12.1 billion. The credit union sector posted a profit of CZK 75.6 million, although the rate of profit growth was 8.6% lower than in 2007.

The shocks to world markets associated with the global financial crisis also affected the Czech capital market. In 2008, and particularly in the second half of the year, the collective investment sector recorded a decrease in assets of collective investment funds (owing both to withdrawals of invested funds by investors and to a fall in fair value). Adverse developments in the pension fund sector also necessitated a specific approach by the CNB, especially given the escalating valuation differences item and the need to maintain necessary capital adequacy.

The situation in regulated markets was marked by a full-year decline in prices and by lower trading volumes. Share trading on the Prague Stock Exchange amounted to CZK 852.0 billion, down by 15.9% from CZK 1,013.0 billion in 2007. By contrast, bond trading rose by 26.4% to CZK 643.2 billion from CZK 508.9 billion. The RM-S market also saw a decline in total trading volumes. RM-S, which had previously been an over-the-counter market, was converted into a regulated market on 1 December 2008. The capital market situation is documented by the evolution of the main indices on both organised markets: the PSE's PX index stood at 858.2 points at the end of 2008 (down by 52.7% from 1,815.1 points a year earlier) and the RM index decreased by 42.9% year on year to 1,943.9 points.

The number of investment firms licensed by the CNB declined by six to 38 in 2008, of which 11 were bank investment firms. As of 31 December 2008, a total of 840 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 1.4 million contracts with clients (a year-on-year increase of 9.3%), of which almost 239,000 were active clients.

In 2008, investment firms executed spot transactions worth CZK 28,061 billion (up by 11.2% compared to 2007), of which transactions worth CZK 9,376 billion were for clients (up by 1.6% year on year) and transactions worth CZK 18,685 billion were for their own account (up by 18.2% year on year). The concentration ratios suggest that the investment firm market is relatively unconcentrated from the point of view of the volume of transactions executed by individual firms in 2008.

At the end of 2008, the CNB registered 27 licensed non-bank investment firms, with total equity capital of CZK 2,851 million. The volume of own funds thus exceeded the required level as of 31 December 2008, with the capital requirements for the individual types of risks reaching CZK 968 million. In aggregate terms, the capital adequacy ratio was about 24%.

A total of 20 management companies were operating on the Czech collective investment market at the end of 2008. These companies managed 142 open-end mutual funds, 41 of them standard funds and 101 special funds. A total of 1,569 foreign funds and 40 foreign management companies had made valid notifications.

The impact of the global financial crisis was also visible in the collective investment sector, particularly in the second half of the year. The assets managed by collective investment funds open to the public decreased by CZK 51.4 billion to CZK 122.9 billion in 2008. Assets in mutual funds thus to a large extent followed the trend in the capital markets. Consequently, equity funds ended 2008 with the worst results, losing more than half of their asset value. The largest nominal fall in asset value was recorded by money market funds (CZK 21.0 billion). As regards investment structure, investments in shares and similar investment securities recorded the largest decrease (46% of the end-2007 value), while long-term bonds showed the smallest decrease (80% of the end-2007 value).

A total of 10 pension funds were active in the private pension scheme market in 2008. At the end of the period under review they managed assets totalling CZK 191.7 billion (up by 14.7% from CZK 167.2 billion at the end of 2007). There were 4.2 million private pension planholders at the end of 2008. The sector's accumulated net profit fell from CZK 4.4 billion to CZK 718 million year on year (down by 83%). The sector's equity capital decreased during the year, owing mainly to the valuation differences item (which was minus CZK 8.5 billion at the end of 2008).

A total of 35 domestic insurance companies, 1 reinsurance company and 18 branches of foreign insurance companies, of which 17 were from EU countries, were operating on the Czech market at the end of 2008. The number of insurance undertakings and branches of insurance undertakings from other EU or EEA Member States offering insurance in the Czech Republic under the freedom to provide services continued to climb. There were 554 such undertakings and branches at the end of 2008, a rise of 76 year on year. The proportion of Czech shareholders in the total share capital of domestic insurance undertakings fell by 4.2 percentage points compared to 2007, to 24.8%.

In addition to the heightened uncertainty on the financial and labour markets, 2008 was characterised by a slowdown in the relatively high growth rate of premiums written recorded in 2007, when gross premiums had increased by 8.8%. This indicator rose by 5.2% to CZK 139.9 billion in 2008. The decrease in the growth rate of total gross premiums written was largely due to a relatively marked decline in the rate of growth of life insurance, which moderated from 14.6% to 5.1%. The growth in non-life insurance was relatively stable compared to 2007, rising by just 0.1 percentage point to 5.3%. Non-life insurance accounted for 59.3% of total premiums written and life insurance for 40.7%. This ratio was unchanged at the 2007 level. The total market share of the 3 largest insurance undertakings declined by 1.2 percentage points year on year, while the shares of the 5 and 10 largest insurance undertakings decreased by 0.8 and 0.2 percentage point respectively.

The most important category of the non-life insurance market is still motor third party liability insurance, which, despite a slightly decreasing share, accounted for 29.1% of non-life insurance premiums written in 2008. The share of investment life insurance is rising, mainly at the expense of traditional life insurance products. It grew by 17.4% in 2008, with premiums written increasing to CZK 21.6 billion. Nonetheless, this insurance category also shows signs of a slowdown linked with the declining economic growth and with households' flight to more conservative investment alternatives.

Claim settlement costs totalled CZK 69.2 billion, rising by 12.5% year on year. The total assets of insurance undertakings stood at CZK 370 billion as of 31 December 2008. This represents an annual rise of 7.2%. Debt securities are the largest financial placement item in insurers' assets. Their value increased by 11.6% compared to 2007 and their share in total assets rose by 2.2 percentage points to 61.0%. The most important item in insurance undertakings' liability structure is technical provisions. The share of net technical provisions (excluding provisions for unit-linked life insurance) in total liabilities fell by 1.7 percentage point year on year to 66.7% at the end of 2008. Despite the adverse financial market situation and slowing economic growth in the Czech Republic in 2008, insurance undertakings operating on the Czech insurance market recorded a relatively high net profit (CZK 9.6 billion). Net profit fell by 22.6% year on year.

PART A
FINANCIAL MARKET SUPERVISION IN 2008

1. INTEGRATION OF FINANCIAL MARKET SUPERVISION

Since 1 April 2006, the Czech National Bank has been the integrated supervisor of the Czech financial market. With effect from January 2008, the original sectoral breakdown into three supervisory departments (banking, insurance and capital market supervision) was replaced by a functional organisational structure and three new supervisory departments with new responsibilities were established – the Financial Market Regulation and Analyses Department, the Licensing and Enforcement Department and the Financial Market Supervision Department. The new set-up has numerous advantages over the sectoral structure.

The CNB supervises entities operating on the financial market, analyses the evolution of the financial system, sees to the sound operation and development of the financial market in the Czech Republic, and contributes to the stability of the Czech financial system as a whole. The CNB also works in close partnership with the Czech Ministry of Finance and other state authorities to create a single strategy and unified rules applying to financial market regulation and supervision. When performing its tasks, the CNB cooperates with central banks and authorities supervising the financial markets of other countries and with international financial institutions and international organisations engaged in financial market supervision.

In the financial market area, the CNB focuses on supervision of banks, branches of foreign banks, credit unions, electronic money institutions, branches of foreign electronic money institutions and other entities that issue electronic money and supervision of the sound operation of the banking system. It also supervises insurance companies, reinsurance companies, pension funds and other entities operating in the financial market area under special legal rules, as well as investment firms, securities issuers, entities keeping a register of investment instruments, management companies, investment funds, settlement system operators, investment instrument market operators and other persons specified in special legal rules governing capital market undertakings.

Financial market supervision also covers decisions on applications for licences, authorisations and prior approvals pursuant to special legal rules; inspection of adherence to the conditions stipulated in licences and authorisations; inspection of adherence to laws insofar as the CNB has the power to conduct such inspections under special legal rules, and inspection of adherence to the decrees and provisions issued by the CNB; collection and enforcement of information needed to perform supervision pursuant to special legal rules and verification of whether such information is true, complete and up-to-date; imposition of remedial measures and penalties pursuant to the Act on the CNB and special legal rules; and proceedings regarding administrative offences.

In cooperation with the Czech Ministry of Finance, which is responsible for the preparation of laws in the financial market area, the Czech National Bank participates in the preparation of primary legislation and is responsible for the preparation of secondary legislation. It issues implementing legal rules in the form of decrees and provisions.

The CNB informs the Financial Market Committee about its main activities in the financial market supervision area every six months. This annual Financial Market Supervision Report[3], containing information on the CNB's supervisory activities and on developments in the individual segments of the financial market, is submitted for information to the Chamber of Deputies, the Senate, the Czech Government and the public.

3 This Report is also published in printed form (in Czech and English). Information on financial market supervision and regulation relevant to both specialists and the public is also available on the CNB website.

2. LEGISLATIVE CHANGES IN THE FINANCIAL MARKET SUPERVISION AREA IN 2008

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 2008.

Act on Banks

On 15 December 2008, an amendment to the Act on Banks was promulgated in the Collection of Laws which increases the compensation for insured deposits to 100% with a ceiling of EUR 50,000. This change was made in response to a joint agreement between Member States connected with the financial crisis that developed in the second half of 2008, and undoubtedly helped to calm depositors at a time of extraordinary shocks to world markets. The change was confirmed by the deposit insurance directive, the full transposition of which will require further legislative changes, particularly as regards the deadlines for payments from the Deposit Insurance Fund and a further increase in the insured deposit limit.

Amendment to the Capital Market Undertakings Act (MiFID)

An amendment to the Capital Market Undertakings Act was promulgated on 30 June 2008 under No. 230/2008 Coll. and took effect on 1 July 2008. The amendment transposes Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments (MiFID). It introduces numerous changes, for example the inclusion of investment advice among the core investment services, the introduction of tied agents, new disclosure duties (pre- and post-trade transparency), additional requirements for best execution, commission disclosure, etc. The amendment also contains other changes going beyond the MiFID framework (e.g. partial liberalisation of securities registers) and amendments of other acts, for example an extension of the permitted number of real estate items owned by one real estate company, a relaxation of the definition of mortgage loans, the possibility of converting commodity exchanges into joint stock companies and the possibility of commodity exchanges organising derivatives markets.

Amendment to the Capital Market Undertakings Act

On 12 February 2008, a minor amendment to the Capital Market Undertakings Act was promulgated under No. 29/2008 Coll., according to which the Guarantee Fund of Investment Firms can be financed from state budget subsidies or by repayable financial assistance from the state budget. The amendment came in response, among other things, to the adverse financial situation of the Guarantee Fund, which was unable to pay the outstanding claims of clients of bankrupt investment firms.

Payment System Act

Throughout the period under review the CNB was actively involved in the activities of a working group of the Ministry of Finance preparing a new payment system act that will transpose Directive 2007/64/EC on payment services in the internal market. A public consultation on discretions in the directive was evaluated in March 2008 and its results were published on the CNB and MoF websites. In 2008, the CNB also attended all the meetings on the preparation of the act with the Czech Banking Association, other associations and other industry representatives in order to ensure that the directive and the act are uniformly understood and interpreted. The bill of the new payment system act and a bill amending a number of laws affected by the directive were completed in January 2009. The bills were then circulated for comments from other government departments and key comments were dealt with by the group. The draft transposition payment system act and the accompanying amending act were submitted to the Government at the beginning of February 2009.

Act on Certain Measures against Money Laundering and Terrorist Financing (AML) and the act amending certain acts in connection with the adoption of the above act

Act No. 253/2008 Coll. on Certain Measures Against Money Laundering and Terrorist Financing and the accompanying Amendment No. 254/2008 Coll. were promulgated on 8 July 2008. The new AML Act reacts to the Third Money Laundering Directive. The Act lowers the threshold for client identification from EUR 15,000 to EUR 1,000, substantially extends the possibility of client identification being taken over from another person, and also extends the provisions on client due diligence for transactions of over EUR 15,000. The accompanying amendment to the Foreign Exchange Act also reflects MiFID requirements, i.e. foreign exchange licences will not authorise their holders to perform derivatives transactions and the definition of non-cash transactions will only include spot transactions. In connection with anti-money laundering measures, the licensing and registration requirements for foreign exchange entities will be enhanced to include the examination of "real owners".

Amendment to the Consumer Protection Act

An amendment to Act No. 36/2008 Coll., on Consumer Protection took effect on the date of its promulgation (12 February 2008). This amendment substantially extends consumer protection in the financial markets to include, for example, the prohibition of unfair commercial practices, the prohibition of discrimination and obligations with regard to pricing information. The CNB, which previously supervised only a very limited part of the consumer protection rules (conclusion of distance contracts for financial services), has been assigned the task of supervising compliance with the rules by regulated entities.

Act on Conversions of Commercial Companies and Cooperatives

Act No. 125/2008 Coll., on Conversions of Commercial Companies and Cooperatives took effect on 1 July 2008. This Act transposes the relevant EU directive and completely changes the form and structure of the present regulation of mergers. The CNB's competences are affected by the new possibility of cross-border mergers of investment funds, which has so far been irrelevant in practice.

Takeover Bids Act

The Takeover Bids Act was promulgated under No. 104/2008 Coll. and took effect on 1 April 2008. This Act makes changes to the procedure for approving takeover bids and in particular increases the CNB's responsibility for deciding on prices in the case of mandatory bids. By contrast, it substantially decreases this responsibility in the case of squeeze-outs, as squeeze-outs in non-listed companies are no longer subject to CNB supervision. In the case of listed companies, the CNB will no longer examine whether the price is objectively commensurate with the share value and will only evaluate whether it is sufficiently justified.

Act on the Activities of Institutions for Occupational Retirement Provision from Member States of the European Union within the Territory of the Czech Republic

Act No. 248/2008 Coll. amends the act giving access to institutions for occupational retirement provision from Member States of the European Union on the territory of the Czech Republic so as to harmonise all elements of the notification procedure, particularly the administrative procedure, with Directive No. 2003/41/EC on the activities and supervision of institutions for occupational retirement provision. This directive was transposed into Czech law only insofar as it allows institutions from other Member States to operate. The Czech Republic does not permit the establishment of domestic institutions.

The financial market and the performance of supervision were also affected by other laws:

Amendment to the Civil Procedure Code

In December 2008, the Czech Parliament completed the approval of an amendment to the Civil Procedure Code which, on the basis of intervention by the Czech National Bank and the Ministry of Finance, orders investment firms to sell securities that are subject to execution. The amendment was promulgated in the Collection of Laws on 8 January 2009 under No. 7/2009 Coll.

Amendment to the Act on the Criminal Register
On 19 March 2008, an amendment to the Act on the Criminal Register was promulgated (with effect from 1 July 2008). This amendment changes the method for proving integrity through the submission of extracts from the Criminal Register in proceedings before administrative authorities. The administrative authority must apply for the extract from the Criminal Register itself. In the case of the CNB, this easing of the administrative burden on applicants mainly concerns proceedings regarding applications.

2.2 DECREES AND PROVISIONS OF THE CZECH NATIONAL BANK

The CNB is entitled to issue implementing legal rules in the form of decrees and provisions. To issue an implementing regulation, authorisation is required.

2.2.1 Decrees

In 2008, legislative work was completed on decrees whose publication was associated with new laws in the financial market area.

In the capital market area, this included the preparation and publication of decrees relating to an amendment of Act No. 256/2004 Coll., on Capital Market Undertakings. The decrees came into effect simultaneously with the amendment to the Act on 1 July 2008 (except for the decree on specimen forms, which took effect on 11 July 2008, and the decree on prudential rules for management companies and investment funds, which took effect on 1 August 2008):

- ***Decree No. 237/2008 Coll., on the details of certain rules in the provision of investment services*** lays down rules for prudent provision of investment services and requirements for control systems and risk management, and also rules of conduct of investment services providers towards clients.

- ***Decree No. 238/2008 Coll., amending Decree No. 58/2006 Coll., on the manner of keeping separate records of investment instruments and records based on separate records of investment instruments*** reacts to changes to the Capital Market Undertakings Act and newly regulates the keeping of records of closed-end mutual fund units and investment fund shares.

- ***Decree No. 236/2008 Coll., on information duties of the operator of the regulated market and operator of a multilateral trading facility*** regulates the content, dates, manner and forms of information disclosure and submission of information to the CNB with a view to increasing market transparency.

- ***Decree No. 235/2008 Coll., on information duties of the settlement system administrator and the central securities depository*** stipulates the content, dates, manner and forms of submitting information needed to perform supervision to the CNB.

- ***Decree No. 234/2008 Coll., amending Decree No. 605/2006 Coll., on certain disclosure duties of an investment firm*** regulates the form and manner of notifying the CNB of transactions in listed investment instruments by investment firms.

- ***Decree No. 255/2008 Coll., on forms for lodging applications pursuant to the Act on Capital Market Undertakings and the contents of their annexes*** replaced Decree No. 268/2004 Coll. of the Czech Securities Commission. It contains specimen forms for lodging applications which by law are decided on by the CNB and specifies the content of their annexes.

- ***Decree No. 283/2008 Coll., amending an amendment to Decree No. 347/2004 Coll., on the manner of compliance with the prudential rules of management companies and investment funds*** reacts to an amendment to the Collective Investment Act effective from 1 July 2008. It took effect on 1 August 2008.

In the area of capital requirements for credit institutions and investment firms, an amendment to the decree incorporating the Basel II framework was issued:

- ***Decree No. 282/2008 Coll., amending Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms.*** This decree is linked to the amendment of the Capital Market Undertakings Act resulting from the implementation of the MiFID. It reflects the new insolvency act and further specifies some transposition provisions. It took effect on 1 September 2008.

In the area of foreign exchange regulation, a decree regarding the Foreign Exchange Act was prepared:

- ***Decree No. 280/2008 Coll., on bureau-de-change activity, non-cash foreign currency transactions and money services*** regulates the fundamental data to be given in applications for registration for bureau-de-change activity or for foreign exchange licences. Foreign exchange entities are obliged to report any changes in these data to the CNB without undue delay. It also regulates the manner of informing the clients of foreign exchange entities about the terms of buying and selling foreign currencies, the exchange rates applied and the prices of services provided, and lays down the conditions for performing non-cash foreign currency transactions and the structure of data reported regarding the quantity of foreign currencies bought and sold and the time limits and manner of reporting. The decree took effect on the same date as the amendment to the Foreign Exchange Act, i.e. on 1 September 2008.

In the AML area, the following decree was issued.

- ***Decree No. 281/2008 Coll., on selected requirements regarding the system of internal principles, procedures and control measures against the legitimisation of the proceeds of crime and financing of terrorism,*** which harmonises the requirements for entities supervised by the CNB and fully replaces Decree No. 247/2007 Coll., stipulating certain requirements for the governance of banks and credit unions. The decree took effect on the same date as the corresponding act, i.e. on 1 September 2008.

2.2.2 Provisions

The following provisions were published in the CNB Bulletin in 2008 regarding the reporting duties of banks, credit unions and electronic money institutions with effect from 1 January 2009:

- ***Provision of the Czech National Bank No. 1 of 11 November 2008, amending Provision No. 3 of 25 June 2007, on reporting by credit unions to the Czech National Bank;***

- ***Provision of the Czech National Bank No. 2 of 28 November 2008, on reporting by banks and foreign bank branches to the Czech National Bank;***

- ***Provision of the Czech National Bank No. 3 of 16 December 2008 on disclosure of information by electronic money institutions.*** The provision implements the authorisation contained in the Payment System Act and regulates the scope of data reported on shareholder structure and on activities and also the financial indicators which an electronic money institution is obliged to publish on a quarterly basis, and the manner of disclosure thereof;

- ***Provision of the Czech National Bank No. 4 of 16 December 2008 on reporting by electronic money institutions to the CNB.***

2.3 OFFICIAL INFORMATION

The CNB issued the following official information documents in 2008:

- Official information of 15 February 2008, issuing the methodology for handling internal information by issuers of listed investment instruments.
- Official information of 22 February 2008 regarding the publication of the rules for examination of insurance agents and insurance brokers.
- Official information of 15 April 2008 regarding mandatory hunting liability insurance, which specifies the obligations of insurance undertakings in the settlement of damages arising from mandatory hunting liability insurance.
- Official information of 12 May 2008 regarding the prudential rules for banks, credit unions and investment firms – transitional provision for the treatment of covered bonds.
- Official information of 24 June 2008 amending the Annex of the Official Information of the Czech National Bank of 18 July 2007 regarding the prudential rules for banks, credit unions and investment firms – operational risk.
- Official information of 7 July 2008 providing information about the practice of the Czech National Bank regarding an extract or a copy from the Criminal Register in administrative proceedings in connection with the amendment to the Act on the Criminal Register effective from 1 July 2008.
- Official information of 14 July 2008 on the abrogation of certain official information documents (three official information documents regarding broker examinations organised by the CNB) in connection with the termination of brokers and broker examinations by an amendment to the Capital Market Undertakings Act.
- Official information of 31 July 2008 on certain financial placement items of insurance or reinsurance undertakings, specifying the categorisation of certain securities into the financial placement items defined in Article 21a of the Insurance Act.
- Official information of 18 August 2008 regarding the prudential rules for pension funds, which provides information on the CNB's approach to the control system of a pension fund.
- Official information of 20 October 2008 on a change in the questions set for professional examinations for the medium and higher levels of competence of insurance intermediaries.
- Official information of 23 December 2008 regarding the submitting of other documents on the activities of domestic insurance/reinsurance undertakings and branches of insurance/reinsurance undertakings from third countries and documents on the activities of branches of insurance undertakings from other EU or EEA member states for 2009, which provides details on reporting by insurance/reinsurance undertakings in 2009.

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 REGULATORY CHANGES UNDER PREPARATION[4]

2.4.1 Draft laws

Numerous other changes to the regulations were under preparation in 2008, mostly in order to transpose EU regulations. Completion of the legislative process for these amendments is expected in 2009. The changes concerned the following laws in particular:

Act on Financial Market Supervision
A draft statement of intent for this act, prepared by the Ministry of Finance in cooperation with the CNB, was discussed by the Government in July 2008. The MoF then suggested that the submission of the structured version of the supervision act to the Czech Government be postponed until the second half of 2010, referring to the need to wait for the final version of the Inspection Act. The Inspection Act is to replace Act No. 552/1991 Coll., on State Inspection. It is intended not only to update the rules for on-site inspections conducted by public authorities, but also to set rules for off-site surveillance. The Czech National Bank has submitted a number of significant comments on the planned law.

Collective amendment to the Capital Market Undertakings Act, the Act on Banks and Credit Unions and the Act on Collective Investment
The Ministry of Finance prepared a bill amending the Capital Market Undertakings Act, the Act on Banks and Credit Unions, the Act on Collective Investment and other laws in connection with the transposition of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (the transparency directive), the transposition of Directive 2007/44/EC amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector (the qualifying holdings directive), and the transposition of Directive 2007/16/EC implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities as regards the clarification of certain definitions (the eligible assets directive). The bill includes some changes going beyond the framework of the above directives, e.g. rules for simplifying access to the activity of non-autonomous funds and a technical amendment to the Collective Investment Act. The bill was subject to comments between 17 and 31 July 2008. The Government approved it on 19 November 2008 and at the end of the year it was prepared for submission to the Parliament, which took delivery of it on 15 January 2009. The bill is being debated as Parliamentary Print No. 705.

Preparation of a new Insurance Act
A bill of a new insurance act was discussed in the committees of the Government's Legislative Council in February and March 2008. It was approved by the Government on 9 July 2008 and sent to the Chamber of Deputies in August 2008. The bill had yet to pass the first reading by the year-end.

Payment System Act
In the second half of 2008, the Ministry of Finance submitted for preliminary and standard comments a bill transposing Directive 2007/64/EC on payment services in the internal market and draft changes to related laws, particularly the Foreign Exchange Act. The CNB was closely involved in the comments procedure.

4 Planned changes to 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.*

Act on Pension Savings
In October 2008, the Government approved a document entitled Proposition for Drafting a New Act on Pension Savings. This act is intended to transform the third pillar of the pension system and, based on a new institutional framework for voluntary pension saving schemes, provide for management of a fund's assets separately from the assets of its manager. The Ministry of Finance prepared the structured version of the bill in the fourth quarter of 2008 and circulated it for comments from other government departments in December 2008. The bill is based on the concept of participating funds which do not have legal personality and whose assets are the joint property of the investors. The funds are managed by an independent, dedicated manager – a pension company. The bill emphasises professional asset management, compliance with the rules for conduct towards clients, including the rules of fair promotion. Planholders have the option of investing in various different participating funds with different investment policies, while the investment risk is fully borne by planholders. The existing private pension system should be maintained, but new planholders will not be admitted. The CNB was actively involved in the comments procedure. Its main comments focused on the key areas of the proposed law, such as the general concept and the parallel functioning of the pension saving system and private pension schemes, investment by participating funds and the rules for migration from the old system to the new one. These comments were aimed at creating a stable environment for pension saving and eliminating the ambiguities contained in the bill. Last but not least, the CNB's intention was to remove the shortcomings of the current Act on Private Pension Insurance. For example, it proposed the creation of clear rules for pension saving intermediation and for asset management in participating funds.

Act on Private Pension Insurance
Owing to the frequent migration of planholders between pension funds, motivated by intermediaries' commissions, an amendment to the Act on Private Pension Insurance has been prepared which should reduce such migration by tightening the requirements for conduct towards clients when concluding private pension policies.

Civil and Commercial Codes
Given the fundamental significance of civil and commercial law for the financial market area, and also given its direct relation to the CNB's responsibilities, e.g. in the takeover bids area, the CNB worked closely with the Ministry of Justice in formulating comments on new laws or regulations to be submitted to the Czech Parliament in 2009.

2.4.2 Draft decrees

In connection with the planned amendment of laws, legislative work commenced in 2008 on decrees which are expected to be completed in 2009. These include:

- a new decree stipulating the expertise and experience required of persons assisting investment firms in their activities. The preparations began in 2008, when a consultation document on the planned decree was released and assessed with the assistance of representatives of professional associations and the Ministry of Finance. The draft structured version of the decree was circulated for comments from other government departments in December 2008.
- an amendment to Decree No. 261/2004 Coll., on the requisites and the manner of keeping of a transactions and orders book of an investment firm and on the principles of keeping records of received and transmitted orders of an investment intermediary. A consultation document on the planned decree was released in autumn 2008. It was then discussed with professional associations and the Ministry of Finance and the results were assessed.
- a new decree implementing certain provisions of the Capital Market Undertakings Act in the areas of protection against market abuse and transparency, linked to the planned amendment of an act transposing the transparency directive and replacing Decree No. 264/2004 Coll. (communication of an annual report of an issuer) and Decree No. 536/2004 (protection against market abuse).

A consultation document on the planned decree was released in September 2008, and the decree is expected to be issued in June 2009 after the amendment to the Capital Market Undertakings Act comes into effect.

- a new decree implementing certain provisions of the Act on Collective Investment, linked to the planned amendment of an act transposing Directive 2007/16/EC implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as regards the clarification of certain definitions (eligible assets). A consultation document on the planned decree was released in September 2008, and the decree is expected to be issued in June 2009 after the amendment to the Act on Collective Investment comes into effect.
- in connection with the bill of a new insurance act, the CNB prepared two implementing decrees which will cover reporting by insurance companies, their control systems, financial placement of assets arising from technical provisions, the calculation of required and available solvency margins, reports by responsible actuaries, etc. The drafts were consulted with the Ministry of Finance, the Czech Insurance Association and the Society of Czech Actuaries and will be circulated for comments from other government departments following the debate on the bill of the insurance act in the first reading in the Chamber of Deputies.
- new decrees implementing the new Payment System Act in the area of regulation of payment institutions and electronic money institutions, including the stipulation of disclosure duties.
- a new decree implementing the amended Foreign Exchange Act in connection with the new Payment System Act in the area of bureau-de-change activities.
- a new decree regulating the essential elements of an application for a licence for the activities of a credit institution and a capital market institution and the acquisition of qualifying holdings, which will replace the existing sectoral decrees.

2.5 ASSESSMENT OF THE SITUATION IN FINANCIAL MARKET REGULATION

2008 was a very hectic year as regards financial market regulation. The end of 2008 saw an extraordinary increase in regulatory activity in the wake of the financial crisis. This included an amendment to the deposit insurance directive and changes in the valuation of HTM bonds in the portfolios of pension funds and insurance companies.

The CNB concentrated on all the key tiers of regulation during the year. In addition to preparing implementing regulations and seeing to their implementation (official information documents in particular), the CNB worked with European institutions on the creation of European regulatory measures and with the Czech Ministry of Finance, which is responsible for primary financial market legislation, and other key authorities such as the Ministry of Justice in the areas of listed companies and takeover bids.

The transposition of Directive 2004/39/EC on markets in financial instruments (MiFID) and Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing was an essential regulatory change in 2008.

The CNB's powers were fundamentally affected by an amendment to Act No. 36/2008 Coll., on Consumer Protection, promulgated on 12 February 2008, under which supervision of compliance with the consumer protection rules by regulated financial market entities was assigned fully to the CNB. This also had implications for the CNB's organisational structure and resulted in the establishment of a new Consumer Protection Department.

By contrast, the new Takeover Bids Act restricted the CNB's powers, as it limited the CNB's competences in the area of takeover bid and squeeze-out approvals to listed companies only, as required by European law.

3. ENHANCEMENT OF FINANCIAL MARKET STABILITY AND TRANSPARENCY

The enhancement of financial market stability and transparency through the implementation of new regulatory frameworks is a long-term process linked with changes to European law.

3.1 THE BASEL CAPITAL ACCORD

In April 2008, the European Commission published a draft amendment to Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and a draft amendment to Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (CRD) for public consultation (completed on 16 June 2008). A discussion of this amendment was commenced in the second half of 2008 and is continuing in 2009.[5]

3.2 SOLVENCY II

The new system of regulation of the European insurance industry, known as Solvency II, is being created with some lag behind banking regulation. The basic concept of Solvency II is similar to that of Basel II. The system is based on three pillars containing quantitative requirements for insurance and reinsurance companies, qualitative requirements for risk management and for supervisory procedures, and reporting and disclosure requirements. The quantitative requirements in Pillar 1 determine 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. The qualitative requirements in Pillar 2 then lay down rules for the internal control systems of insurance companies, for the assessment of such systems and for risk management as well as the supervisor's powers and responsibilities. Pillar 3 aims at bolstering market discipline and market transparency based on reporting and comprehensive disclosure of information by supervised entities.

The debate in the Council of the EU and the European Parliament on the draft directive prepared by the European Commission continued in 2008. The discussions in the Council's financial services working group were delayed because of controversial issues contained in the draft (in particular the transfer of supervisory powers to supervisors in the home countries of the parent companies of insurance groups, which was proposed by the EC and which the CNB disagreed with, and an alternative calculation of the capital requirement for equity risk incorporated into the draft by the French Presidency at the last minute). The ECOFIN Council approved a "general approach" on 2 December 2008. This provides a mandate for discussions with the European Parliament. The most problematic provisions in the part concerning group supervision were dropped from the draft. On 7 October 2008, the European Parliament's ECON Committee approved some proposed amendments to the text which run counter to the compromise achieved in the EU Council, particularly with respect to the aforementioned group supervision. Negotiating a final compromise thus became a task – and one of the priorities – of the Czech Presidency in the financial services area. The CNB as an expert works in close cooperation with the Ministry of Finance.

Within the Lamfalussy framework, the Commission may adopt implementing regulations for the framework directive which will regulate some areas of the directive in more detail. Preparatory work on these regulations continued in 2008. Under the Lamfalussy framework, draft legal rules are prepared by Level 3 committees – CEIOPS in this case, which in 2008 prepared two recommendations for the European Commission concerning the implementation of the proportionality principle and the supervision of insurance groups. These proposals serve, among other things, as a basis for the discussions on the framework directive. Other implementing regulations will deal with valuation of assets and insurance liabilities, the calculation of capital requirements, rules for internal models, etc. The deadline for preparing these recommendations for the Commission is October 2009. The process of approval by the EIOPC (a Level 2 committee) will then start. The CNB is also involved in the preparation of the above implementing regulations owing to its membership in CEIOPS.

5 See section 6.1 *Cooperation within European Commission structures* for details on the draft CRD amendment.

Solvency II includes quantitative impact studies (QIS) conducted by CEIOPS at European level. The fourth QIS took place between April and June 2008. It tested further the proposed standard formula for the calculations of capital requirements and the proposed simplifications and proxies for the calculations of technical provisions and capital requirements. The CNB extended its cooperation with the Czech insurance market, which led to a further increase in the number of participants. A total of 14 Czech insurance companies took part in QIS4 (compared to 12 participants from the Czech Republic in QIS3), with market shares of 85.5% and 94.0% in the life and non-life insurance markets respectively. The results for the Czech participants did not differ substantially from those at European level.

3.3 REGULATION IN THE COLLECTIVE INVESTMENT AREA

In July 2008, the European Commission published a proposal for a new directive to replace Directive 85/611/EEC. The proposal includes new provisions intended above all to improve the efficiency of the standard collective investment fund sector. These provisions should facilitate and simplify the cross-border activities of such funds (by allowing a management company to establish standard funds in a state other than the one in which its registered office is situated) and improve the efficiency of asset management by maximising the volume of portfolios managed (cross-border mergers, asset pooling, a master-feeder structure). The proposal also modifies the concept of the simplified prospectus to get it nearer to the original intention of providing investors with clear, concise, easily understandable and relevant information. In December 2008, the proposed directive was discussed by ECOFIN in a version incorporating the "management company passport" (allowing a management company to establish standard funds in other EU countries). The legislative process in the European Parliament was completed at the start of 2009.

3.4 SECURITIES SETTLEMENT SYSTEM

An amendment to Directive 98/26/EC on settlement finality in payment and securities settlement systems and an amendment to Directive 2002/47/EC on financial collateral arrangements was approved by the European Parliament on 18 December 2008. The amendment to the settlement finality directive reflects cross-border interconnection of payment systems and securities settlement systems. A system itself may now be a participant of an "interoperable system", the directive now recognises "indirect participants" (e.g. clearing houses), and "night-time settlements" are now governed by uniform rules. The amendment to the financial collateral arrangements directive extends the list of eligible types of collateral to include special types of claims, e.g. credit claims. The transposition deadline depends on the date of publication in the Official Journal (approximately June 2010; implementation deadline approximately December 2010).

3.5 REGULATION OF CREDIT RATING AGENCIES

On 12 November 2008, the European Commission published a proposal for a regulation on credit rating agencies (CRAs). The requirements for CRAs proposed in the regulation are not fundamentally new. They are based mainly on the IOSCO Code of Conduct Fundamentals for CRAs and on the requirements for ratings and CRAs already established under Basel II. In the light of new information arising from the present financial crisis, some more requirements defining CRAs' activities in more detail have been added. Much of the regulation deals with the registration process and supervision of CRAs. This represents a new obligation on supervisory authorities, and new obligations have also been assigned to the CESR. The Ministry of Finance represents the Czech Republic in discussions on the proposed regulation in the EU Council, and the CNB provides the MoF with its opinions.

3.6 INTERNATIONAL ACCOUNTING STANDARDS

On 13 October 2008, the International Accounting Standards Board (IASB) issued amendments to IAS 39 and IFRS 7 regarding transfers between categories of financial instruments. Under the amendments, a financial instrument may be reclassified out of the held-for-trading subcategory of the fair value through profit and loss category provided that the financial instrument is no longer held for the purpose of selling or repurchasing it in the near term. It is up to the accounting entity to decide, after taking the financial instrument out of the held-for-trading subcategory, whether to classify it in the available-for-sale category, i.e. to continue to revaluing it at fair value and record revaluation gains/losses under equity, or in the categories of financial assets measured at amortised cost. Such reclassification may be applied, for example, to instruments consisting of a host instrument and an embedded derivative.

However, it is still not possible to reclassify a derivative out of the fair value through profit and loss category. Neither is it possible to reclassify a financial instrument out of the fair value through profit and loss category if it was initially included in this category using the fair value option.

A corresponding European Commission regulation was published in the Official Journal on 16 October 2008 with effect from 17 October 2008. This ensured that no differences arose between the IFRS issued by the IASB and the IFRS governed by EC law. The CNB did not support these changes.

4. DIRECT FINANCIAL MARKET SUPERVISION IN 2008

4.1 LICENSING, APPROVAL AND AUTHORISATION ACTIVITIES
(information and figures on individual types of approval activity).

Credit institutions[6]

In 2008, the CNB received a total of 55 applications for the opening of administrative proceedings from regulated credit institutions (banks, bank branches and credit unions), 20 of them from banks, 31 from credit unions and 4 from rating agencies applying for entry in the list kept by the CNB.

As regards electronic money institutions, which also belong to this sector according to European law and which may be established in the Czech market pursuant to Act 124/2002 Coll., on Payments, the CNB registered no applications and conducted no administrative proceedings.

A total of 52 administrative decisions were issued during the year.

Table A.I – Numbers of administrative proceedings in the credit institution sector

Continuing from 2007	Opened	Completed	Continuing into 2009
2	55	54	3

The most significant action was the granting of a banking licence in April 2008 to První česko-ruská banka, a. s. for its wholly-owned Czech subsidiary Banka mezinárodní spolupráce, a. s.[7] This was the first licence to be issued to a new bank in the Czech Republic in six years (the previous one had been granted in 2002 to Wüstenrot hypoteční banka, a. s.) and the process took four years of effort. První česko-ruská banka became the first bank with a Russian shareholder to start operating in the Czech banking market. The CNB had conducted three administrative proceedings with this applicant since 2004, one of which was suspended and one was rejected; only this application was successful. The bank should open for business in full in April 2009.

Other important administrative decisions concerned two changes to banking licences and one change to a credit union licence through the expansion of permitted activities. The licences concerned were those of J&T BANKA, a.s. (broadened to include some investment services, since the bank also has an investment firm licence), building society Modrá pyramida (to include reinsurance operations) and credit union Vojenská družstevní záložna.

The concentration of the banking sector continued in 2008. The market saw significant mergers preceded by complex and multiple administrative decision-making by the CNB. eBanka, a. s. merged with Raiffeisenbanka, a. s. and ceased to exist, while Raiffeisen stavební spořitelna, a. s. merged with Hypo stavební spořitelna, which ceased to exist.

6 For details see Part B, section 2.1 *The structure of the banking sector* and section 2.6 *The credit union sector.*
7 In April 2009 the bank changed its business name to Evropsko-ruská banka.

The largest number of proceedings traditionally relates to prior consents to acquire a qualifying holding in a bank or to the investment of another membership contribution in a credit union. The CNB issued 15 such consents in 2008. German Landesbank Baden-Württemberg's entry into BAWAG Bank, a. s. (including a change in name to LBBW Bank) was one of the significant acquisitions in this area.

At the start of 2008, after complicated multiple administrative proceedings, Citibank, a. s. was converted into a branch of the Irish bank Citibank Europe plc., operating in the Czech Republic under the single licence.

Table A.II – Numbers of entities in the credit institution sector

	As of 31 Dec. 2007	Entries	Exits	As of 31 Dec. 2008
Banks	23 (of which 6 BS)	1	3	21 (of which 5 BS)
Foreign bank branches (SL)	14	2		16
Credit unions	19		2	17

Note: BS (building societies), SL (EU single licence principle)

In 2008, administrative proceedings were also conducted with rating agencies Fitch, Moody's and Standard & Poor's in respect of entry in the list kept by the CNB. Entry in this list creates room for banks to choose appropriate listed agencies for the purposes of calculating their capital requirements for credit risk or operational risk within the Basel II framework.

The remaining administrative proceedings included regulatory consents for directors of some bodies of a credit institution and consents to a decrease in a membership contribution, the liquidation of credit union DOMOV, and the change of an address abroad.

The exercise of the right of establishment under the European legislation on the basis of the single licence principle in another EU Member State in 2008 was unchanged from 2007. One domestic bank (J&T BANKA, a.s.) is operating as a branch in Slovakia and four domestic credit unions (Fio, Unibon, WPB and Prague Credit Union SD) are operating in Slovakia, Poland, Hungary and Cyprus.

The collective investment and pension fund sectors

The trend of entry of new entities into the collective investment sector continued in the period under review. This was mostly associated with the amendment to the Collective Investment Act that took effect on 26 May 2006, which removed the barriers to establishing special real estate funds (open to the public) and special funds for qualified investors. In 2008, there was increased interest in establishing or creating special funds for qualified investors (in the form of both investment funds and mutual funds) specialising in investment in real estate and real estate companies.

Table A.III – Numbers of entities in the collective investment and pension fund sectors (active or newly licensed)

	As of 31 Dec. 2007	Entries	Exits	As of 31 Dec. 2008
Management companies	18	2 i)	0	20
Investment funds	7	9	0	16 ii)
Open-end mutual funds	121	30	9	142
of which: standard funds	38	3	0	41
Closed-end mutual funds	0	2	0	2
Pension funds	11	0	1 iii)	10
Depositories	8	0	0	8

i) Management company Fortius Global Investments, investiční společnost, a. s., was granted a licence by decision of the CNB of 21 December 2007, took effect on 8 January 2008.
ii) Two of these investment funds (KZP uzavřený investiční fond a. s. and MAO, uzavřený investiční fond, a. s.) were not entered in the Commercial Register as of 31 December 2008.
iii) Zemský penzijní fond, a. s. was dissolved without liquidation by merger on 31 December 2007; as of 1 January 2008 there was one pension fund less. The successor company is ČSOB Penzijní fond Progres, a. s., a member of ČSOB Group.

The following 221 administrative proceeding were conducted in the collective investment area in 2008:

- 3 proceedings to grant a management company licence (only 1 new company, Hanover Asset Management, investiční společnost, a. s., was granted a licence; 2 proceedings were not completed in 2008);
- 15 proceedings to grant an investment fund licence (licences were granted to 9 funds): UNIMEX GROUP, uzavřený investiční fond, a. s., IMPERA ŽSD, uzavřený investiční fond, a. s., MBI, uzavřený investiční fond, a. s., Arca Capital CEE, uzavřený IF, a. s., Výnosový uzavřený investiční fond, a. s., Pozemkový uzavřený investiční fond, a. s., KZP uzavřený investiční fond, a. s., LUCROS uzavřený investiční fond, a. s. and MAO, uzavřený investiční fond, a. s.[8]; 1 proceeding was discontinued at the request of a participant to the proceedings and 4 proceedings had not been completed by the end of the year);
- 34 proceedings to grant a licence to establish an open-end or closed-end mutual fund (of which 2 had not been completed by the end of the year);
- 2 proceedings concerning authorisations to merge mutual funds (of which 1 was discontinued at the request of a participant to the proceedings and 1 had not been completed by the end of 2008);
- 6 proceedings concerning withdrawals of licences to establish an open-end mutual fund (of which 1 had not been completed by the end 2008);
- 120 proceedings concerning the approval of a change in the statutes of a collective investment fund (of which 4 were discontinued at the request of a participant to the proceedings and 9 had not been completed by the end of 2008 – in 3 cases negative decisions had been issued in the first instance (at the level of the CNB's Licensing and Enforcement Department) and appeals had been lodged in the second instance (at CNB Bank Board level) and the appeals proceedings had not been completed by the end of 2008);
- 9 proceedings concerning consents to the acquisition of a qualifying holding in a management company or an investment fund (1 was discontinued at the request of a participant to the proceedings and 1 had not been completed);
- 21 proceedings concerning prior consents to the discharge of office of director of a management company or an investment fund (3 of which had not been completed by the end of 2008);
- 10 proceedings concerning authorisations to offer securities of a foreign special fund to the public (2 of which were discontinued at the request of a participant to the proceedings);
- 1 proceeding concerning a change in a depository of a mutual fund.

8 MAO, uzavřený investiční fond, a. s. was granted a licence twice during 2008. The first decision was not consummated because the applicant failed to enter the investment fund in the Commercial Register in time.

Table A.IV – Numbers of administrative proceedings in the collective investment and pension fund sectors

No. of proceedings continuing from 2007	No. of proceedings opened in 2008	No. of proceedings completed in 2008	No. of proceedings continuing into 2009
21	238	234	25

There were no major changes in the private pension area in 2008. This was in line with developments in the sector and thus also with the nature of the decisions issued. The number of pension funds decreased from 11 to 10 owing to a merger. The following 38 administrative proceedings were conducted in the private pension area in 2008:

- 2 proceedings concerning authorisations to establish and operate a pension fund (of which 1 (Slavia pojišťovna, a. s.) was terminated by withdrawal of the application and 1 (KKCG Finance B.V.) had not been completed by the end of the year);
- 2 proceedings relating to the granting of prior consent to Société Beaujon to acquire more than 10% of the equity capital of AXA penzijní fond, a. s. (of which 1 was discontinued by withdrawal of the application by a participant to the proceedings due to incomplete submission and 1 was not completed in 2008);
- 1 proceeding concerning an approval of a change in the statutes of Generali penzijní fond, a. s.;
- 33 proceedings relating to prior consents to the election of a person to a pension fund body, including the re-election of existing members of a pension fund body (6 of which were discontinued because of withdrawal of the application by a participant to the proceedings due to incomplete submission).

Table A.V – Numbers of entities in the investment services provider sector

	As of 31 Dec. 2007	Entries	Exits	As of 31 Dec. 2008
TOTAL	44	1	7	38
Non-bank investment firms	31	0	4	27
Bank investment firms	13	1	3	11

In the area of investment services providers, a total of 44 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 2008. One new investment firm licence was granted in 2008 (to GE Money Bank, a. s.). One investment firm licence was withdrawn due to termination of the conditions for granting the licence (Burzovní společnost pro kapitálový trh, a. s.) and 3 licences expired owing to changes in objects of business. Two bank investment firms ceased to exist due to merger (eBanka, a. s., Živnostenská banka, a. s.) and 1 licence was withdrawn at the bank's own request (Citibank, a. s.). The CNB registered 38 investment firms, 11 of them banks, as of the end of 2008.

Table A.VI – Numbers of administrative proceedings in the investment services provider sector

No. of proceedings continuing from 2007	No. of proceedings opened in 2008	No. of proceedings completed in 2008	No. of proceedings continuing into 2009
183 (of which 1 from 2004)	178	346	15

The CNB issued 346 first instance decisions in the area of investment services provision in 2008, more than one-half of which were decisions to grant investment intermediary registration.

Three decisions were issued regarding approval of or changes to auction rules. Twelve decisions concerned prior consents to the discharge of office of director of an investment firm. One application for prior consent to the discharge of office of director was rejected. The CNB issued 2 decisions rejecting applications for prior consent to the discharge of office of director of a financial holding entity. The CNB issued prior consent to the acquisition of qualifying holdings in investment firms in 2 cases and rejected an application for such consent in 1 case.

Other decisions in the investment services area mostly concerned the issuance, extension or withdrawal of broker's licences (32 issued/extended and 4 withdrawn) and registration of investment intermediaries (40 withdrawn and 1 refused).

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 start of 2008. In the period under review, 30 new licences were issued and 4 licences were withdrawn. The CNB organised 19 rounds of broker examinations in 2008, with 169 participants (74 were successful, 81 failed and 14 did not turn up for the examination).

On 1 July 2008, the MiFID-transposing amendment to the Capital Market Undertakings Act No. 230/2008 Coll. came into effect. Under a transitional provision of Section II, items 25 and 32 of the amendment, all broker's licences ceased to exist by law and all uncompleted proceedings were discontinued. The CNB will no longer issue broker's licences and has ceased to organise broker examinations. The amendment to the Capital Market Undertakings Act also lays down a new approach to ensuring the expertise of persons assisting investment firms in their activities.

The insurance sector

Domestic insurance companies and reinsurance companies and insurance companies from third countries (non-EU/EEA countries) are subject to licensing and approvals by the CNB.

A total of 35 domestic insurance companies (including the Czech Insurers' Bureau) and one reinsurance company were subject to supervision by the CNB as of the end of 2008. The CNB also supervised 18 branches of insurance companies – 17 from the EU/EEA countries and 1 from a third country (Switzerland) – to a limited extent.

Table A.VII – Numbers of entities in the insurance sector

	As of 31 Dec. 2007	Entries	Exits	As of 31 Dec. 2008
INSURANCE COMPANIES (incl. branches and reinsurers)	53	2	1	54
of which:				
domestic insurance companies	35	0	0	35
branches of insurance companies from EU/EEA	17	1	1	17
branches of insurance companies from third countries	1	0	0	1
reinsurance companies	0	1	0	1

The CNB, as the supervisory authority in the insurance area, conducted 92 licensing administrative proceedings and issued 88 administrative decisions in 2008.

Table A.VIII – Numbers of administrative proceedings in the insurance sector

No. of proceedings continuing from 2007	No. of proceedings opened in 2008	No. of proceedings completed in 2008 (incl. not finally and conclusively)	No. of proceedings continuing into 2009 (decisions not issued in 2008)
10	82	88	4

Three new entities expanded the range of services offered on the insurance market. In 2008, the first-ever reinsurance licence in the Czech Republic was granted to VIG RE zajišťovna a. s., which was authorised by the CNB to carry on reinsurance activities for all life and non-life insurance segments as well as other related activities as part of Vienna Insurance Group. AXA pojišťovna, a. s. and Wüstenrot pojišťovna, a. s., joined the ranks of insurance service providers and are authorised under their new insurance licences to carry on insurance activities in most non-life insurance categories. In addition to their activities in life insurance in the Czech Republic, the AXA and Wüstenrot groups thus now also operate in the non-life insurance market.

Besides the entry of new entities into the market, 2008 saw an expansion in the activities of insurance companies already operating on the insurance market. The CNB approved 9 applications for the extension of insurance licences. It approved additions of new categories of life insurance (PRVNÍ AMERICKO-ČESKÁ POJIŠŤOVNA, a. s.), non-life insurance (Komerční úvěrová pojišťovna EGAP, a. s., Slavia Pojišťovna, a. s., MAXIMA pojišťovna, a. s.), life and non-life insurance (VICTORIA VOLKSBANKEN pojišťovna, a. s., Generali Pojišťovna, a. s.), and insurance-related activities (ČSOB Pojišťovna, a. s., a member of ČSOB Group, POJIŠŤOVNA CARDIF PRO VITA, a. s. and Triglav Pojišťovna, a. s.).

The CNB in 2008 revoked the insurance licence of AIG CZECH REPUBLIC pojišťovna, a. s., which for organisational reasons transferred its insurance portfolio to the French company AIG EUROPE S.A., operating in the Czech Republic through a branch of AIG EUROPE, S.A. pobočka pro ČR. AIG CZECH REPUBLIC pojišťovna, a. s. was carrying on no insurance business in 2008. The licence of Komerční pojišťovna, a. s. was narrowed to exclude activities which the firm had stopped performing a long time ago. In both cases, the licences were revoked at the insurance company's request and the revocation was not meant as a penalty.

One of the most significant events in the area of acquisition of qualifying holdings in insurance companies was the merger of the insurance business of the Generali and PPF groups in Central and Eastern Europe into a joint venture. Prominent among the ten prior consents issued by the CNB in 2008 were decisions approving the takeover of Česká pojisťovna, a. s., Česká pojišťovna ZDRAVÍ a. s. and Generali Pojišťovna, a. s. by a Generali-PPF Holding B.V. joint venture in which the ratio of the shares of Generali and PPF is 51:49. The supervisory authority issued consents both to intra-group transfers of qualifying holdings (within ERGO Group relating to Evropská Cestovní Pojišťovna, a. s. and VICTORIA VOLKSBANKEN pojišťovna, a. s., and the takeover of AXA životní pojišťovna, a. s. by Société Beaujon, a member of AXA Group) and to the entry of new shareholders (the takeover of Pojišťovna České spořitelny, a. s. by WIENER STÄDTISCHE Versicherung AG Vienna Insurance Group).

Other decisions included the approval of a merger between Generali pojišťovna, a. s. and its subsidiary Generali Real Estate, s. r. o., and the granting of consent to a different financial placement structure to the Czech Insurers' Bureau and Kooperativa pojišťovna, a. s., Vienna Insurance Group.

The CNB issued 61 decisions granting prior consent to membership of a statutory or supervisory body of an insurance or reinsurance company.

The CNB conducted 23 administrative proceedings concerning registration in, or deletion from, the register of responsible actuaries. In all, 17 responsible actuaries were deleted and 5 were registered (one will be registered in February 2009). As of the end of 2008, the CNB registered a total of 48 responsible actuaries.

Securities issues and regulated markets

At the start of 2008, a total of 87 companies whose securities had been admitted to trading on a regulated market (issuers of listed securities) were registered, 17 of which were located outside the Czech Republic and 1 outside the EU. In the course of 2008, the number of issuers of listed securities dropped by 21, largely due to the decision of regulated market operators to exclude 14 securities issues due to non-compliance with the conditions for being admitted to trading (chiefly because of low liquidity). The number of licensed regulated market operators (RM-Systém, a. s., Prague Stock Exchange, a. s.) and settlement systems (SVYT, the short-term bond market and UNIVYC) was the same as in 2007.

Table A.IX – Numbers of securities issues and regulated markets

	As of 31 Dec. 2007	Entries	Exits	As of 31 Dec. 2008
Issuers of listed securities	87	2	21	68
of which: foreign	17	2	1	18
Regulated market operators	2	0	0	2
Settlement systems	3	0	0	3

In 2008, the CNB issued 150 first instance decisions in the area of securities issues and regulated markets.

Most of these decisions (97) concerned the approval of documents relating to new issues of securities, i.e. bond issue conditions in compliance with Act No. 190/2004 Coll. on Bonds, securities prospectuses and combinations thereof for the purposes of public offers 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 formal check of the essential elements of such documents. In the case of approvals of securities prospectuses, compliance with the conditions laid down in European Commission Regulation No. 809/2004 is checked.

In addition to these approval proceedings, 11 proceedings were held in 2008 in relation to the disclosure duties of issuers of listed securities, in particular proceedings concerning the narrowing of the scope of annual reports (8 proceedings).

A total of 27 administrative proceedings were opened and 30 administrative decisions issued in 2008 in the takeover bids area (3 proceedings continued from 2007). These included 22 decisions concerning prior consents to the justification of a consideration amount when applying the squeeze-out principle and 8 decisions concerning takeover bids relating to listed participating securities. The most significant administrative proceedings were conducted in respect of squeeze-outs in PARAMO, a. s. and SPOLANA, a. s. and also in connection with takeover bids in ZENTIVA N.V. and ECM Real Estate Investments A.G.

Table A.X – Numbers of administrative proceedings in the area of securities issues and regulated markets

No. of proceedings continuing from 2007	No. of proceedings opened in 2008	No. of proceedings completed in 2008	No. of proceedings continuing into 2009
9	141	144	6

On 1 April 2008, a significant legislative amendment terminated the CNB's supervision of squeeze-outs of unlisted joint-stock companies and changed the law regulating takeover bids in connection with the transposition of the takeover bids directive (2004/25/EC).

As regards market infrastructure, the most important decision in 2008 was the approval of the application by Wiener Bőrse AG, the regulated market operator in Austria, for prior consent to acquire a qualifying holding in Burza cenných papírů Praha, a. s. (the Prague Stock Exchange), the regulated market operator in the Czech Republic. In this connection, one prior consent was granted to the discharge of office of director. The CNB also granted two UNIVYC requests for the approval of changes in settlement system rules.

Proceedings to grant a central securities depository licence were opened at the start of 2008. At present, the applicant is preparing documents for the granting of the licence. In the second half of 2008, administrative proceedings were opened to grant a regulated market operator licence to the Prague Energy Exchange for some commodity derivatives. These proceedings were completed in January 2009 with the issuing of approval. In connection with these proceedings, a decision was also taken in administrative proceedings on the expansion of UNIVYC's licence to operate a settlement system, specifically in relation to the relevant derivative instruments.

4.2 NOTIFICATIONS (UNDER THE SINGLE LICENCE)

The Czech Republic's accession to the EU in 2004 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)[9].

During 2008, the CNB received 734 announcements by foreign regulators of notifications of cross-border provision of services, of which 57 from banks (6 of them electronic money institutions), 80 from insurance companies,[10] 271 from collective investment funds, 4 from management companies and 322 from investment services providers.

A total of 3 banks, 4 insurance companies, 1 management company and 181 foreign funds (collective investment funds) terminated their cross-border service provision activities in 2008.

The competent supervisory authorities from EU 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.

Table A.XI – Cross-border service provision notifications (end-of-year data)

	2007	2008
BANKS	198	252
of which: electronic money institutions	6	12
Insurance companies	478	554 i)
Funds	1,479	1,569
Management companies	37	40
Investment services providers	518	840

i) 122 of which are branches of these insurance companies in the EU/EEA.

9 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*).

10 In addition to insurance companies, insurance company branches operating in other EU/EEA countries are notified in this manner. In 2008, the CNB was notified by foreign regulators of the intention of 22 branches to provide services in the Czech Republic (this figure is included in the total of 80 notifications).

In the area of prospectus notifications, the CNB received 166 notifications from foreign regulators.

During 2008, the CNB also received notification of the intention to carry on business in the Czech Republic from 1,297 insurance intermediaries having a home Member State other than the Czech Republic (1,239 of them from the Slovak Republic).

4.3 REGISTRATIONS

As of the end of 2008, a total of 26 representations of foreign banks and financial institutions were registered in the Czech Republic under Article 39 of the Act on the Czech National Bank (2 representations terminated their activities in 2008 and 1 new one was registered). Such representations are not authorised to carry on business in the Czech banking sector, but intermediate and promote the services of their banks in the Czech Republic.

In all, 1,885 registrations were issued and 33 cancelled in 2008 under Article 30 of the Capital Market Undertakings Act. At the same time, 2,334 registrations were cancelled by law because the entities concerned were entered in the list of tied agents (under an amendment to the Capital Market Undertakings Act in effect from 1 July 2008). The CNB registered 12,873 investment intermediaries as of the end of 2008.

On 1 July 2008, an amendment to the Capital Market Undertakings Act introduced tied agents, a new type of investment services provider representing an investment firm, investment intermediary or management company. In 2008, the CNB entered 3,639 entities in the list of tied agents and deleted 129 entities from the list. It thus registered a total of 3,510 tied agents as of 31 December 2008.

In 2008, a total of 18,702 intermediaries were listed in the register of insurance intermediaries and independent loss adjusters, 91 of which were insurance agents and 59 insurance brokers.[11] At the end of 2008 the register contained 86,232 insurance intermediaries, 7,118 of them foreign (compared to 78,661 active insurance intermediaries as of 31 December 2007). In connection with the registration of insurance intermediaries, the CNB holds professional examinations of insurance agents and insurance brokers (to verify whether the applicants are competent to perform such activities at a medium or higher level of competence). In all, 627 candidates took these examinations and 610 passed.

4.4 ENFORCEMENT

Activity in the penalty proceedings area remained an integral part of financial market supervision in 2008 and consisted in the investigation of petitions for the opening of administrative proceedings, decision-making on the opening of administrative proceedings or the deferral of cases, and the conduct of first instance administrative proceedings, within which fines and remedial measures were imposed, licences revoked and registrations cancelled.

The work also includes communication with law enforcement authorities, including the preparation of documents and opinions, and communication with the Finance Ministry's Financial Analytical Unit (FAU) as regards money laundering and terrorist financing. International cooperation with other supervisory authorities, particularly in the area of unauthorised business in the financial market, also deserves mention.

11 The register of insurance intermediaries is available on the CNB website: www.cnb.cz – *Financial market supervision – Supervision of the insurance industry – Register of insurance intermediaries.*

Table A.XII – Summary of administrative penalty proceedings

No. of proceedings continuing from 2007	No. of proceedings opened in 2008	No. of proceedings completed finally and conclusively in 2008	No. of proceedings continuing into 2009
21	48 i)	47	22

i) Two finally and conclusively completed proceedings were re-opened in 2008.

As regards supervision of credit institutions, two administrative penalty proceedings were opened in 2008 – on the grounds of shortcomings detected in a bank's control system and bookkeeping and due to failure to submit a credit union's approved annual report to the CNB within the set time limit.

A total of 22 penalty or offence proceedings were opened in the capital market area. Among the main proceedings conducted with capital market undertakings was one on the activity of an investment firm in a share buy-back programme. This was the first ever case of its type in the Czech capital market. There was also a case of "black collective investment", which set an important precedent in the assessment of such activity in the future as unauthorised in terms of both content and form (fund pooling methods, the presentation and promotion of the purpose of such pooling, the investment returns and profit for investors in relation to assets, and the "promised" yield).

A total of 21 decisions in the capital market area entered into force in 2008. The cases closed by a final and conclusive ruling included:

- 5 decisions related to breaches of the takeover bid duty towards holders of listed securities of a target company,
- decision in administrative proceedings due to breaches of the duty to report management trades.

In all, fines totalling CZK 2,100,000 were imposed in 2008.

In the insurance area, 4 penalty proceedings were opened, 1 of which concerned a breach of the duties of an investment intermediary, 2 a cancellation of an extraordinary reporting obligation of an insurance company and 1 a failure to implement remedial measures. Two decisions on the cancellation of an extraordinary reporting obligation of an insurance company took effect in the same period.

A total of 18 administrative proceedings were opened in 2008 regarding the violation of foreign exchange regulations.

The CNB issued final decisions or orders in 24 administrative penalty proceedings, of which fines were imposed in 22 cases, a foreign exchange licence was revoked in 1 case and proceedings were discontinued in 1 case. The total fines imposed amounted to CZK 400,000.

As regards the cancellation of entries in the register of insurance intermediaries, 56 administrative proceedings were opened and 113 final decisions were issued in 2008 regarding failure to prove the expertise of insurance intermediaries.

Five administrative proceedings relating to the appointment of liquidators of supervised entities in liquidation and 5 proceedings relating to entries in the list of forced administrators and liquidators maintained by the CNB were conducted in 2008.

Monitoring of financial market entities in liquidation

The CNB monitors the process of liquidation of financial market entities on the basis of a statutory disclosure duty and ad-hoc requested information. Three credit unions, one investment fund and two management companies were deleted from the Commercial Register in 2008.

The credit union DOMOV went into liquidation at its own request and the CNB filed a court petition to appoint a liquidator and set the liquidator's remuneration package. Insurer AIG CZECH REPUBLIC pojišťovna, a. s. also went into liquidation at its own request. The CNB appointed its liquidator and determined his remuneration.

New liquidators were appointed in 3 investment funds and 1 management company. In 1 management company and 1 investment fund where the assets were not sufficient to cover the liquidation costs, the liquidator's remuneration and cash expenditures were paid by the Ministry of Finance. In 1 management company with zero assets, an advance was provided on the cash expenditures of the liquidator via the Ministry of Finance. Insolvency proceedings were opened in 1 management company.

Three natural persons were entered in the list of forced administrators and liquidators for the capital market maintained by the CNB. Two entry proceedings were conducted in the insurance sector (in the list of forced administrators for insurance companies and the list of liquidators for insurance companies). One natural person was entered (in the list of liquidators) and one entry was rejected.

Other regulated entities

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

Act No. 130/2008 Coll., amending Act No. 455/1991Coll., on Trade and Entrepreneurial Activities (the Trades Licensing Act), as amended, and other related acts, took effect on 1 July 2008. The amended Trades Licensing Act includes a revised Annex 3, which contains licensed small businesses. As a result of this revision, licensed small businesses no longer include bureau-de-change activities.

The amendment of the Foreign Exchange Act, implemented by Act No. 254/2008 Coll., amending some laws in connection with the adoption of certain measures against money laundering and terrorist financing, took effect on 1 September 2008. In this amendment, authorisation of foreign currency cash purchases and sales was unified. Under the amended Foreign Exchange Act, bureau-de-change activities are defined as the provision of services to third parties, the subject of which is the purchase or sale of banknotes, coins or cheques in foreign or Czech currency in return for banknotes, coins or cheques in another currency.

Under the legislation in effect until 31 August 2008, bureau-de-change activities were carried out on the basis of licensing certificates issued by local trade licensing offices. These certificates authorised entrepreneurs (natural or legal entities) to purchase foreign currency in cash only. Before granting licensing certificates, trade licensing offices would request the CNB's opinion. Entrepreneurs could purchase foreign currencies only on premises and in exchange machines approved by the CNB in advance. In 2008, the CNB issued 44 opinions on the granting of licensing certificates and 123 opinions on the approval of premises. The total number of foreign exchange entities with licensing certificates was 2,514 at the end of 2008.[12] According to data

12 Under a transitional provision of the amendment to the Foreign Exchange Act (Article XXII(1) of Act No. 254/2008 Coll.) foreign exchange licence holders can carry on such activities until the date of issue of a decision on registration for bureau-de-change activities, although for no longer than 18 months from the date of effect of Act No. 254/2008 Coll., i.e. until 28 February 2010 at the latest.

available to CNB branches, roughly 48% of them were carrying on bureau-de-change activities. The number of foreign exchange entities has been flat since 2002. Compared to 2007 the number slightly declined, as did the number of foreign exchange premises, which totalled 2,313 at the end of 2008. The lower number of foreign exchange premises than licensing certificates is due to non-performance of bureau-de-change activity by licensing certificate holders.

Since 1 September 2008, the CNB has been performing registrations for bureau-de-change activity. Such work is carried on by CNB branches. Between 1 September 2008 and 31 December 2008, the CNB received 90 applications for registration for bureau-de-change activity, 82 of which were approved.[13]

Until 31 August 2008, CNB branches made decisions locally on the granting of foreign exchange licences for the selling of foreign currency in return for Czech currency in cash. However, the amended Foreign Exchange Act no longer regulates this type of licence, as sales of foreign currency have become a part of bureau-de-change activities. Other foreign exchange licences continue to be issued by CNB headquarters. In 2008, the CNB received 20 foreign exchange licence applications. Most of these applications were approved by the CNB; applications were refused on the grounds of failure to meet the conditions for granting foreign exchange licences. As of 31 December 2008, the CNB registered 328 valid foreign exchange licences.

Non-banking foreign exchange entities may carry on bureau-de-change activities or non-cash foreign exchange transactions or provide financial services only on premises registered for this purpose in advance by the CNB. Between 1 September 2008 and 31 December 2008 the CNB registered 97 premises in total.

In 2008, the CNB issued 6 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 2008[14] (one of them is a holder of two permits for various products). The Czech Republic continues to be in a leading position among the EU Member States in terms of the number of electronic money institutions. 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 2008, 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. A new type of electronic money issuer is a company that intermediates "micro-payments" for third party services using mobile or internet applications (direct pay). 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.

4.5 OFF-SITE SURVEILLANCE

Off-site surveillance consists in continuously monitoring the activity and financial performance of the individual entities operating on the financial 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 required, an extraordinary reporting duty is imposed on financial institutions.

13 One application for registration for bureau-de-change activity was withdrawn, one application was refused and the decisions on the remainder had not been made by 31 December 2008.

14 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).

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.

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.

Owing to the financial crisis in 2008, off-site surveillance focused more intensively on the potential impacts of financial market developments on the performance of domestic financial institutions. In this context, the portfolios of the supervised institutions were analysed in more detail and their exposure to risky entities or instruments was determined. The risk exposure was relatively low and so its impacts on institutions' financial results were limited. Considerable attention is also being paid to the liquidity of key financial institutions. In this context, the supervisory authority communicated intensively with the supervised institutions. Extraordinary reporting of selected indicators and information was also introduced for a number of entities.

4.5.1 Supervision of credit institutions

Off-site surveillance of credit institutions consists mainly in continuously monitoring the activities and financial condition of banks, foreign bank branches and credit unions and the risks they undertake. Off-site surveillance in 2008 additionally focused on the potential impacts of the global market turbulence. In this respect, credit institutions' portfolios were analysed and their potential risk exposures determined.

The main analytical instrument employed in off-site surveillance is regular comprehensive analyses to assess the financial condition of individual entities and the sector as a whole. An analysis of the financial condition of each bank and credit union and the risks it undertakes is prepared quarterly. This serves as a basis for decisions on the intensity and manner of their supervision. Foreign bank branches are assessed under a slightly simpler regime, as the CNB's powers of supervision of these entities are limited.[15]

Another analytical instrument is early warning information, which helps supervisors to identify potential negative tendencies in individual banks. The outputs of the automated early warning system are assessed for individual banks on a monthly basis. Compliance with prudential limits (e.g. for capital adequacy and credit exposure) and other prudential rules is monitored at the same frequency.

Ratings dividing banks into five categories according to their financial condition and management quality are prepared for internal CNB supervisory purposes twice a year

Given the international financial market situation, off-site surveillance of banks and foreign bank branches was extended as from 1 October 2008 to include an extraordinary daily reporting obligation covering data on liquidity positions, the volume and structure of quick assets, the volume of deposits, exposures to groups of foreign parent undertakings and the volume of loans provided. Banks were also obliged to inform the CNB about any significant fall in their quick assets and about expected transactions that might significantly affect their liquidity position. Off-site surveillance also focused on banks' credit portfolio quality and capital adequacy. The reporting duty revealed no major signals of adverse movements in banks' liquidity or exposure to parent companies. The Bank Board receives information on this extraordinary reporting duty every week.

15 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 under the Act on Banks.

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 institutions 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.

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 2008, CNB Banking Supervision obtained auditors' reports on control systems in 3 banks, evaluating the situation in these banks as of 31 December 2007. For 2008, requests for such audits were placed in the case of one bank and five credit unions. These audits were made available to the CNB in the first quarter of 2009. 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 in banks where necessary. Following the completion of the consolidated audits for 2007 discussions were held with selected banks on their financial accounts for 2007 and the outlook for 2008. In 2008, these visits also focused on the potential impacts of the global financial market turbulence on the performance of domestic credit institutions.

In 2008, a total of 93 decisions were issued relating to the assessment of the competence and integrity of proposed senior officers in banks, the approval of external auditors of banks and credit unions, the approval of 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 credit institutions are carrying on their business in compliance with the Act on Banks and other legal regulations.

On 1 April 2006, in connection with the integration of supervisory activities, the CNB also assumed responsibility for supervising the credit union sector. Supervision of this sector in 2008 continued under the standard regime and focused in particular on assessing the current situation and developments in individual credit unions. The credit union licence of Komerční spořitelní a úvěrní družstvo DOMOV terminated in the first half of 2008. The CNB granted its prior consent to the cancellation of the licence and the members' meeting decided to cancel it in June 2008. Four new credit unions joined the CERTIS payment system in 2008. At the end of 2008, a total of six credit unions[16] were participants in the payment system.

Shortcomings identified in credit institutions' activities 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. To this end, credit institutions are required to send the CNB 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 or Article 28 of the Act on Credit Unions can be applied.

16 See: http://www.cnb.cz – *Payments – Bank codes.*

4.5.2 Supervision of capital market undertakings

In the capital market area, the CNB supervises investment firms, investment instrument markets, collective investment entities, pension funds 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, based on which regular assessments of the level of risk of supervised entities and the potential impact of their failure on the financial market stability were carried out. In addition to regular analyses, the data were used mainly in the context of on-site examinations and other activities associated with the licensing process.

During 2008, investment firms were inspected in terms of their quality of compliance with the Basel II reporting duty, focusing mainly on the correctness of the reporting of individual capital requirements. Fulfilment of the disclosure duty laid down in the CNB Decree on prudential rules for banks, credit unions and investment firms was also verified. Communication continued with investment firms in the field of consolidated supervision with the aim of identifying the structure of consolidated groups containing non-bank investment firms.

After the amendment to the Capital Market Undertakings Act implementing the MiFID into Czech law took effect, the volume of methodological activity increased markedly. In addition to drawing-up explanatory opinions on new or newly identified obligations of investment service providers under the MiFID, investment firms and some investment intermediaries were examined to verify whether their internal regulations and operating procedures are compliant with the new legislation. The way in which individual investment firms had informed their customers about the new rules relating to the best execution of orders was checked. At the end of 2008, an examination of compliance with the new disclosure duties for transactions in listed shares was commenced. In the conditions of market fragmentation resulting from the establishment of the new market platforms envisaged by the MiFID, disclosure of information on transactions represents an important element for maintaining the integrity and transparency of the capital market.

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

Standard supervisory work in the area of investment instrument markets was focused on continuous monitoring of transactions with regard to potential manipulation or insider trading. Increased attention was paid to issues where share buy-backs or takeover bids were in progress. The fairness of presentation of investment recommendations was also monitored on an ongoing basis. Supervisors also cooperate with foreign regulators in this area.

Implementing regulations governing the provision of information by regulated markets in unified format for supervisory needs in the area of market trading took effect during 2008. Work continued on the capital market monitoring information system, which should facilitate more efficient data management and analysis. This system is scheduled to go live during 2009.

In the area of private pension insurance the CNB focused during 2008 on communication with the Association of Pension Funds and individual pension funds as regards compliance with the prudential rules. Given the adverse financial market situation, the CNB in the second half of 2008 introduced an extraordinary monthly reporting duty concerning the financial results of pension funds. The Bank Board was regularly informed about the results.

Off-site surveillance in the collective investment sector was focused on analysing data acquired under the disclosure duties. Asset eligibility, asset valuation and compliance with investment limits were verified and checked. In the second half of 2008, the CNB introduced an extraordinary daily reporting duty in this segment of the financial market, too. This duty was aimed primarily at monitoring the liquidity of money market individual funds.

4.5.3 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 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 prior to April 2006 (the date of integration of the supervisory authorities into the CNB) 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. At the beginning of 2008, this duty to present reports was being fulfilled by two insurance undertakings, although this obligation was cancelled in both cases during 2008.

In line with the new strategy for risk-based supervision, an early warning system was completed in 2008. This uses financial indicators to assess the recent trend in an insurance company's development at quarterly frequency from regularly obtained statements. It also enables supervisors to identify potential weaknesses in an insurance company's finances. Work was started on an overall internal rating system for insurance companies in the second half of 2008.

Information-gathering visits to all Czech insurance companies, focusing in particular on obtaining information on their current financial and business situation and their other plans and strategies, were an integral part of supervision in 2008. Besides the standard information-gathering visits, thematic information-gathering visits in selected insurance companies are planned for 2009, each focusing on a specific insurance class based on an economic and actuarial analysis.

In order to extend and enhance supervisory analytical procedures, new reports were prepared for insurance companies for 2009 which will, for example, facilitate verification of the sufficiency of the most significant non-life insurance technical provisions and analysis of the level of risk of individual classes of non-life insurance.

Significant supervisory attention in 2008 was devoted to monitoring the impacts of crisis-related financial market developments on the financial condition of individual insurance companies and the effect on their liquidity. Extraordinary weekly reporting of selected information was introduced in some insurance companies; at the beginning of 2009 this was changed to monthly reporting. The Bank Board receives regular information on this extraordinary reporting.

Several joint inspections were conducted by the CNB and relevant foreign supervisory authorities at the international financial group level in 2008. These joint inspections were targeted at unifying the methodologies for individual areas of supervision within the EU. More joint inspections are planned for 2009.

4.5.4 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 2008, the CNB acted as a supplementary supervision coordinator for one financial conglomerate.

4.5.5 Supervision of other regulated entities

In the foreign exchange area, the CNB supervises almost 3,000 non-bank foreign exchange entities. These consist of entities offering cash purchases or sales of foreign currency as well as holders of foreign exchange licences for non-cash foreign currency transactions and holders of foreign exchange licences for the provision of financial services. The CNB's foreign exchange supervisory work involves checking compliance with the foreign exchange regulations, examining anti-money-laundering and anti-terrorist-financing measures and also inspecting measures relating to international sanctions. The inspections conducted by the CNB are focused particularly on enforcement and strengthening discipline in the supervised areas.

The CNB may open administrative proceedings if it finds that the foreign exchange regulations have been contravened.[17] If a suspicion of contravention of the foreign exchange regulations is proved, the participant's activity that is in breach of the foreign exchange regulations may be suspended or prohibited, the scope or terms of the licence may be changed, the registration for bureau-de-change activity may be cancelled, the foreign exchange licence may be revoked or a fine may be imposed, depending on the extent, manner and duration of the contravention.

In 2008, as in previous years, most of the foreign exchange offences were due to breaches of the conditions for cash purchases/sales of foreign currency in return for Czech currency. These mostly concerned erroneously made out and labelled deductions for foreign currency sales and purchases and insufficient record-keeping in the case of foreign exchange books. The offence of unauthorised offering, performance or intermediation of foreign currency transactions was identified in two cases. Where the CNB finds a contravention of the foreign exchange regulations consisting in the unauthorised offering, performance or intermediation of foreign currency transactions, it either orders the offender to terminate the unauthorised activity or opens administrative penalty proceedings.

The CNB's supervision of electronic money institutions – based on the permit 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.

In the field of consumer protection, the CNB supervises compliance with the obligations laid down in Act No. 634/1992 Coll., on Consumer Protection, as amended, and also compliance with the obligations in respect of distance contracts for financial services under Part One, Title Five of Act No. 40/1964 Coll., the Civil Code, as amended.

17 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.

4.6 ON-SITE EXAMINATIONS

The standard toolkit for supervisory work in financial institutions includes on-site examinations of regulated entities. These are an essential instrument of supervision, since they facilitate verification of the functioning of the system for compiling off-site surveillance reports, the correctness of the data reported as well as information that cannot be included in such reports, i.e. the quality of the internal control systems of individual supervised institutions. On-site examinations are performed in compliance with the legislation in force (the State Inspection Act) and are focused on checking compliance with the regulatory rules under the legal and implementing regulations pertaining to the activities under examination. The individual examinations focus either on verifying all the relevant activities of the examined entity (comprehensive examinations) or on verifying selected areas thereof (partial examinations).

A separate category is the validation of advanced methods for calculating capital requirements for market, credit and operational risk. These examinations are focused on assessing the preparedness of applicants for the approval of internal models.

Great emphasis is put on assessing systems for identifying, measuring, monitoring and regulating the risks faced by the examined entities in the areas inspected. This concept is taken into account when setting up inspection teams, whose members are selected on the basis of their risk specialisations.

The on-site examinations conducted in 2008 were based on a plan of activity compiled with due regard to the off-site surveillance requirements. Part of the CNB's on-site examination capacity was earmarked for the validation teams' needs and the potential need to conduct extraordinary (i.e. unplanned) examinations.

The examined entities' managements were notified of any shortcomings detected. On-site examination reports were written and measures were imposed. Compliance with such measures is systematically monitored and evaluated.

4.6.1 On-site examinations in credit institutions

The examinations were planned on the basis of the off-site surveillance requirements after considering the results of the risk assessment system, the time elapsed since the last examination and the potential impacts of financial market developments. Methods requiring the regulator's approval were validated on the basis of applications submitted by the relevant institutions.

In the course of 2008, nine examinations were carried out in credit institutions, all of them banking institutions. Although these were all partial examinations, some of them resembled comprehensive examinations as they covered most activities. The examinations focused on credit risk management, internal auditing, compliance, operational risk management, money laundering prevention, information systems and technology, and the generation of related reports for regulatory purposes. The liquidity area was examined in only one credit institution. The process of validation of advanced or other risk measurement and management methods requiring the regulator's approval took place in five credit institutions.

The examinations identified no shortcomings posing a direct and significant threat to the financial position or existence of the institutions examined. However, some of the shortcomings were in contravention of the relevant regulations, in particular Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms. This was reflected in the wording of the corresponding examination findings and remedial measures.

Examinations of credit risk management systems

Credit risk examinations focus on evaluating compliance with the regulatory requirements for credit risk management in lending, trading with counterparties and asset securitisation. The credit risk management requirements concern the lending process itself, the sufficiency of collateral, the method for measuring, monitoring and assessing risks undertaken, the system of limits, and reporting.

The most significant and most common findings identified in 2008 included insufficient documentation of lending processes, errors in entering data into information systems (including accounting systems), shortcomings in assessing and monitoring collateral value (even in cases where the provision of credit was not based on the borrower's ability to repay, but on the value of the collateral provided) and monitoring of concentration risk and groups of connected persons.

Examinations of management of market risks, liquidity risk and risks associated with trading on financial markets

Owing to the integration of financial market supervision, the capacity of the unit specialising in examining market risks, liquidity and risks associated with financial market trading in 2008 was used for inspecting insurance companies and also for validating advanced methods for calculating capital requirements for operational risk and partially also credit risk. This area was examined in only one credit institution and only in the liquidity area. The more significant findings included shortcomings in the area of stress testing and liquidity scenarios as well as under-diversification of deposits.

Examinations of operational risk management, including IS/IT risks

In operational risk examinations, the CNB in 2008 started checking the calculation of capital requirements for operational risk and stepped up its examinations of the risks associated with the growing integration of banks operating in the Czech Republic into the process of concentration of information technology and services in international financial groups.

The on-site examinations in 2008 continued to verify the way in which banks 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. Special attention was also given to issues relating to business continuity and outsourcing. In 2008, 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 2008, the CNB paid close attention to electronic banking in relation to the number and risk of incidents and further development in this area of banking business.

The most serious and most common findings identified in the operational risk management area included shortcomings in recording data on operational risk events, in updating contingency plans and in informing the relevant departments and bodies of the entities examined. In the area of IS/IT management, shortcomings were identified in analytical activities, security policy compliance, classification of information system assets, management and monitoring access to information and IT communication management and operation. Shortcomings were also detected in assessing and limiting outsourcing risks.

On-site supervision in the operational risk area also involved verifying banks' preparedness for the introduction of 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

Although the relevant components of internal control systems are examined as part of the inspection of the management of individual risks (as an integral part of the management of such risks), given the cross-sectional nature of these systems the key overall prerequisites for sound corporate governance and internal control systems are additionally inspected. The internal control system examinations in particular check and assess internal auditing, compliance[18] and the system for detecting and remedying shortcomings in internal control systems. Examinations in the area of corporate governance focus on evaluating the role of credit institutions' bodies and committees in internal control systems, overall organisational structures, information flows and mutual links, sufficient traceability and so on.

The main findings included insufficient prerequisites for ensuring compliance and the shortcomings in the internal audit area. These mainly involved shortcomings in the assessment of risks and creation of the internal audit activity plan, in the quality of some audits, in the verification of the fulfilment of recommendations and in the provision of information to the management of the examined entity. Weaknesses were indentified in the system for eliminating shortcomings, failure to comply with internal regulations, ambiguous delineation of powers and responsibilities, insufficient regulation of procedures in the internal rules and limited traceability of some activities. Shortcomings were also detected in control bodies (including the composition of the supervisory board) and in the minutes of the board of directors. Other problems included the absence of principles for the remuneration of directors and parallel membership of bank representatives and employees in the statutory bodies of other companies in contravention of the legislation.

Anti-money laundering (AML)

The examinations are focused on verifying the operation and effectiveness of the AML system. Supervisors check the compliance of the examined entity's activities with Act No. 253/2008 Coll. and other related acts (e.g. Act No. 69/2006 Coll., on the Performance of International Sanctions, etc.) and CNB Decree No. 281/2008 Coll., the application of appropriate "know-your-customer" policies, the sufficiency of vetting of persons, the ability of the credit institution to identify and assess suspicious transactions, the process of reporting suspicious transactions to the Ministry of Finance, etc. The CNB works closely with the Ministry of Finance's Financial Analytical Unit as far as methodology is concerned.

The shortcomings detected in the money laundering prevention area usually also constituted infringements of the relevant laws or CNB decree governing this area. They included shortcomings in the manner of determining information about customers and assessing relevant risk factors, in the classification of customers, in the sharing of existing information on risky customers, in the scope of checking against lists of persons on which sanctions have been imposed, in the formalities of evaluation reports, and in training.

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. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms, of 15 May 2007, banks are allowed to use advanced approaches based on mathematical models in order to calculate capital requirements.

In 2008, the teams set up in order to examine special methods continued their intensive consultations with all regulated institutions that have shown an interest in using the IRB approach for credit risk or the ASA and AMA approaches for operational risk. The activities of the two teams included ongoing communication with foreign banking supervisory authorities in the area of establishing a common approach to validating these advanced approaches in multinational banking groups.

18 Given the very brief definition in Decree No. 123/2007 Coll., the CNB additionally uses acknowledged standards – especially BIS documents: *The Compliance Function in Banks* (April 2005) and the CEBS *Guidelines on the Application of the Supervisory Review Process under Pillar 2* (January 2006).

Intensive pre-validation[19] and validation processes for the IRB approach were conducted in two banks operating 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 2008, authorisation to use the IRB approach to the calculation of capital requirements was granted to one bank in the Czech Republic, which had been included in its foreign parent bank's application to use the IRB approach. Consent to the use of the ASA approach was granted to one bank and one credit union in the Czech Republic. At the same time, documents necessary for the final decision on the AMA approach were prepared in one bank which had been included in the application of its parent company. These documents were forwarded to the home supervisor and – by mutual agreement – taken into account in the final decision.

4.6.2 On-site examinations in capital market institutions

In the collective investment area, one on-site inspection was conducted in a management company, focusing on compliance with the prudential rules and the rules of organisation of the internal operations of management companies and the rules of conduct and professional care in the management of assets in a mutual fund and the management of assets of a client under contract with the client.

One inspection was completed in a depository in 2008 and three others were still ongoing in 2009. These inspections were concentrated on the handling of assets of collective investment funds and pension funds, the execution of orders, the method of valuation of assets of collective investment funds and pension funds and the calculation of the present value of mutual fund units or investment fund shares.

Shortcomings were identified particularly in the checking of instructions on the dates stipulated in the regulations, checking of payments from pension fund assets, systematic checking of professional care in price setting and other terms and conditions of transactions, checking of redemptions of collective investment fund units, checking of the calculation of the present value of mutual fund units, and checking of limits.

In the area of private pension schemes, inspections were carried out in two pension funds in 2008, focusing chiefly on compliance with the obligation to manage pension fund assets with professional care and compliance with the obligation to handle assets in a manner consistent with the interests of planholders as regards covering the direct and indirect costs of recruiting new planholders and of related activities, and in one case on compliance with the Consumer Protection Act. In addition, actions following up on inspections conducted in several pension funds in 2007 were completed in 2008.

Eight on-site examinations were commenced in the area of investment service provision in 2008 (five in investment firms and three in investment intermediaries). Seven of these examinations were comprehensive, focusing on compliance with the rules for prudent provision of investment services (in particular, administrative and accounting principles, internal control systems, financial risk management systems and liquidity management systems), the rules of conduct towards clients and maintenance of registers. The remaining examination was a follow-up control focusing on determining whether remedial measures had been implemented. Entities in which an inspection had not previously been conducted were also examined.

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

19 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.

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. In the event of errors, the shortcomings are eliminated by means of remedial measures, including penalties. An inspection often follows, with the aim of determining how the remedial measures have been applied in practice.

4.6.3 On-site examinations in insurance companies and insurance intermediaries

Five on-site examinations were carried out in 2008. As in the previous period, the supervisory teams focused on comprehensively assessing the condition of the individual insurance companies, and in particular on checking insurance risk management systems (creation and use of technical provisions, reinsurance systems) and market, counterparty and liquidity risk management systems. Attention was also devoted to the structure of financial investments (compliance with the requirements arising from the Act on Insurance and its implementing decree) and management of legal risk (passive lawsuits) and operational risk (registration and administration of insurance policies, settlement of financial market transactions, payments, and loss adjustment processes). In some cases, administrative and accounting procedures, solvency management and calculation methods and internal audit functions were also inspected.

Significant shortcomings were found mainly in the area of creation of technical provisions (including cases of undervaluation, which, however, were not of a material nature), in interest rate risk and liquidity risk management, in internal control environments (particularly in the areas of payments, loss adjustment and settlement of financial market transactions) and in internal audit activities.

Although the shortcomings detected in the examined insurance companies were often of a systemic nature and in some cases constituted breaches of the legislation (particularly in the technical provisions area), none of them was assessed as a direct threat to the companies' financial stability or ability to fulfil their obligations.

In 2008, one on-site examination focusing on the obligation to carry on insurance intermediary activities with professional care was in progress in an insurance intermediary and one such examination was terminated in another insurance intermediary. In the latter case, the CNB had received a large number of complaints from clients regarding the intermediary's activities. The on-site examination found that the intermediary had violated the obligation to act with professional care, mainly by not having sufficiently and appropriately arranged contractual relations with persons conducting intermediary activities on its behalf and by not ensuring appropriate control of its network of recruiters. After the completion of the examination and appeal proceedings the case was forwarded to the administrative proceedings department.

4.6.4 On-site examinations in other regulated entities

The CNB conducts on-site foreign exchange examinations through its branches. The aim of these examinations is to verify effectively all activities performed by a particular non-bank foreign exchange entity and its individual establishments. A total of 399 on-site foreign exchange examinations were conducted in 2008. Breaches of legal regulations were found in 250 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 explicitly authorised by law to conduct on-site examinations of entities that issue electronic money pursuant to Article 19 of the Payment System Act.

4.7 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 within the required deadlines, though in some cases there are 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 included 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 the 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 exchange of information. This good cooperation has been particularly apparent in the context of the ongoing financial crisis as the CNB has progressively introduced extraordinary reporting duties in individual financial market segments in order to obtain information on the current financial condition of individual supervised institutions. The central bank is endeavouring to further strengthen this mutual communication and exchange of information in relation to both individual entities and their professional associations.

5. CENTRAL CREDIT REGISTER

The Central Credit Register (CCR) is an information system that has been administered by the CNB since 2002. It enables banks and foreign bank branches operating in the Czech Republic (hereinafter referred to as banks) to exchange information on the credit commitments and payment discipline of their clients. The operational availability of information on the current commitments of business borrowers and on the repayment of those commitments in the CCR's time history is an important confidence-boosting factor for lending transactions in the Czech banking sector. The CCR is now regarded as a natural part of the set of instruments that banks employ in operational risk management.

The CCR contains information on the range and quality of loans provided to business borrowers broken down by types of balance-sheet and off-balance sheet banking liabilities. All banks have access to the information in the CCR. All banks are also obliged to update the CCR on a monthly basis and maintain the quality of the information stored in its database. The information in the CCR is made available to bank users immediately after each monthly update.

The key objective of CCR database administration is to guarantee the completeness and correctness of the information reported. The processes associated with the monthly CCR data update carried out by banks are therefore supported by IT as much as possible. Data processing is designed as an automated process comprising several tiers of control mechanisms focused on ensuring the accuracy and completeness of the information registered.

Independently of the checks performed during data collection and processing, the CNB also conducts methodological inspections of CCR practices in individual banks. In addition to compliance with the CCR reporting rules, these inspections focus on fulfilment of the statutory conditions for the use of CCR information in banks' lending activities and reflect banks' practical experience with using the register. Suggestions obtained during these inspections are a valuable resource for the elaboration of CCR development plans. Methodological inspections were carried out in two banks in 2008.

Use of the CCR has been steadily rising since its launch. The initial slower growth in the CCR's use during its first few years of operation was linked with its gradual acceptance as a new phenomenon changing established practices in the field of information support for lending processes in banks. The level of use of the CCR then gradually increased following the introduction of new systems providing automated support for business processes and credit risk management, which were predicated on active use of the CCR. This upward trend continued into 2008.

Table A.XIII – Main operational characteristics of the CCR

	31 Dec. 2006	31 Dec. 2007	31 Dec. 2008
Number of registered borrowers	356,247	403,417	461,277
of which: individual entrepreneurs	213,704	237,703	271,770
legal entities	142,543	165,714	189,507
Total loans outstanding (CZK billions)	1,101	1,141	1,265
Number of CCR users	2,284	2,422	2,472
Ad hoc enquiries about credit commitments (thousands/year)	140.7	148.3	179.6
Number of pieces of information on credit commitments in aggregate monthly reports (thousands/year)	2,250	2,390	2,800
Number of extracts made for clients in year	195	225	278

The rise in the number of registered borrowers and the total amount of loans outstanding corresponds to the gradual rise in the range of bank lending to businesses. The numbers of users provide evidence of the availability of information via the CCR. This indicator is likely to be flat or gradually falling in the years ahead as a result of expanding use of internal bank applications to access CCR information.

The numbers of pieces of information provided on debtors' credit commitments illustrate the intensity of use of basic CCR information. Banks may verify registered data on clients' credit commitments as and when necessary via "ad hoc" inquiries with "on-line" responses in the CCR application or in their own applications linked to the CCR database through a direct communication channel. For regular checking of the evolution of risk characteristics, banks use an aggregate monthly report containing a complete survey of the credit exposures of all their own clients in the current period, including a retrospective credit history.

The continuously rising number of applications for extracts from the CCR prepared by the CNB corresponds to the rising use of the CCR in the banking sector. To make the CCR more accessible to the public, the CNB in 2008 introduced the option of submitting applications for extracts from the CCR via an electronic mailroom.

As well as running the CCR, the CNB continuously analyses the needs for further enhancements and defines requirements for implementing relevant changes in the CCR project. Many new user functions have been added since 2006. These have focused not only on upgrading the CCR's core features, but also on making more intensive use of its existing information potential. Particular value added comes from new CCR functions and outputs intended for analytical and statistical use in banks and in the CNB.

In 2007, the latest suggestions for upgrading the system's functions were incorporated into the next CCR development phase – "CCR Optimisation and Stabilisation". In this phase, the CCR system underwent a fundamental technical enhancement in 2008 responding to the rising volume of data processed and the growing demands as regards use of the CCR.

In 2008, a new aggregation tool was put into operation allowing monitoring of month-on-month changes in the values of individual claims and other indicators and tracking of the rate of growth of selected indicators in time series. These functions are accessible to statisticians and analysts in banks and at the CNB via the CCR's analytical module and outputs.

The growing demands as regards use of CCR information via banks' internal applications generated a need to make changes in the links between the CCR database and banks' systems. A project launched in 2008 aims to introduce a new technology that will streamline the exchange of information between banks and the register and facilitate CCR implementation in banks' current and new projects.

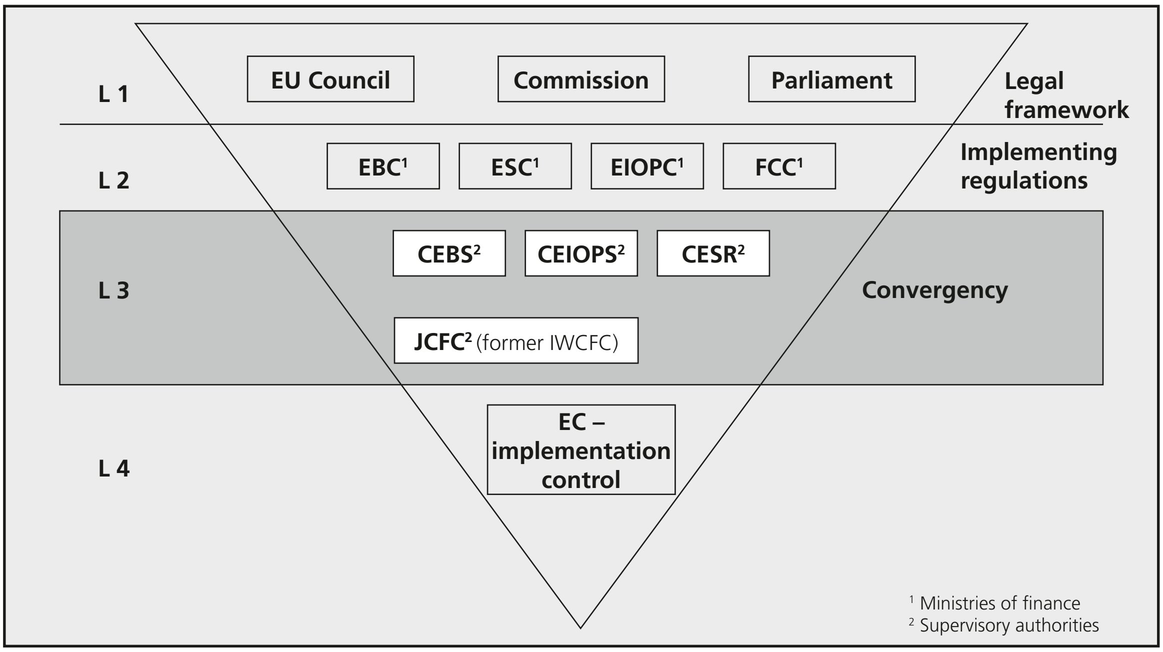
The current phase of the project is also focused on upgrading the functions of the registration and client management subsystem, primarily with the aim of simplifying the identification processes and tightening the conditions for registration of foreign borrowers in connection with the planned international exchange of data. Integration of the Slovak Register of Economic Entities into the CCR system is also being addressed.

Integration of the CCR into the international credit data exchange system forms part of the CCR's longer-term development strategy. The international data exchange idea was initiated by the ECB with the aim of boosting the information value of national credit registers in an environment of growing cross-border credit operations by EU banks. At present, seven EU countries are integrated into the international data exchange system and another four, including the Czech Republic, are preparing to join. The international data exchange system is receiving organisational support from the BSC Working Group on Credit Registers.

6. INTERNATIONAL COOPERATION

6.1 COOPERATION WITHIN EUROPEAN COMMISSION STRUCTURES

As a financial market supervisor, the CNB is actively involved in European structures at Lamfalussy Level 3, the primary objective of which is to strengthen convergence between EU countries. The Lamfalussy framework is illustrated in the following diagram:



European Banking Committee (EBC)

The European Banking Committee (EBC), along with the European Securities Committee (ESC), the European Insurance and Occupational Pensions Committee (EIOPC) and the Financial Conglomerate Committee (FCC), is a Lamfalussy Level 2 Committee responsible for preparing implementing measures in the financial market area at European level. This level falls within the competences of the ministries of finance, and the Czech National Bank worked actively with the Czech Ministry of Finance in the preparations for, and participation in, meetings of the European Banking Committee (EBC)[20] in an expert role.

In 2008, the EBC focused on the Capital Requirements Directive (CRD, Directive No. 2006/48/EC and Directive No. 2006/49/EC), on deposit guarantee schemes, and on the tools used by regulators for dealing with ailing banks, including the option of transferring assets within a group. Attention was also focused on the financial crisis. The committee members exchanged information and opinions. The European Commission (EC) indicated that it wanted to concentrate on the measures adopted by the Member States with regard to their impact on the market. The recapitalisation of banks necessitates a prudential assessment of, for example, whether higher capital requirements have caused deformation of the banking sector.

20 The European Banking Committee is an advisory committee to the European Commission in the banking area.

As regards the regulation of capital requirements, exposures and related areas, the EC published specific proposals in 2008 which were also sent to the EU Council and the European Parliament for discussion. The proposals were as follows:

- an amendment to the CRD, published on 1 October 2008;
- an amendment to the Deposit Guarantee Schemes Directive, published on 15 October 2008;
- a regulation on credit rating agencies, published on 12 November 2008.

On 24 September 2008, the EBC members approved a second amendment to the CRD (within a Comitology procedure)[21] containing technical amendments to the CRD's annexes.

The Capital Requirements Directive

The changes in the CRD amendment of 1 October 2008 mainly concerned relations between home and host regulators in the supervision of cross-border banking groups, exposure rules, the inclusion of hybrid instruments[22] in regulatory capital, securitisation, and liquidity risk management principles. In the case of liquidity risk and particularly of securitisation, this also constituted a response to the financial market crisis.

The CNB disagreed with the proposal that the amount of the supplementary capital requirement of a given institution (a member of a consolidated group) and the extent and dates of reporting by institutions should be decided by the home (consolidating) regulator where such regulator fails to reach agreement with the host regulator during the previous six months. The CNB supported the idea that the CRD should still include discretions under which it would be possible, but not obligatory, to waive the application of limits for exposures to members of a consolidated group, including cross-border banking groups.

The Directive on Deposit Guarantee Schemes

The amendment to the Directive on Deposit Guarantee Schemes contained in particular a shortening of the time taken to pay compensation payments from deposit guarantee schemes (to three days), the termination of co-insurance, and the unification of the amount of compensation paid to clients (and an increase in the coverage from EUR 20,000). The CNB commented mainly on the excessive shortening of the time limits for supervisory authorities or the courts to decide whether a credit institution is unable to meet its commitments, and on the shortening of the time limit for the payment of compensation from deposit guarantee schemes. The amendment was approved by the EU Council and the European Parliament at the end of 2008. The Member States must ensure that the coverage for the aggregate deposits of each depositor is EUR 50,000 by 30 June 2009 and EUR 100,000 by 31 December 2010 in the event of deposits being unavailable. Deposit guarantee schemes must be in a position to pay duly verified claims by depositors within 20 working days of the date on which the competent authorities find that the credit institution is unable to meet its commitments.

The Regulation on Credit Rating Agencies

The incorrect setting of ratings by rating agencies was regarded as one of the causes of the financial crisis. In response to problems such as insufficient quality of ratings and rating methods, lack of transparency and conflicts of interests in the activities of such agencies, the EC published a draft legislative proposal for a regulation aimed at remedying the shortcomings. The CNB felt that the legislation in question should take the form not of a regulation (directly effective in the Member States), but of a directive. The CNB did not support the proposed role of the CESR in the process of registration and approval of agencies' registration applications due to the costs and complexity of this solution (including interference of the CESR and colleges of supervisors in national supervisory authorities' powers) and proposed the application of the single home supervisor principle.

21 The ECB is authorised to approve selected amendments to the CRD, which are then submitted to the European Parliament for its opinion.
22 Hybrids are instruments combining the characteristics of equity and debt instruments and can be included in Tier 1 if certain conditions are fulfilled.

Reorganisation and winding up of credit institutions
In 2008, the European Commission addressed the issue of the reorganisation and winding up of credit institutions in response to an ECOFIN[23] request for a study of the barriers to cross-border transfers of assets. The reason was to review crisis management within the context of entire banking groups. The EBC worked on a document that not only included preliminary findings, but also characterised the main barriers to asset transferability motivated particularly by the protection of shareholders and creditors. On the one hand, restrictions on transfers within a group should be regarded as prevention of "contagion" risk. On the other hand, however, it is necessary to put in place a legal framework making it possible to transfer assets if no other solution exists.

Plans for the period ahead
In relation to the CRD, the EC identified areas which it intends to address in 2009. These include securitisation, a supplementary capital requirement for the trading book, commodities, and technical amendments. The EC will also look at reducing the number of national discretions (on 17 October 2008, CEBS submitted a proposal to the EC on how to deal with the 152 discretions). In preparing proposals in the securitisation and trading book areas the EC will take into account the approach of the Basel Committee on Banking Supervision.

The review of the reorganisation and winding up of credit institutions will concentrate on insolvency-related issues. The results will serve as a basis for a White Paper on Early Intervention Tools for Dealing with Ailing Banks, which the EC intends to publish in mid-2009. The main focus will be to assess whether the current range of crisis prevention/resolution/stabilisation tools available to regulators should be complemented by additional tools. Attention will be also concentrated on whether there is a case for further convergence of these tools at EU level.

Committee of European Banking Supervisors (CEBS)

The aims of the Committee of European Banking Supervisors (CEBS), 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, including the exchange of information. The committee has 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's work in 2008 focused mainly on dealing with the unfolding financial market crisis, implementing the conclusions of the Lamfalussy review, providing technical advice to the European Commission and giving guidance related to the banking directive.

Owing to the financial crisis, the priorities ensuing from the Committee's work programme for 2008 were reviewed and Pillar 2 implementation activities were postponed to 2009. In line with the ECOFIN conclusions, CEBS facilitated cooperation between banking supervisors and information exchange, contributed to the development of a crisis Memorandum of Understanding, carried out a pilot assessment of banking sector risk and monitored the measures adopted by individual Member States to eliminate the adverse impacts of the crisis on financial markets. It also further intensified its dialogue with the industry by establishing industry expert groups composed of its representatives.

The Committee took on new tasks following the Lamfalussy review, which resulted in efforts to strengthen the 3L3 Committees' role, the introduction of qualified majority voting into these committees' Charters, stronger cooperation and coordination within colleges of supervisors and the monitoring of their functioning.

23 ECOFIN: The Council for Economic and Financial Issues, made up of finance ministers.

In 2008, CEBS provided the European Commission with guidance based on calls for advice on large exposures, own funds, liquidity risk management and options and national discretions. Together with CESR, CEBS published technical advice for the European Commission on the review of commodities business, and together with CEIOPS it published technical advice on the equivalence of supervisory measures in Switzerland and the United States.

In 2008, CEBS, CESR and CEIOPS issued guidelines on the prudential assessment of acquisitions and increases in shareholdings in the financial sector and continued implementing and updating the 14 guidelines for credit institutions and supervisory authorities issued so far.

In 2008, CEBS also published a report on bank transparency and a report assessing the European regulatory framework with regard to systemic risk for custodian banks, and approved a proposal for streamlining and harmonising FINREP.

Committee of European Securities Regulators (CESR)

The Committee of European Securities Regulators (CESR) aims to improve the coordination and cooperation among regulators and ensure consistent and timely implementation of EU legislation in the Member States. The Czech National Bank is represented in all its major working groups.

CESR's work streams were updated in 2008 as the crisis in the financial markets deepened. In addition to meeting in plenary sessions, the members responded to the latest capital market developments.

Owing to the capital market developments, CESR established new working groups for dealing with short selling, the impact of Lehman Brothers' insolvency on investors, the valuation of illiquid securities and the impacts of the crisis on money market funds. The CNB was actively involved in the short-selling group.

CESR started to discuss more intensively the role of credit rating agencies in the financial crisis and focused on the proposed regulation of the European Commission in this area and on the next steps the committee will have to take. At the end of 2008, the CNB nominated a member to the Expert Group on Credit Rating Agencies.

CESR also completed its work on the implementation of the ECOFIN resolution on strengthening the 3L3 Committees. Like the other 3L3 Committees, CESR discussed an amendment to its Charters including more effective voting, a proposal for a new cross-sector training platform, and potential projects for future co-financing from the EU budget. At an extraordinary session in September 2008, CESR approved Charters enabling, among other things, qualified majority voting.

Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

CEIOPS continued working on the new Solvency II prudential framework and prepared implementing measures for the Solvency II Framework Directive. CEIOPS approved and submitted to the European Commission two pieces of advice (on the basis of calls for advice), one on implementation of the proportionality principle within Solvency II and the other on aspects of the Directive Proposal related to supervision of insurance groups. The advice covered cooperation in colleges of supervisors and the application of group support (although this part is no longer relevant as the Member States' agreed to delete it from the Framework Directive). CEIOPS also started preparing advice for the Commission on the remaining implementing measures – delivery of these documents is scheduled for October 2009.

CEIOPS also prepared, implemented and assessed the fourth quantitative impact study (QIS4) on Solvency II, in which 14 Czech insurance companies participated. Participation in the study was voluntary. A total of 1,412 insurance companies from all 30 EEA countries took part. QIS4 focused on testing the proposed simplifications and proxies for calculating both the technical provisions and capital requirements of insurance companies. The final report is available on the CEIOPS website.[24] The results for Czech insurance companies did not differ substantially from the European-wide ones.

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 the financial stability in the insurance sector, which is sent to other European institutions and authorities (e.g. FSC, EFC).

CEIOPS established Review Panel within its internal structure. The Review Panel is mandated to monitor the convergence in supervisory practices in this area across CEIOPS members and to assess the implementation of CEIOPS recommendations (peer review). At present, the committee is preparing a pilot assessment of the member authorities. The CNB is actively involved in these activities.

CEIOPS continued monitoring the financial market crisis and its impacts on the European insurance market. It submitted these evaluations to the European Commission and ECOFIN.

The CNB participated in CEIOPS plenary sessions and CNB employees were involved in the activities of individual expert groups.

Cooperation between CEBS, CESR and CEIOPS

In 2008, the cooperation between the Lamfalussy Level 3 Committees (CEBS, CESR and CEIOPS) focused, among other things, on the implementation of the ECOFIN conclusions of October and December 2007 aimed at improving the functioning of the Lamfalussy process. The aim was to strengthen the position of the Committees in the financial supervision area. The 3L3 Committees incorporated into their Charters the possibility to apply qualified majority voting coupled with a "comply or explain" procedure[25].

On the basis of an ECOFIN request of May 2008, the European Commission conducted a review of its decisions establishing the Level 3 Committees in order to strengthen their role in the area of supervisory cooperation and convergence and in the assessment of risks to financial stability in the EU. The proposal for the reviewed decisions gives the Committees new tasks, including the role of mediator, an advisory role, the creation of training programmes, secondment of experts, common supervision, delegation of tasks, promotion of the functioning of colleges of supervisors and the creation of a common reporting format. In addition, the Committees are supposed to contribute to assessing financial stability in the EU.

The 3L3 Protocol was revised to reflect the growing need for effective coordination and cooperation on common tasks. The revised Protocol introduces "rotation of coordination", with CEPS, CESR and CEIOPS alternating in the role of coordinating committee at six-month intervals.

One of the main objectives of the Lamfalussy process is to establish a common supervisory culture within the EU. To achieve this target, the 3L3 Committees organised sectoral seminars, short-term and long-term staff exchanges, and cross-sectoral seminars.

24 http://www.ceiops.eu – *Consultations – QIS – Qualitative Impact Study 4 – Final Report.*
25 Member States that do not implement a committee decision will have to explain their reasons in detail.

Interim Working Committee on Financial Conglomerates (IWCFC/JCFC)

The Interim Working Committee on Financial Conglomerates was established by the European Financial Conglomerates Committee (EFCC). The Czech Republic is represented in the IWCFC by the Czech National Bank. CEBS and CEIOPS cooperate via this committee in the area of supervision of financial conglomerates, and CESR can also participate in this cooperation. Following the revision of the decision on the establishment of CEBS, CEIOPS and CESR, the IWCFC was renamed the Joint Committee on Financial Conglomerates (JCFC) at the beginning of 2009.

Work on assessing the Financial Conglomerates Directive accounted for a large part of the IWCFC's activities in 2008. The output will be a response to a European Commission call for advice concerning definitions and terminology, scope and internal control requirements. The following issues were identified in 2008: the significance thresholds for defining a financial conglomerate, the definition of "participation" and its implications for the scope of application, and the treatment of "participations" in respect of intra-group transactions and risk concentrations. Work on assessing the Directive will continue into 2009, when the response to the call is to be submitted to the Commission.

The IWCFC also prepared an annual prudential report on financial conditions and financial stability in financial conglomerates and updated its list of financial conglomerates identified in Europe.

6.2 COOPERATION WITHIN EUROPEAN CENTRAL BANK STRUCTURES

Banking Supervision Committee (BSC)

The CNB has two representatives in the Banking Supervision Committee at the Central European Bank. In 2008, the BSC discussed the ECB's half-yearly Financial Stability Reviews, the Multilateral Memorandum of Understanding between financial market supervisors, central banks and ministries of finance on financial stability in the EU which took effect on 1 June 2008, and half-yearly reports on the results of a project to stress test banks' liquidity and their contingency plans in the liquidity management area. The BSC also discussed the impacts of the current financial crisis on the EU banking system, which it paid increased attention to in the second half of 2008.

The CNB is also actively involved in the work of three BSC working groups. The first is the Working Group on Macroprudential Analysis (WGMA). In addition to the tasks it regularly discusses, which include Banking Sector Stability Report and its contribution to the aforementioned Financial Stability Reviews, the group also examined the impacts of the financial crisis on the stability of the EU financial system. The second group is the Working Group on Developments in Banking (WGBD), which prepared the regular EU Banking Structures Report, analysed some key aspects of the stability of the Member States' banking sectors and, like the BSC and WGMA, paid special attention to analysing the impacts of the financial crisis on the EU banking system. The last of these groups, the Working Group on Credit Registers (WGCR), focused in 2008 on enhancing the international credit data exchange system, preparing a territorial extension of the credit register information exchange system to include further Member States, and finally also on strengthening the use of credit register information for financial statistics and research.

In addition to its regular working groups, BSC also has ad hoc working groups for specific projects. CNB experts are working in four of these, covering profit and loss accounts, crisis management, liquidity and harmonisation of statistical and supervisory reporting by credit institutions (a joint STC-CEBS group).

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

The CNB is represented in the International Liaison Group (ILG) and its working subgroup, the International Liaison Group on Capital (ILGC). Three meetings of the ILG were held in 2008, focusing mainly on asset impairment and provisioning, risk-based supervision and microfinance. As regards asset impairment, it was confirmed that the level of provisioning had not increased in any country after the introduction of IAS 39. IAS 39 is based on incurred loss, whereas the previous concept was more conservative and based on expected loss. However, IAS 39 is not the only factor reducing provisioning. Others include profit pressures from parent companies, the favourable phase of the business cycle, and methodological problems (a lack of data and experience in estimating losses). An examination of risk-based supervision revealed that many supervisory authorities apply combined supervisory approaches incorporating risk assessment. The ILGC dealt with credit risk concentrations, capital monitoring and Pillar II.

6.4 COOPERATION WITHIN THE GROUP OF BANKING SUPERVISORS FROM CENTRAL AND EASTERN EUROPE (BSCEE)

Since 1996, the CNB has been a member of the BSCEE, whose main activities consist in the exchange of information between supervisory authorities within the region to promote the development of banking sectors in individual countries, and the organising of seminars. The annual BSCEE conference held in Belgrade in 2008 focused mainly on the impacts of the ongoing market turbulence on the CEE region and the impacts of rapid credit growth on financial stability. The Austrian supervisory authority (FMA) and the Banking Agency of the Republic of Srpska of the state of Bosnia and Herzegovina joined the BSCEE in 2008. The group now has 22 members – 11 from EU Member States and 11 from outside the EU.

6.5 COOPERATION WITHIN THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)

The CNB is a signatory (March 2007) to the Multilateral Memorandum of Understanding within the International Organization of Securities Commissions.[26] It is actively cooperating with specific countries under the Memorandum. 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 (IOSCO ERC) and the Emerging Markets Committee (IOSCO EMC).

IOSCO's work was affected significantly in 2008 by the ongoing global financial crisis. The main topics discussed at IOSCO meetings in this regard included convergence of international financial reporting standards and strengthening the accountability of accounting standards makers to national authorities responsible for public sector reporting at national level, restoring investor confidence through the regulation of abusive short selling of securities, enhancing market transparency and information disclosure in respect of all financial products, and revising international regulatory and supervisory standards for credit rating agencies to reflect their role in structured finance markets.

26 IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, IOSCO MMoU, 2002.

Other topics included regulatory approaches to alternative forms of investment, focusing on hedge funds, funds of hedge funds, private capital funds and sovereign wealth funds; rules for the provision of information to retail investors buying financial products, including an obligation to assess the suitability of instruments offered; competition and consolidation of stock exchanges around the world; the cross-border effects of Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments (MiFID)[27]; and regulatory convergence between EU Member States and third countries.

IOSCO's main outputs in 2008 included a revision of the Code of Conduct Fundamentals for Credit Rating Agencies[28], a report on the role of credit rating agencies in structured finance markets[29], a report on the subprime mortgage crisis[30], a report on private equity[31], a report on the objectives and principles of capital market regulation[32], a report on funds of hedge funds[33], a report on regulatory approaches to assessing the suitability of financial products[34], a report on regulatory approaches to the disclosure duty to retail investors buying financial products[35], and a report on crisis management in the provision of audit services[36].

In connection with its new tasks, IOSCO established two new task forces, one on commodity markets (identification of trends) and the other on the role of sovereign wealth funds in public markets. In order to support the recommendations of the G-20 Leaders Summit on Financial Markets and the World Economy of 15 November 2008, IOSCO established a further three task forces on short selling (identification of regulatory gaps), unregulated financial markets and products (identification of ways of enhancing the transparency of OTC markets for derivatives and other structured products) and unregulated financial entities (identification of regulatory approaches to hedge funds).

The CNB was also actively involved in IOSCO's work in the area of questionnaires. In May 2008, a CNB representative attended the IOSCO conference and an IOSCO ERC meeting.

6.6 COOPERATION WITHIN THE INTERNATIONAL ORGANISATION OF PENSION SUPERVISORS (IOPS)

In 2008, the CNB cooperated within the International Organisation of Pension Supervisors, including its work on a specific risk-based supervision toolkit project. In the first half of 2008, the CNB attended an IOPS meeting that discussed a wide range of issues relating to private pension arrangements and the supervision thereof, standards in the area of regulation and supervision of pension funds, and analysis of private pension systems. Involvement in IOPS activities is also a valuable source of information. Owing to other priorities, however, the CNB did not attend the IOPS AGM and related committee meetings in the second half of 2008. Nevertheless, the CNB stands ready to continue working within this organisation in 2009.

27 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.
28 Code of Conduct Fundamentals for Credit Rating Agencies, Technical Committee of IOSCO, revised in May 2008.
29 The Role of Credit Rating Agencies in Structured Finance Markets, Final Report, Report of the Technical Committee of IOSCO, May 2008.
30 Report on the Subprime Crisis, Final Report, Report of the Technical Committee of IOSCO, May 2008.
31 Private Equity – Final Report, Report of the Technical Committee of IOSCO, May 2008.
32 IOSCO Objectives and Principles of Securities Regulation, March 2008.
33 Report on Funds of Hedge Funds – Final Report, Report of the Technical Committee of IOSCO, June 2008.
34 Customer suitability in the retail sale of financial products and services, The Joint Forum, April 2008
35 IOSCO Point of Sale Disclosure: Issues Paper, May 2008.
36 Contingency Planning for Events and Conditions Affecting Availability of Audit Services, Final Report of the Technical Committee of IOSCO, May 2008.

6.7 COOPERATION WITHIN THE INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS (IAIS)

In 2008, the CNB cooperated within the International Association of Insurance Supervisors and attended the IAIS annual conference, which focused on the impacts of the globalisation of financial services on regulators' activities. The CNB downscaled its involvement in the meetings of IAIS working committees and subcommittees, but actively monitored the work on individual standards and guidance papers and took part in various IAIS surveys.

6.8 COOPERATION WITH PARTNER SUPERVISORY AUTHORITIES

In June 2008, the CNB signed the Multilateral Memorandum of Understanding on Cross-Border Financial Stability in the EU. The Memorandum was signed by 118 signatories from 27 EU Member States. The MoU is designed to facilitate the management and resolution of cross-border financial crises and to minimise crisis-related economic and social costs. The MoU defines procedures and practical arrangements for parties involved in crisis situations, paying due regard to the legal obligations of the competent authorities. In contrast to the 2005 MoU between the banking supervisory authorities, ministries of finance and central banks of the EU, the new MoU was signed by the supervisors of all financial sectors, finance ministries and central banks.

By the end of 2008, the CNB had signed bilateral MoUs with eight banking supervisory authorities and six insurance supervisors, while in the capital market area it continued cooperating primarily on the basis of MoUs prepared by IOSCO or CESR.

In the supplementary supervision of insurance companies in groups, the CNB attends the meetings of coordination committees of supervisors of specific insurance groups. Intensive cooperation with supervisors of insurance companies belonging to insurance groups operating in the Czech Republic continued. Multilateral and bilateral meetings of supervisors of entities from such groups take place in this context. Cooperation with partner supervisory authorities also continued in the supplementary supervision of financial conglomerates, no matter whether the partner supervisor or the CNB was acting as coordinator.

At the turn of 2008, a short-term staff exchange took place between the CNB and the Belgian CFBA. One supervisory employee from each institution had the opportunity to gain a wide range of experience regarding the partner supervisor's procedures and methods for the supervision of insurance companies.

The number of MoUs in the banking area was unchanged in 2008, reflecting domestic banks' relatively stable shareholder structure as regards their owners' home countries.[37] In addition to the exchange of information on the financial condition of banks and other entities from financial groups operating in both countries, the discussions with foreign regulators focused mainly on practical issues connected with the implementation of Basel II and recently also on closer supervisory cooperation in resolving potential crisis situations. Several meetings of colleges of supervisors were held in various banking groups. Various initiatives are arising within these colleges, such as interest in concluding specific MoUs relating to specific financial groups and interest in coordinating on-site examinations conducted by individual national regulators in supervised entities of particular financial groups. CNB supervisors are also 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 the assessment of individual banks, the development of the banking sector as a whole – and of its individual segments – is also subject to continuous analysis. Basic aggregated banking sector indicators are published quarterly on the CNB's website.[38] The CNB also communicates regularly with numerous entities interested in the development of the Czech banking and financial sectors (international organisations such as the IMF, the World Bank, the OECD, the ECB and credit rating agencies).

37 See: http://www.cnb.cz – *Financial market supervision – Banking Supervision – (Important information) – Memoranda of Understanding.*
38 See: http://www.cnb.cz – *Financial market supervision – Banking Supervision – Banking Sector – Basic indicators on banking sector.*

In September 2008, the CNB organised in Prague an international conference of representatives of seven financial market supervisory authorities (Greece, the Netherlands, France, Italy, Croatia, Estonia and the Czech Republic) on current issues of supervision of IS/IT risks in financial institutions. The topic discussed included methods of supervision and cooperation of national supervisory authorities, outsourcing and centralisation of IS/IT in financial groups, electronic banking, computer crime, and the role of IT in supervision of the anti-money laundering system.

PART B
THE FINANCIAL MARKET IN 2008

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 all banks[39] excluding the CNB. To better illustrate the situation, external information is sometimes also used in some passages, with the relevant source being cited.[40]

From 2007 onwards, the data presented 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 the 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 January 2008 all 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.

The data in the text and in the annex of tables may differ owing to revisions during the preparation of the report, e.g. following audits. When using historical data, it must be borne in mind that the year-on-year comparisons do not involve the same sets of entities, especially in the area of capital market analyses.

39 Unless indicated otherwise. See section 2.1 for information on the structure of the banking sector.
40 The differences are described in more detail at: www.cnb.cz – *Statistics – Monetary and financial statistics – FAQ*.

1. THE ECONOMIC ENVIRONMENT IN 2008[41]

The global financial crisis that erupted in 2007 as a result of the turmoil on the US subprime market turned into an economic crisis in 2008 which spilled over to Central Europe and affected macroeconomic developments in the Czech Republic. The adverse economic trends impacted on the financial performance of institutions operating on the domestic financial market and the ability of businesses and individuals to repay their obligations. Adjusted for price and seasonal effects, GDP increased by 0.7% year on year in 2008 Q4, but fell by 0.9% in quarter-on-quarter terms.[42] Real GDP adjusted for seasonal and working day effects grew by 3.1% for 2008 as a whole, making the Czech Republic one of the more successful EU countries in this respect. In Germany, which has long been the Czech Republic's largest trading partner, the growth rate of real GDP also declined considerably, from 2.5% in 2007 to 1.3% in 2008. Average GDP growth for all 27 EU countries was 0.9% in 2008. GDP in the Czech Republic reached CZK 3,705.9 billion at current prices.

The gradual decline in GDP growth in 2008 was counteracted above all by domestic demand, in particular rising household consumption. The contribution of gross capital formation to GDP was negative, owing chiefly to inventories. Foreign trade had a negative impact on the annual growth rate of GDP in 2008 Q4 only; otherwise it recorded positive contributions to GDP growth in 2008.

Inflation rose compared to the previous year. The average inflation rate in 2008 was 6.3%, up by 3.5 percentage points on a year earlier. In 2008, inflation was affected strongly by an increase in the lower VAT rate and the effects of previous growth in world prices of energy-producing materials and food. Annual consumer price inflation exceeded 7% at the beginning of the year and remained significantly above the CNB's inflation target until 2008 Q3. However, it started to decline in 2008 Q4 as the cost shocks gradually subsided, returning to the tolerance band around the CNB's inflation target of 3% in December 2008.

The koruna's appreciation trend against the euro and the dollar continued until 2008 Q3. The bulk of exports and imports are traded in these two currencies. The strengthening koruna reduced the prices of most imported commodities and dampened inflation growth. In year-on-year terms the koruna appreciated from an average of CZK 27.8 to the euro in 2007 to CZK 25.0 to the euro in 2008. The strengthening of the koruna against the dollar was even more sizeable, from an average of CZK 20.3 to the dollar in 2007 to CZK 17.1 to the dollar in 2008.

In 2008, the balance of payments recorded similar results to the previous period. The current account deficit decreased moderately, by 0.1 percentage point to 3.1% of GDP. In absolute terms it reached CZK 113.9 billion. The persisting deficit was due to a further widening of the income deficit, influenced primarily by non-residents' FDI profits. There was an increase in dividends paid in particular. As in previous years, the financial account showed a surplus of CZK 151.2 billion in 2008, which is roughly the same as in 2003–2005. The financial account surplus in 2008 was due almost exclusively to a direct investment surplus. Portfolio investment recorded a net outflow of CZK 9.1 billion. However, this represented a marked decrease in the portfolio investment outflow.

41 The data in this section are based on CZSO data available in April 2009.
42 A quarter-on-quarter decline in GDP was recorded for the first time since 1998.

The labour market situation deteriorated towards the end of 2008 as a result of the slowing economic growth. The labour market developments suggested a shift to a downward phase of the business cycle. The number of vacancies decreased. The number of unemployed persons was already starting to increase at the end of 2008. The labour shortages visible in previous quarters subsided. Inflow of labour from abroad moderated in 2008 H2. Long-term unemployment was 2.1% on average. The average registered unemployment rate was close to 5.5% under the existing methodology. The increase of 8.6% in the average gross monthly nominal wage in 2008 was 1.3 percentage points higher than in the previous year. Average real wages increased by 2.1% year on year owing to higher inflation, representing a decline of 2.3 percentage points compared to 2007. Aggregate labour productivity grew by 2.0% year on year, i.e. 0.1 percentage point slower than real wage growth.

Despite the marked slowdown in economic growth, the state budget deficit in 2008 was lower than a year earlier. The absolute deficit declined compared to the previous year to an estimated CZK 52.1 billion, or 1.4% of GDP. The government debt-to-GDP ratio was little changed in 2008, totalling 29.8% at the end of the year.

The Czech National Bank tightened monetary policy at the start of 2008. However, in 2008 H2 it lowered its key interest rates in response to the significant change in the economic environment. The Czech National Bank changed its key interest rates four times in 2008 (in February, August, November and December) by a total of 1.25 percentage points compared to the end of 2007. Its monetary policy decisions were based on forecasts drawn up for the Czech economy, the inflation rate and the external economic outlook. The two-week repo rate was lowered from 3.50% to 2.25%, the discount rate from 2.50% to 1.25%, and the Lombard rate from 4.50% to 3.25%.

2. CREDIT INSTITUTION SECTORS

2.1 THE STRUCTURE OF THE BANKING SECTOR

As of 31 December 2008, the Czech banking sector consisted of 37 banks and foreign bank branches. The number of banks has long been stable and the same number of entities have been offering banking services in the domestic banking sector since 2006. The internal structure of the banking sector changed during 2008. As a result of a merger between Raiffeisenbank a.s. and eBanka, a.s., only Raiffeisenbank has been active on the market since 16 May 2008. The activities of HYPO stavební spořitelna a. s. were terminated on 19 August 2008 owing to the acquisition of a direct qualifying holding by Raiffeisenbank, a. s.[43] After acquiring a qualifying holding in BAWAG Bank CZ a. s., LBBW Bank CZ a. s. has been active in the Czech Republic since 26 August 2008. On 1 January 2008, Citibank, a. s., was converted into a branch of the Irish bank Citibank Europe plc, which operates in the Czech Republic under the single licence. By contrast, Banka mezinárodní spolupráce, a. s., whose home country is the Russian Federation, was granted a licence by the CNB.[44] The foreign bank branch Straumur-Burdaras Investment Bank hf – organizační složka entered the banking market on 20 June 2008.[45]

At the end of 2008, the banking sector comprised 20 banks (4 large banks, 4 medium-sized banks, 7 small banks and 5 building societies; one bank had yet to launch its activities) and 16 foreign bank branches.[46] The distribution of banks into these five groups remained broadly unchanged in 2008. The largest part of the Czech banking sector consists of the four large banks. Their share in the total assets of the entire banking sector fell slightly below 58% in 2008, as all the other groups except building societies expanded faster.

TABLE II.1

Shares of bank groups in total assets

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

	2006	2007	2008
BANKS, TOTAL	100.0	100.0	100.0
of which:			
large banks	61.4	61.7	57.5
medium-sized banks	9.3	10.3	12.2
small banks	4.3	4.4	5.3
foreign bank branches	12.6	12.4	14.1
building societies	12.4	11.2	10.8

The significant worldwide and European trend towards consolidation of financial and banking groups is also visible in the Czech banking sector. A merger between HYPO stavební spořitelna and Raiffeisenbank stavební spořitelna was completed on 31 October 2008, and HYPO stavební spořitelna ceased to exist as of that date. A merger between Raiffeisenbank and eBanka was also rounded off in 2008.

Transformation of subsidiaries to foreign bank branches did not occur to any major extent in the Czech Republic. Only Citibank chose this option in 2008.

43 HYPO stavební spořitelna and Raiffeisen stavební spořitelna subsequently merged and the former ceased to exist.

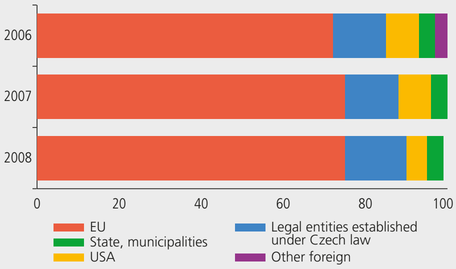
44 Banka mezinárodní spolupráce opened for business in 2009 Q1.

45 A branch of the foreign bank Straumur, whose home country is Iceland (EEA), was operating in the Czech Republic under the single banking licence. In 2009 Q1 the branch was heading towards cancellation of its single passport and termination of its right of establishment in the Czech Republic (closure of the branch). These steps are being taken in all EU countries where it is active. In Iceland the bank was nationalised after suffering large losses as a result of the financial market crisis.

46 The breakdown into groups is provided in Annex 3. For analytical purposes, groups of banks are defined in terms of asset size. In 2007, the boundaries between the groups were 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.

The Czech Republic's accession to the EU in 2004 opened up the domestic financial market to other entities entitled to benefit from the free movement of services under the single licence. A total of 252 banks (of which 12 were electronic money institutions) from EU Member States that had notified the Czech National Bank of this activity were prepared to provide banking services on this basis at the end of 2008. 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 and regulation. The number of banks that have notified the CNB of the provision of cross-border services in the Czech Republic increased by 57 (of which 6 were electronic money institutions) in 2008. Three banks gave notification of the termination of such activities.

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



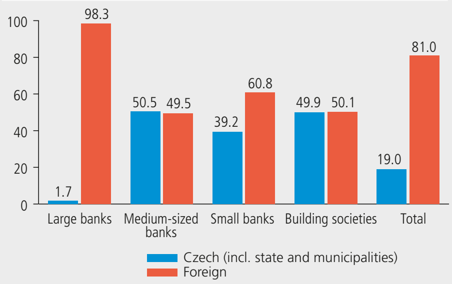
Note: Shares in capital

Banking services were also offered in other EU Member States under the single licence by banks having their head offices in the Czech Republic. As in the previous period, Komerční banka and GE Money Bank continued to provide cross-border services in Slovakia. In 2008, no other bank gave notification of the provision of such activities. Only J&T BANKA, whose home country is the Czech Republic, was offering its services in other EU countries through a foreign branch at the end of 2008. In 2008, ČSOB transformed its branch network in Slovakia to a subsidiary.[47]

2.1.1 Ownership structure

The Czech banking sector has long had a stable shareholder structure. At the end of 2008, as in the previous year, foreign capital dominated the sector's capital, with a direct share of 81.0% (this refers to cases where a legal entity registered outside the Czech Republic holds a direct share in a bank). The representation of foreign capital in individual banks is also significant. Foreign capital predominates in 13 banks (from the legal perspective in terms of the banks' country of registration), eight of them being wholly owned by foreign capital. Seven banks are majority owned by Czech shareholders. Five banks are still wholly Czech-owned (Hypoteční banka, J&T BANKA and Modrá pyramida stavební spořitelna plus two state-controlled banks specialising mainly in export and business promotion – Česká exportní banka and Českomoravská záruční a rozvojová banka).

CHART II.2
Capital origin
(in %; for banks with licences as of 31 December 2008)



A total of 97.1% of the sector's total assets were controlled by foreign owners at the end of 2008.[48] Owners from EU countries continue to dominate. Their share in the foreign ownership of the sector stabilised at the end of 2008 at 92.9%. 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. Shareholders from other territories now have a more-than-

47 On 1 January 2008, an independent legal entity started operating in Slovakia instead of the previous foreign branch of ČSOB. Its business name is Československá obchodná banka, a. s. The subsidiary 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%).

48 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.

marginal representation (a 1.1% 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.

2.1.2 Employees and banking units

A total of 39,003 people[49] were employed in the Czech banking sector at the end of 2008, a decline of 2,204 from the previous year. The number of employees in the domestic banking sector fell by 5.3% year on year, but the sector's total assets rose by 7.9% over the same period. Banks in the Czech Republic are streamlining their operations. The results of organisational changes linked with completed mergers are visible. In 1996, domestic banks employed a record number of almost 51,000 people. Only small banks and foreign bank branches took on new employees to serve their clients. Large and medium-sized banks as a whole reduced their workforces in 2008.[50] Large banks, which account for 70.0% of employment in the banking sector, decreased their workforce by 921 people year on year. By contrast, small banks and foreign bank branches needed, respectively, 210 and 55 more employees to develop their banking activities in 2008. The total number of employees of building societies declined only by six in 2008.

Unlike the number of employees, the number of banking units serving clients has been growing steadily since 2003 (with the exception of 2007). Last year, 128 new banking units were created in the Czech Republic, taking the total number to 1,993 (excluding headquarters). Medium-sized banks and large banks made the biggest contributions (46 and 42 units respectively) to the growth in the number of banking units serving clients. Foreign bank branches and small banks also expanded their retail networks, by 30 and 15 units respectively. The development of retail networks in the banking sector is due to banks' efforts to leverage the growth potential of banking business and to the constant expansion of the range of services offered. On the other hand, banks are trying to streamline their activities and establish new 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. 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.

At the end of 2008, there were around 5,300 citizens per banking unit in the Czech Republic. In year-on-year terms this represents a continued downward trend leading towards higher availability of banking services and greater convenience for clients. In addition to residents, however, retail bank networks provide services to clients temporarily resident in the Czech Republic and to other clients, particularly tourists and other visitors. Productivity as measured by total assets administered per employee is rising constantly and reached CZK 103.7 million at the end of 2008, up by 14.0% year on year, a growth rate significantly exceeding the inflation rate in the Czech Republic.

CHART II.3
Number of employees and number of branches

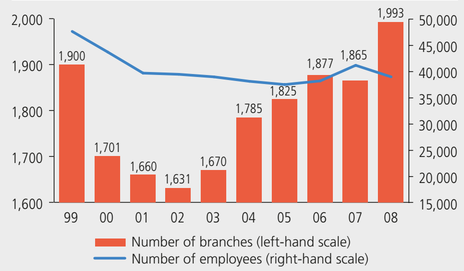


TABLE II.2
Number of employees and banking units in Czech banking sector
(for banks with licences as of the given date)

	2006	2007	2008
Number of employees	38,232	41,207	39,003
Number of banking units	1,877	1,865	1,993
Number of employees			
per bank	1,033	1,114	1,083
per banking unit	20.4	22.1	19.6
Number of citizens			
per bank (thous.)	278.0	280.6	282.9
per banking unit (thous.)	5.5	5.6	5.3
per employee	269.1	251.9	268.2

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

50 A change in the methodology for the calculation of the number of employees in one bank significantly affected the numbers for the banking sector as a whole. On 1 January 2008, moreover, an independent legal entity started operating in the Slovak Republic instead of the previous foreign branch of ČSOB. The employees of the branch had been included in the total number of employees in the domestic banking sector until the end of 2007.

2.1.3 Electronic banking

Access to accounts is no longer restricted to visiting traditional bank branches. Bank clients are increasingly using all forms of electronic banking. Most arrange some form of electronic access to their bank accounts. This usually takes the form of access by card, telephone, computer or mobile phone and the internet. This 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. Operators' pricing policies allowing connections to networks using 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)

	2006	2007	2008
Number of ATM networks	4	4	4
Number of ATMs	3,281	3,357	3,406
Number of cards issued (thous.)			
total	8,181	9,044	9,605
debit cards	6,824	7,197	7,474
credit cards	1,357	1,847	2,131
Current and deposit accounts (households; thous.)			
total	7,563	7,447	7,940
with cards issued	5,523	5,576	5,771
with PC access	2,537	2,801	3,588
with telephone access	2,824	2,773	3,247
without electronic access	1,106	1,140	1,097

The number of current and deposit accounts of households (individuals) was up by 6.6% year on year at the end of 2008. The number of accounts enabling access by card, telephone or computer rose by 8.5%. By contrast, the number of accounts without electronic access fell by 3.8% in the same period. Accounts with computer access grew fastest in absolute as well as relative terms: almost 787,000 new clients used computers to access their accounts, an increase of 28.1% compared to the end of 2007. At the end of 2008, only 13.8% of the more than 7.9 million household accounts lacked electronic access completely. Telephone and PC transactions could be executed on 40.9% and 45.2% of accounts respectively. Banks are responding to trends and client needs, expanding the range of electronic banking products they offer. In traditional branches they are focusing on products requiring one-on-one client service and consulting services. At the same time, the security of electronic banking transactions and client data protection are being enhanced. Examples include wider use of chip cards and the introduction of new transaction authorisation features in internet banking. The intensity of use of electronic signatures has been rising recently.

The ATM network is well-established in the Czech Republic. The number of ATMs continues to increase, but the rate of growth is slowing sharply every year. The number of newly installed ATMs rose by "only" 1.5% in 2008. Credit cards are becoming more prevalent, recording annual growth of more than 15% as of the end of 2008, partly due to base effects. The total number of payment cards issued rose by 6.2%. The number of international payment cards issued by banks is constantly rising and increased by roughly 6.4% in 2008. The range of operations available through payment cards is broadening, as retail chains have also started to offer debit card cashback. The range of cards offered is increasingly focusing on security. Demand for hybrid cards[51] rose the fastest, with their issuance being one-third higher in 2008 compared to the end of 2007. By contrast, the number of cards with magnetic strip only fell by more than 20% in 2008.

51 These cards contain both a chip and a magnetic strip.

2.2 BANKING SECTOR PERFORMANCE

2.2.1 Profit from financial activities and profit from other operating activities[52]

The long-term financial stability of banks depends primarily on ongoing generation of profit from financial activities, i.e. profit from core banking activities. Such profit has to be high enough at least to cover banks' operating expenses and the costs arising from the banking risks they undertake.

In 2008, the banking sector continued to generate a profit. Its profit from financial activities grew by CZK 4.0 billion (2.9%) to CZK 138.4 billion at the year-end. The majority of the banking institutions operating in the domestic market also posted profits, and banks mostly recorded year-on-year profit increases. The financial results of the individual groups of banks were more diverse. Profit from financial activities rose fastest in building societies (by 25.7% to CZK 9.1 billion). Small banks and foreign bank branches recorded increases of 20.5% and 16.4% respectively (to CZK 5.5 billion and CZK 12.1 billion). Generation of profit from financial activities also rose in medium-sized banks (by 12.4% to CZK 21.3 billion). Large banks posted lower profit from financial activities than in the previous year. At CZK 90.4 billion, their profit from financial activities declined by 3.1% in 2008. Nevertheless, large banks accounted for 65.3% of the profit from financial activities generated in the whole sector.

The structure of profit from financial activities in the banking sector as a whole changed in 2008. Interest profit was the only category of profit from financial activities to record significant growth, rising by 15.7% (CZK 13.3 billion) year on year to CZK 98.0 billion. Interest profit accounted for more than 70% of total profit from financial activities, up by 7.8 percentage points on a year earlier.

The increase in interest profit in 2008 was aided by growth in the loan portfolio, which occurred, however, in an environment of declining interest rates.[53] Interest profit was affected chiefly by continuing growth in interest income from "other clients" (i.e. excluding commercial banks, the central bank and general government). The annual growth of CZK 27.3 billion (31.2%), to CZK 114.6 billion, was a result of stable lending in almost the entire period under review.[54] Interest received from other clients accounted for 60% of the banking sector's total interest income (for comparison: the 50% level had been exceeded at the end of 2005). Interest income was stable, totalling CZK 191.8 billion at the end of the year. The share of interest from general government is constantly falling and was less than 1.5% at the end of 2008. Interest income from central banks and credit institutions recorded year-on-year growth of CZK 2.0 billion and CZK 2.7 billion respectively, reaching CZK 13.4 billion and CZK 21.0 billion in total. Interest on debt securities amounted to CZK 29.4 billion, up by 3.9% (CZK 1.1 billion) on 2007.

52 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.

53 Loans and receivables, already accounting for more than 60% of total assets, increased by about 11% year on year. The CNB changed its key interest rate four times during 2008, reducing it by 1.25 percentage points overall.

54 The portfolio of receivables from other clients expanded in 2008, but the growth rate declined. The exception was the end of the year, when the portfolio declined in absolute terms. For more details, see section 2.3 Activities of the banking sector.

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

	2006	2007	2008
PROFIT FROM FINANCIAL ACTIVITIES	116,864	134,392	138,356
of which:			
interest profit	71,547	84,698	98,026
dividend income	1,676	5,886	3,730
profit from fees and commissions	32,918	35,841	36,111
gains on financial assets not measured at FV through profit or loss	45	-158	-882
gains on financial assets held for trading	6,511	4,422	-2,392
gains on financial assets designated at fair value through profit or loss	0	-2,203	-11,191
gains from hedge accounting	-390	-536	-272
other gains	4,558	6,442	15,227
ADMINISTRATIVE EXPENSES	55,652	59,673	61,720
DEPRECIATION, PROVISIONS	7,022	9,021	7,875
IMPAIRMENT	5,163	6,525	15,399
PROFIT/LOSS FROM CURRENT ACTIVITIES	49,028	59,173	53,363
other profit/loss	114	27	722
GROSS PROFIT before tax	49,142	59,201	54,085
tax expense	11,132	12,213	8,405
NET PROFIT	38,010	46,987	45,680

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

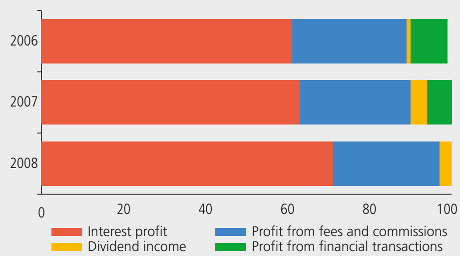


CHART II.5
Interest rate spread
(in %)

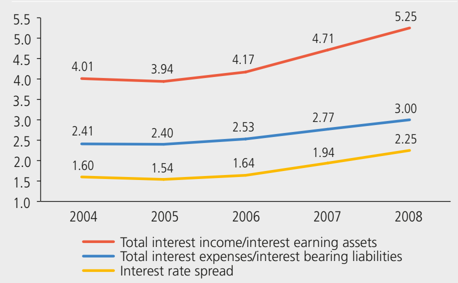


Chart II.6
Interest rate spread in 2008
(in %)

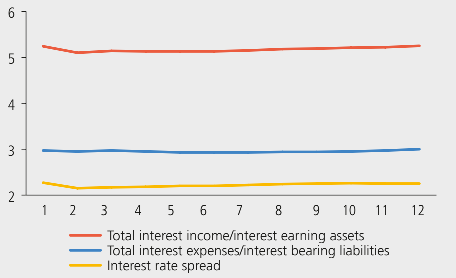
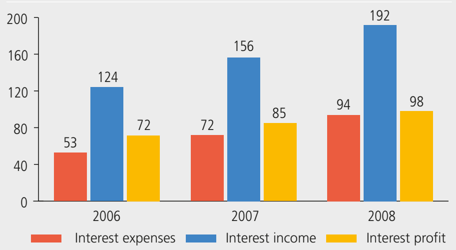


Chart II.7
Interest income and expenses
(in CZK billions)



The banking sector's interest expenses reached CZK 93.8 billion at the end of 2008. Owing to a rising volume of client deposits even amid decreasing interest rates, interest expenses grew by 30.8% (CZK 22.1 billion) during the year. As in case of interest income, interest paid to other clients (excluding credit institutions, central banks and general government) accounted for the largest share (more than 46% of all interest expenses). The amount paid to clients in this way totalled CZK 43.8 billion in 2008, up by CZK 9.2 billion (26.4%) compared to the previous year. As a result of interest rate movements, the interest rate spread increased slightly year on year to 3.00% at the end of 2008. The net interest margin grew as well, reaching 2.68%.[55]

Profit on fees and commissions accounts for 90% of the non-interest profit of the domestic banking sector. In 2008 it rose by less than 1% (CZK 0.3 billion) to CZK 36.1 billion. This represents a stagnation compared to 2007, but the rate of growth is much lower than in 2001–2004, when profit from fees and commissions rose by 12.0%–18.9%, i.e. by CZK 2.7–4.9 billion in absolute terms. The positions of the individual banks differ significantly. The majority of banks recorded a year-on-year decline in fee and commission profit in 2008.[56] This was due primarily to competition on the market amid low interest rates and still 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. In 2008, almost 60% of total fee and commission income was attributable to payment system fees and commissions, which rose by 5.4%. Banks' total income from payment system fees and commissions was more than CZK 27 billion. Fees and commissions from sales of financial products to clients (securities transactions, products of non-banking financial institutions, etc.) are steadily gaining in importance within the structure of fees and commissions. Commissions on pledges and guarantees are an increasingly important source of fee revenues.

Banks' dividend income also had a positive effect on profit from financial activities, although it fell by almost 37% compared to 2007, amounting to CZK 3.7 billion as of 31 December 2008. This income category pertains almost exclusively to large banks, which account for 96.9% of total dividend income. This income consists mainly of dividends from subsidiaries and associates within financial groups.[57]

The financial market crisis partially affected the domestic banking sector in 2008. Profit from financial operations dropped to CZK 0.3 billion (i.e. 3.8% of the figure recorded in 2007), due to a decline in the value of some financial assets, which are revalued to fair value through the profit and loss account on an ongoing

55 These indicators (the interest margin and the interest rate spread) relate to the figures reported for all economic sectors. The interest rate spread is the difference between total interest income/interest earning assets and total interest expenses/income bearing liabilities. Gains and losses from hedging interest rate derivatives are not included. This indicator does not take into account any differences in the structure and volume of the assets and liabilities for which it is calculated. The net interest margin indicator is a measure of interest profit relative to interest earning assets. Interest profit is the difference between interest income and interest expenses, excluding any gains and losses from hedging interest rate derivatives. Interest earning assets are given at gross book value.

56 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.

57 In 2007 this indicator was exceptionally high owing mainly to an extraordinary dividend received by one of the large banks.

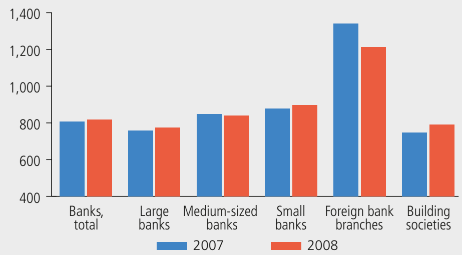
basis. This decline in value was largely due to the problems on global financial markets in 2008, which had been triggered back in 2007 by the mortgage crisis in the USA. The loss from financial assets at fair value shown on the profit and loss account at the end of 2008 was CZK 11.2 billion. In addition to the above revaluation, profit from financial operations was affected by a loss from interest rate operations (interest rate derivatives) of CZK 3.4 billion. However, this loss is usually largely offset by valuation changes, which form part of gains/losses from other activities and which grew by 50% year on year, reaching CZK 11.9 billion at the end of 2008 for the banking sector as a whole.

Other operating income and other operating expenses also increased slightly in 2008. Operating expenses were CZK 0.8 billion higher than operating income.[58] The most significant item on the expenses side was the contribution to the Deposit Insurance Fund (DIF), which was virtually unchanged in year-on-year terms at CZK 1.8 billion.[59]

2.2.2 Administrative expenses and impairment

The administrative expenses of the banking sector totalled CZK 61.7 billion in 2008. Their annual increase of CZK 2.0 billion (3.4%) was roughly one-half of that recorded at the end of 2007. As a result of slower growth in profit from financial activities, the share of administrative expenses in profit from financial activities increased slightly to 44.7% as of 31 December 2008. The shares of personnel expenses (50.5%) and other administrative expenses (49.5%) are almost identical, with the latter rising faster (6.3% year on year). The strongest growth in terms of volume was recorded by other administrative expenses, which rose by CZK 1.8 billion to CZK 30.6 billion. Wages and salaries rose more moderately in 2008, by 4.2% (CZK 0.9 billion). Average annual personnel expenses per employee increased by 1.5% to CZK 818,400.[60] The rise in administrative expenses was due to all components of other administrative expenses. Outsourcing costs increased at the highest rate (28.4%) and, like IT costs, accounted for almost 18% of other administrative expenses.

CHART II.8
Personnel expenses per employee
(in CZK thousands)



Asset impairment rose by 137.9% (CZK 9.0 billion) year on year, reaching CZK 15.4 billion at the end of 2008. Impairment on loans and other receivables – the biggest contributor to impairment – totalled CZK 14.5 billion (up by 123.7%, or CZK 8.6 billion, year on year). By contrast, impairment on the banking sector's non-financial assets was low in 2008 (only CZK 14.5 million). Impairment on investments in associates and subsidiaries was reduced by the release of provisions for real estate and ownership interests.

58 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.

59 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 DIF 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.

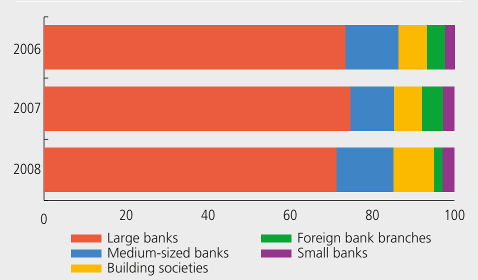
60 Calculated from the average converted stock of employees in 2008 (the average number of employees in the given year converted into full-time equivalents). Personnel expenses consist mainly of wages and social and health insurance, but also include employer contributions to health care, private pension schemes and food allowances, etc.

2.2.3 Net profit

Net profit in 2008 was 3.2% lower than in 2007, when it had recorded a record high. Gross (pre-tax) profit totalled CZK 54.1 billion, a year-on-year decrease of CZK 5.1 billion (9.1%). Interest profit rose significantly (by 15.8%) and the loss on financial assets also increased (by CZK 9.0 billion). Administrative costs rose by much less (3.4%), but depreciation, provisions and impairment (of receivables in particular) increased by 50.5%.

The net profit of the banking sector dropped by CZK 1.3 billion year on year, to CZK 45.7 billion as of 31 December 2008 (compared to the record high of CZK 47.0 billion at the end of 2007). Profit from financial activities, which rose by 2.8% in the period under review and reached CZK 138.4 billion at the end of 2008, remained the main source of net profit. The sector's net profit was also affected by reported income tax. At CZK 8.4 billion, total income tax represented only 70% of the 2007 figure (CZK 11.1 billion in 2006 and CZK 12.2 billion in 2007). This reflected a reduced tax rate and tax optimisation.

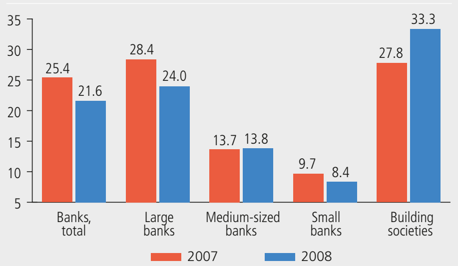
CHART II.9
Shares of bank groups in profit of sector
(in %)



The biggest contributor to the sector's net profit were large banks, which generated a net profit of CZK 32.4 billion (down by 7.7% year on year), accounting for 71.2% of total banking sector profit. The net profit of medium-sized banks was CZK 6.3 billion (up by 27.0%). Small banks and foreign bank branches achieved net earnings of CZK 1.4 billion (up by 4.9%) and CZK 0.9 billion (down by 61.5%) respectively. By contrast, building societies were highly profitable (CZK 4.5 billion, up by 38.1%). The differences in performance across the groups were due partly to the changes in the structure of the banking sector and to the nature of banks' business activities. As regards individual banks, seven recorded a loss in 2008, of which six were foreign bank branches. Owing chiefly to the specific nature of building saving schemes, all building societies significantly increased their net profits by at least 20% in 2008. The maximum increase even exceeded 110%.

2.2.4 Profitability, efficiency and productivity

CHART II.10
RoE for bank groups
(in %)



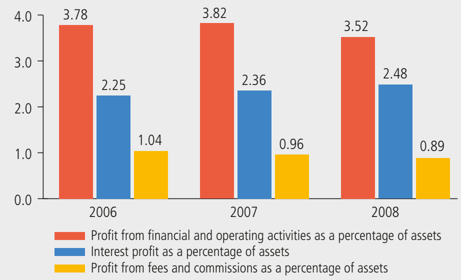
The performance of the Czech banking sector in 2008, when the effects of the financial crisis were fully visible in the financial markets, can be regarded as positive despite a decline in the banking sector's profitability as measured by net profit generated per unit of capital. At the end of 2008, return on Tier 1 (RoE) was relatively high from this point of view (21.6%), although it was 3.8 percentage points lower than in 2007. Profitability ratios fell in large and small banks, remained broadly unchanged in medium-sized banks and recorded a year-on-year increase of 5.6 percentage points to 33.3% in building societies. In large banks, which are the crucial group for the evolution of the entire banking sector, RoE reached 24.0%, down by 4.4 percentage points year on year. The profitability of small banks was 8.4% (down by 1.3 percentage points) and that of medium-sized banks was flat at 13.8%.

Return on assets (RoA) fell by 0.17 percentage point, influenced by the slower growth of the banking sector. As of 31 December 2008, RoA was 1.16%. The performance of medium-sized banks was reflected in the fact that they recorded the highest RoA (1.45%). As regards the other bank groups, return on assets exceeded 1% only in large banks (1.37%) and building societies (1.06%). The latter were the only group to record an annual increase in RoA (0.22 percentage point). Small banks and foreign bank branches recorded values below 1%.

At 44.7% as of the end of 2008, the ratio of administrative costs to profit from financial activities increased slightly (by 0.3 percentage point year on year). The lowest values were recorded by building societies (32.0%) and medium-sized banks (42.5%). The ratio of administrative costs to profit from financial activities rose only in large banks (by 2.2 percentage points to 44.8%).

The stable generation of net profit and conservative employment policies brought about a rise (of 2.2%) in net profit per employee to CZK 1,165,700. Profit from financial activities per employee increased by 8.6% to CZK 3.5 million, again thanks to the moderate growth in profit from financial activities.

CHART II.11
Profit as a percentage of assets
(in %)



2.3 ACTIVITIES OF THE BANKING SECTOR

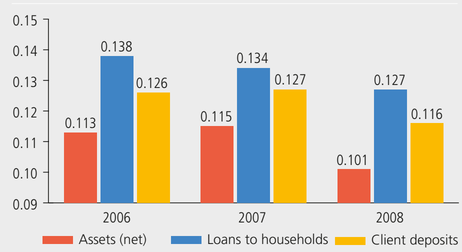
The assets of the banking sector rose by CZK 295.0 billion (7.9%) to CZK 4,045.5 billion in 2008. The rate of growth slowed significantly compared to the previous year (when annual growth of CZK 594.8 billion, or 18.9%, had been recorded). Taking into account the financial market crisis, the activities of the Czech banking sector developed further in 2008, thanks mainly to continued lending activity. Large banks more or less stagnated (up by 0.5%), their assets increasing by CZK 12.3 billion. Building societies also recorded a lower rate of growth of 4.4% (CZK 18.5 billion). By contrast, the increases in the assets of small and medium-sized banks were higher than the banking sector average (30.7%, or CZK 50.6 billion, and 28.2%, or CZK 108.9 billion, respectively). The assets of foreign bank branches rose by CZK 104.6 billion (22.5%). Owing to the higher asset growth in all groups except large banks, the share of large banks in banking sector assets decreased by 4.2 percentage points to almost 57.3% at the end of 2008. The degree of concentration, as measured by the Herfindahl index, fell in terms of total assets (0.101), loans to households (0.127) and client deposits (0.116), indicating a modest rise in competition in the banking sector.[61]

The global financial market crisis did not fully affect the asset structure of the banking sector in 2008. Loans and receivables accounted for the largest share in the Czech banking sector (61.1%), increasing by 11.6% year on year. The banking sector's credit exposure did not decline. Receivables from clients continued to grow at the fastest pace in 2008, increasing by 13.2% (for comparison, they rose by 27.5% in 2007). The crisis affected the interbank market, with receivables from credit institutions falling by more than 10%. The volume of transactions with the CNB was only 1% higher in year-on-year terms.

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

	2006	2007	2008	Structure 2008 in %
TOTAL NET ASSETS	3,152	3,751	4,045	100.0
Cash	34	36	40	1.0
Cash balances with central banks	365	308	311	7.7
Financial assets held for trading	225	366	360	8.9
Financial assets designated at fair value through profit or loss	n.a.	66	62	1.5
Available-for-sale financial assets	234	285	335	8.3
Loans and receivables	1,845	2,216	2,473	61.1
Held to maturity investments	321	327	287	7.1
Derivatives - hedge accounting (positive fair value)	13	11	21	0.5
Fair value changes of the hedged items in portfolio hedge of interest rate risk	2	0	0	0.0
Tangible and intangible assets	47	46	46	1.1
Investments in associates, subsidiaries and joint ventures	46	66	71	1.8
Other assets	20	18	34	0.8

CHART II.12
Herfindahl indices of market competition



61 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.13
Concentration of banking sector
(as of 31 December 2008; in %)

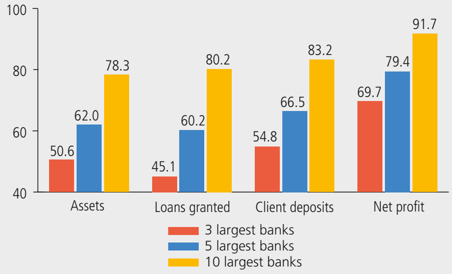


CHART II.14
Receivables in 2008
(in CZK billions)

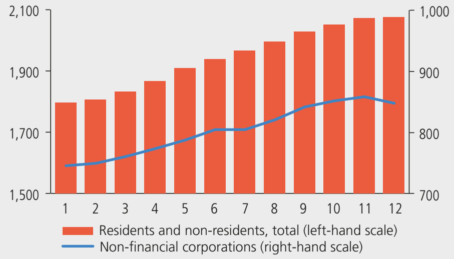
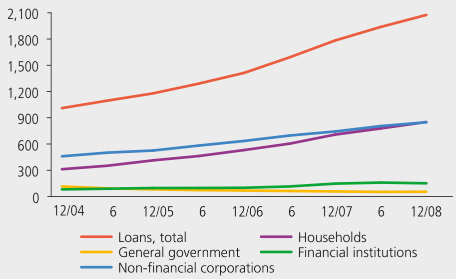


TABLE II.6
Liabilities by sector

	Volume in CZK bn 2006	2007	2008	Change in % from 2007
TOTAL	1,413	1,784	2,076	16.4
A. RESIDENTS	1,339	1,669	1,927	15.4
non-financial corporations	635	743	848	14.1
financial institutions	100	147	151	2.5
general government	68	57	54	-5.6
households	531	708	851	20.3
trades	36	39	43	10.4
individuals	495	669	808	20.9
non-profit institutions serving households	6	13	22	67.2
B. NON-RESIDENTS	74	115	149	29,6

CHART II.15
Sector structure of loan porfolio
(in CZK billions)



The concentration of the banking sector saw no major changes in 2008. The modest changes in market shares were affected by a transformation in the group of the ten largest banks.

2.3.1 The loan portfolio
(sectoral breakdown)[62]

The business activities of the banking sector expanded further in 2008. The financial crisis manifested itself chiefly in slower annual growth rates. Growth in loans provided by all groups of banks recorded a slowdown. Loans to households/individuals continued to rise, albeit at a much slower pace than in the previous years. Further growth was recorded in mortgage loans, or loans for house purchase. Domestic banks' total loans to clients rose by CZK 291.7 billion (16.4%) to CZK 2,075.7 billion. A change in the lending trend is apparent. In 2007 the volume of loans had risen by 26.4% year on year and in 2006 it had gone up by 19.9%.

All groups of banks increased their credit exposure in 2008. Large banks recorded the biggest annual rise in loan volume (CZK 78.5 billion). Although this was only 7.7% more than at the end of 2007, it represented as much as one-third of the annual growth in the banking sector's loan volume. All the other groups recorded increases of more than 10%. The credit exposure of medium-sized banks rose by 19.8% (CZK 60.7 billion) and that of small banks by 26.0% (CZK 28.4 billion). Lending by foreign bank branches rose by CZK 23.2 billion (11.8%) year on year, while building societies recorded the biggest increase of CZK 48.4 billion, representing an annual growth rate of 26.8%.

Loans to households (individuals and trades) and loans to corporations, together accounting for almost 82% of all loans provided, showed portfolio growth in 2008. Receivables from households rose by CZK 143.7 billion (20.3%) to CZK 851.5 billion as of 31 December 2008. Their share in total loans (41.0%) exceeded that of loans to corporations (40.9%) for the first time. The share of loans to non-financial corporations has long been falling and decreased by almost 0.8 percentage point year on year. Bank loans to non-financial corporations rose by CZK 104.7 billion (14.1%) in 2008, reaching CZK 848.1 billion. This is roughly the same rise as in the previous year (CZK 108.6 billion). Still significant growth was recorded in 2008 in lending to private corporations with domestic owners (almost CZK 77 billion). Lending to foreign-owned private corporations showed less growth (more than CZK 30 billion). Loans to private corporations, both domestic and foreign-owned, increased by about 15%.

62 Data from the monetary statistics reporting statements submitted by banks were used to prepare this section. These comprise loans provided to residents 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 banking statistics – FAQs. The quality (degree of risk) of the loan portfolio is dealt with in section 2.4.1 Credit risk.

The share of bank loans to financial institutions in total bank loans fell from 8.2% to 7.2% in 2008, with loans to financial institutions rising only by 2.5% (CZK 3.7 billion). Banks reduced their exposure to the interbank market. The banking sector's exposure to general government also continued declining in 2008. Receivables from general government fell by another CZK 3.2 billion (5.6%) to CZK 54.3 billion. In particular, loans provided to central government recorded a decrease of CZK 4.9 billion. By contrast, receivables from local government continued edging up in 2008 (by 5.1% to almost CZK 34 billion), accounting for more than 62% of such loans.

2.3.2 Loans to individuals[63]

Lending to individuals has been a major factor underlying the dynamic recent growth of the banking sector. Private individuals' debt with domestic banks continued rising in 2008, although the rate of growth declined. As of 31 December 2008, bank loans to individuals totalled CZK 808.4 billion, of which almost CZK 140 billion was lent in 2008 alone (up by 20.9% year on year). The loan structure was affected by the continuing trend towards home buying. As usual, therefore, housing loans showed the highest growth. This was particularly true of mortgage loans for housing, which increased by CZK 63.5 billion (18.9%) during 2008 to account for 49.1% of all the loans provided to individuals (compared to 49.9% at the end of 2007). Consumer credit to individuals showed faster growth, rising by 22.8% (CZK 31.4 billion) year on year. The preponderance of housing loans means that almost 91% of all loans to individuals are long-term ones. Their share has risen steadily from 76.9% in 2004 and 87.1% at the end of 2006. The shares of medium-term and short-term loans to individuals are recording a downward trend. Medium-term loans remain flat in absolute terms, while short-term loans are increasing, owing chiefly to the rise in consumer credit.

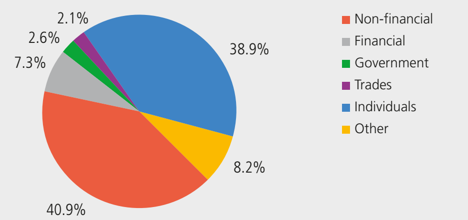
Housing loans[64] accounted for nearly 76% of all loans to individuals at the end of 2008. Their share has stabilised around 75% over the last three years. Even in 2008, when the global financial market crisis emerged, CZK 102.6 billion more was lent in housing loans in the Czech Republic, representing an increase of 20%. This is a lower growth rate than in 2007, when it reached a record high. The main cause of the slowdown was an expected sharp economic downturn and its impact on the labour market.

The banking sector had provided mortgage loans totalling CZK 589.4 billion by the end of 2008. These were mostly long-term loans, with 46.5% being mortgages with maturities of over 20 years. Mortgage loans are used mainly to finance house purchases (71.2%, or CZK 420.1 billion).

TABLE II.7
Loans to households by time and type

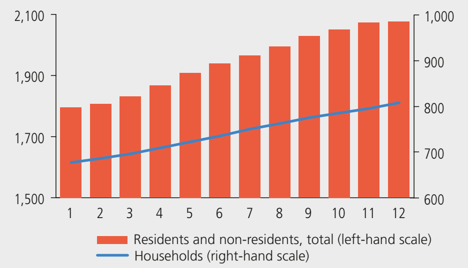
	Volume in CZK bn 2006	2007	2008	Change in % from 2007
TOTAL LOANS AND RECEIVABLES	495	669	808	20.9
of which:				
short-term	24	29	30	3.6
medium-term	40	39	40	2.7
long-term	431	600	738	22.9
of which:				
housing loans	371	511	614	20.1
of which mortgage loans for housing purposes	238	334	397	18.9
consumer credit, including current account overdrafts	109	138	169	22.8
other	14	20	26	27.7

CHART II.16
Structure of loans by economic sector
(as of 31 December 2008)



Note: Only loans granted in the Czech Republic

CHART II.17
Receivables in 2008
(in CZK billions)



63 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.
64 In addition to mortgage loans, housing loans include building society loans (standard and bridging) and consumer credit for real estate purchase or reconstruction.

TABLE II.8
Basic building society indicators
(in CZK billions)

	2006	2007	2008	Change in % from 2007
Amount saved	360	385	401	4.2
Total loans	135	179	227	26.6
of which:				
building society loans	35	39	43	10.5
bridging loans	100	140	184	31.1
Total loans/amount saved (%)	37.6	46.6	56.7	21.7

Thanks to their security and other advantages, building saving schemes are a very popular and accessible source of co-financing of housing or financing of home improvements. Building societies traditionally contribute to the expansion of housing loans. They provided loans totalling CZK 227.4 billion – a record year-on-year increase of CZK 48.1 billion.[65] In 2007, the year-on-year increase in building society loans had been CZK 43.8 billion. This growth was positively reflected in the loans-to-savings ratio, which rose from 46.6% to 56.7%. 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 new 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 2008, building savings clients concluded 21.7% new contracts more year on year (705,500 contracts). The average new housing loan provided by a building society increased from CZK 445,000 to CZK 508,000 in 2008.[66]

Consumer credit (including current account overdrafts) rose the fastest in 2008, increasing by CZK 31.4 billion year on year. As of 31 December 2008, consumer credit provided to households totalled CZK 169.1 billion. The year-on-year increase in consumer credit in 2008 was again higher in absolute terms than in the previous year (CZK 28.5 billion). The annual growth rate was relatively high: the consumer credit repayable by households at the end of 2008 was 22.8% higher than a year earlier (compared to a rise of 26.1% in 2007).

2.3.3 Other asset items

The crisis in the global financial markets did not affect the domestic banking sector very much and banks continued to expand their operations, although the rates of growth decreased. However, the interbank market recorded a decline, reflecting a lack of confidence visible in a decrease of receivables from banks of CZK 46.6 billion to CZK 417.0 billion in 2008. This absolute reduction led to a fall in their share in the banking sector's total assets to 10.3%. The decline on the interbank market was particularly visible in 2008 H2.

The banking sector's receivables of CZK 311.5 billion from the CNB are also significant. They increased slightly by CZK 3.3 billion compared to the end of 2007. 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.

65 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).
66 Source: Association of Czech Building Societies, http://www.acss.cz.

The securities that are part of banks' assets include debt securities, equity instruments and interests in associates and subsidiaries. The value of securities in banks' portfolios exceeded CZK 900 billion, of which debt securities totalled CZK 809.8 billion at the end of 2008. The annual decrease in the value of bonds of almost CZK 38 billion (4.5%) was associated with developments in global financial markets. Within the banking sector portfolio, debt securities issued by credit institutions and other clients are losing share to government debt securities. More than 62% (worth CZK 504.1 billion) were debt securities issued by general government, of which most (42.3%) are held to maturity and a smaller proportion (23.1%) are held for trading. The value of ownership interests grew by 7.1% to CZK 71.2 billion. Of this, 94.4% (CZK 67.2 billion) is due to controlling shares. The value of equity instruments[67] surged by 38.8% to CZK 21.8 billion, up by CZK 6.1 billion on a year earlier. These instruments account for 2.4% of the banking sector's securities.

Most of these securities are still held by large banks (73.5%) and building societies (17.9%). Ownership interests are highly concentrated, most of them (99.8%) being held by large banks (CZK 71.1 billion). This is linked with the effect of the large financial groups operating on the Czech banking market, to which the large banks belong.

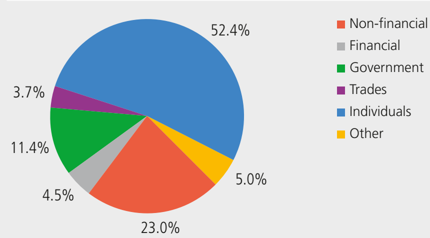
TABLE II.9
Banking sector liabilities

	Volume in CZK bn 2006	2007	2008	Structure 2008 in %
TOTAL LIABILITIES	3,152	3,751	4,045	100.0
Deposits, loans and other financial liabilities vis-à-vis central banks	0.03	0.01	38.04	0.9
Financial liabilities held for trading	76	102	207	5.1
Financial liabilities designated at fair value through profit or loss	n.a.	150	67	1.7
Financial liabilities measured at amortised cost	2,762	3,156	3,367	83.2
Derivatives - hedge accounting (negative fair value)	5	9	13	0.3
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	0	0	0.0
Provisions	11	12	12	0.3
Other liabilities	62	64	48	1.2
Equity, total	234	257	292	7.2
of which:				
issued capital	71	74	74	1.8
retained earnings	67	81	97	2.4
profit for accounting period	38	47	45	1.1

2.3.4 Banking sector funds

The Czech banking sector has long had sufficient and stable funds. This was still true in the second half of 2008, when the global financial markets were hit by the financial crisis. The continuing confidence in the banking sector manifested itself in an annual increase in client deposits, which grew by CZK 198.3 billion (8.3%) to CZK 2,567.6 billion in 2008. Total deposits of general government increased, while deposits of credit institutions recorded a slight decline. Banks increased their financial liabilities vis-à-vis central banks (deposits) by more than CZK 38 billion in 2008 Q4, so the stability of, and confidence in, the banking sector were not jeopardised. Deposits of other clients account for 88.6% of all client deposits. In 2008, (non-government) client accounts recorded an inflow of CZK 65.9 billion. Clients continued to prefer current account deposits, although their year-on-year growth is weaker by comparison with time deposits. Demand deposits represented 52.8% of client deposits at the end of 2008. Short-term deposits dominated the structure of time deposits (87.4%). The year-on-year increases in deposits also reflected banks' pricing policies. Client deposits in medium-sized banks rose by CZK 26.6 billion and those in building societies increased by CZK 16.7 billion year on year. With a rise of CZK 32.2 billion, foreign bank branches were the most successful in attracting deposits. In relative terms, the largest increase in client deposits was recorded by small banks (22.2% year on year), followed by medium-sized banks (18.5%) and foreign bank branches (15.1%). Only large banks, which are very successful in attracting primary deposits (their share exceeds 60%), recorded an annual decline (of 1.7%). At the end of 2008, total primary deposits in large banks were CZK 24.6 billion lower than at the end of 2007.

CHART II.18
Structure of deposits by economic sector
(as of 31 December 2008)



Note: Only deposits accepted in the Czech Republic

TABLE II.10
Client deposits by sector

	Volume in CZK bn 2006	2007	2008	Change in % from 2007
TOTAL	2,025	2,369	2,567	8.3
A. RESIDENTS	1,973	2,282	2,474	8.4
non-financial corporations	520	614	591	-3.8
financial institutions	91	133	116	-13.2
general government	161	213	293	37.4
households	1,174	1,290	1,440	11.7
trades	91	100	94	-6.0
individuals	1,083	1,189	1,346	13.1
non-profit institutions serving households	27	31	34	9.2
B. NON-RESIDENTS	52	87	93	6.7

67 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.

TABLE II.11
Banking sector off-balance sheet

	Volume in CZK bn			Change in % from
	2006	2007	2008	2007
SELECTED OFF-BALANCE SHEET ASSETS	6,869	9,646	10,788	11.8
of which:				
commitments and guarantees given	685	847	834	-1.6
pledge given	3	2	3	82.7
receivables from spot transactions	64	91	44	-51.7
receivables from futures, forwards, swaps etc.	5,354	7,724	8,801	14.0
receivables from options transactions	628	851	1,027	20.7
write-off receivables	40	37	29	-21.0
values given to custody	95	95	50	-47.5
SELECTED OFF-BALANCE SHEET LIABILITIES	8,820	12,121	13,235	9.2
of which:				
commitments and guarantees received	341	471	493	4.7
pledge received	1,195	1,366	1,475	8.0
liabilities from spot transactions	63	93	45	-51.7
liabilities from futures, forwards, swaps etc.	5,326	7,695	8,799	14.3
liabilities from options transactions	628	853	1,025	20.2
values received to asset management	36	35	41	17.6
values received to custody	1,231	1,608	1,357	-15.6
NET POSITION FROM SPOT TRANSACTIONS	0.8	-1.8	-0.9	-49.9
NET POSITION FROM FUTURES, FORWARDS, SWAPS ETC.	28.3	28.2	2.3	-91.9
NET POSITION FROM OPTIONS	-0.1	-1.8	1.8	-198.9

CHART II.19
Client deposits in 2008
(in CZK billions)

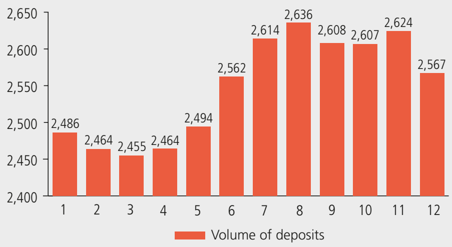


TABLE II.12
Classification of receivables from clients
(in CZK billions and %)

	Volume in CZK bn			Change in % from
	2006	2007	2008	2007
INVESTMENT PORTFOLIO RECEIVABLES, TOTAL	1,863.6	2,191.0	2,481.9	13.3
A. RECEIVABLES FROM CLIENTS	1,457.5	1,846.5	2,096.1	13.5
non-default	1,404.0	1,795.2	2,025.9	12.8
standard	1,302.7	1,733.2	1,941.4	12.0
watch	101.3	62.0	84.5	36.4
default	53.5	51.3	70.2	36.9
substandard	20.4	15.7	22.8	44.9
doubtful	9.0	8.7	10.5	19.7
loss	24.1	26.8	36.9	37.8
B. RECEIVABLES FROM CREDIT INSTITUTIONS	406.2	344.6	385.8	12.0
non-default	405.5	344.0	384.9	11.9
standard	404.2	342.7	382.7	11.7
watch	1.3	1.2	2.3	81.1
default	0.7	0.6	0.9	58.0
substandard	0.7	0.6	0.4	-28.9
doubtful	0	0	0.5	x
loss	0	0	0	1,291.9
C. ALLOWANCES AND LOSS OF VALUE	32.9	36.1	46.7	29.3
allowances for individually assessed financial assets	31.3	29.3	40.4	38.2
allowances for individually non-impaired assets	0.9	1.6	1.7	5.3
allowances for portfolio of individually immaterial assets	0.7	5.2	4.6	-12.7
Allowances and loss of value by sector	32.9	36.1	46.7	29.3
allowances and loss of value for credit institutions	0.1	0.1	0.1	29.3
allowances and loss of value for clients	32.8	36.0	46.6	7.6
Allowances and loss of value/ investment portfolio receivables (%)	1.76	1.65	1.88	13.9

The banking sector's liabilities to banks fell moderately compared to 2007 (by CZK 6.6 billion to CZK 428.6 billion). The interbank deposit market was very volatile. Liabilities to banks dropped in large banks and building societies but increased in medium-sized banks, small banks and foreign bank branches. Liabilities from debt securities issued were flat year on year, totalling CZK 368.5 billion at the end of 2008.

On the liability side, the banking sector's own funds are increasing almost constantly. In 2008, banks again retained part of their profits in their balance sheets as retained earnings and reserves. In 2008, the growth in retained earnings (CZK 16.7 billion) increased again by comparison with 2007 and reserves were increased in line with legal requirements.[68]

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.18). 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 less than one quarter. The contribution of general government showed the largest rise, to more than 11%, while that of financial institutions fell to 4.5%.

2.3.5 Off-balance sheet transactions

The off-balance sheet total continued to rise in 2008, 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 14%. Options transactions rose by more than 20%.

The net position from futures, forwards, swaps etc.[69] at nominal value decreased by CZK 25.9 billion to CZK 2.3 billion as of 31 December 2008. However, its value fluctuated significantly from month to month (from CZK 81.1 billion in August 2008 to CZK -3.1 billion at the beginning of 2008). The net fair value of derivatives (a balance sheet item that better expresses the potential level of risk of derivatives operations) remains low.

68 For more details on own funds, subordinated debt and banking sector reserves, see section 2.5 Capital adequacy.
69 The difference between the nominal value of receivables and liabilities arising from futures, forwards, swaps, etc.

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 a record-low volume of classified loans. Since 2004, the volume of default loans has been going up again, owing to sizeable growth in banks' loan portfolios and since 2008 also as a result of deteriorating macroeconomic indicators.

Loan quality is assessed according to whether or not default has taken place.[70] 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. 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 2,410.8 billion of the total value of investment portfolio receivables of CZK 2,481.9 billion. The value of all default receivables increased by CZK 19.2 billion (37.1%) to CZK 71.1 billion and their share in total receivables was 2.86%, up by 0.5 percentage point year on year. The trends in default loans did not differ much across the groups of banks. All groups of banks recorded increases in default loans in 2008. The annual increases were CZK 11.3 billion (37.6%) in large banks, CZK 1.0 billion (8.3%) in medium-sized banks, CZK 3.1 billion (119.9%) in small banks and CZK 3.3 billion (84.1%) in foreign bank branches. The rise of almost 27% in the credit exposure of building societies was also accompanied by a large increase in default loans (of CZK 0.5 billion, or 17.3%). However, they still recorded a low share of such loans in the total value of their investment portfolio both in absolute terms (1.3%) and relative to the other groups of banks. This share was also 0.1 percentage point lower than at the end of 2007. In medium-sized banks, the share of default loans in the total portfolio fell from 3.6% to 3.3% due to faster growth in the volume of loans. As for large banks, default loans accounted for 3.2% of their portfolio. Substandard and doubtful loans were up by 39.6% and 58.8% respectively, while loss loans rose by 30.8% year on year. The relatively high default loan growth rates in 2008 were due to base effects, continuing bank lending and an increasing inability of bank clients to meet their obligations. The increase in the ratio of default loans to investment portfolio receivables does not indicate any major deterioration in loan portfolio quality.

CHART II.20
Loan portfolio quality
(client loans assessed individually; in CZK billions)

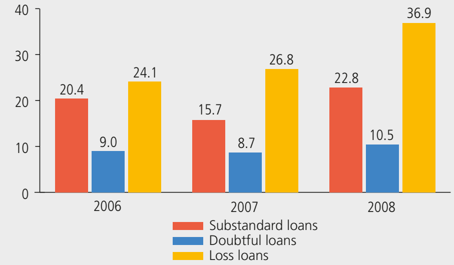


TABLE II.13
Receivables in default by sector

	Volume in CZK bn 2006	2007	2008	Change in % from 2007
RECEIVABLES IN DEFAULT, TOTAL	50.3	47.3	67.0	41.8
non-financial corporations	28.2	22.8	36.3	59.0
financial institutions	0.6	0.7	0.6	-9.5
general government	0.1	0.0	0.2	212.5
households	17.6	21.1	25.6	20.9
of which:				
trades	3.3	2.8	3.5	25.7
individuals	14.3	18.3	22.0	20.2
of which:				
housing loans	6.0	7.9	10.0	27.3
mortgage loans	3.1	4.3	6.1	43.4
consumer credit	7.9	10.2	11.4	12.1
non-profit institutions serving households	0.00	0.01	0.04	158.9
non-residents	3.9	2.6	4.4	68.8

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

Non-default loans assessed as standard loans accounted for most of the banking sector's investment portfolio at the end of 2008 (93.6%, down by 1.1 percentage points from a year earlier). Assessed by default period, default loans were most frequently classified as more than 360 days past due; such loans dropped to 50% (CZK 19.1 billion) of total default loans. The share of the banking sector's past-due receivables in default loans was almost 53% (CZK 37.5 billion).

The banking sector responded to the deterioration in loan quality by increasing allowances by CZK 10.6 billion (29.3%) year on year to CZK (46.7 billion). Allowances assessed individually increased, while allowances assessed on a portfolio basis declined.

Chart II.21
Structure of loans in default provided to non-financial corporations
(as of 31 December 2008)

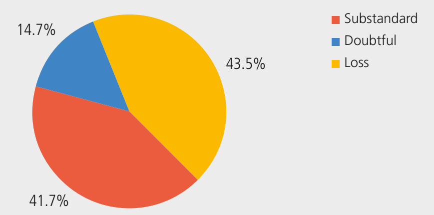
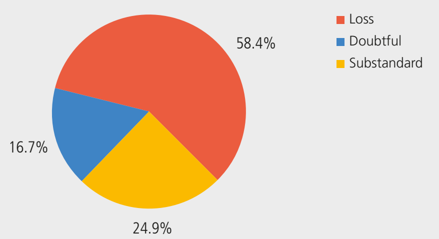


Chart II.22
Structure of loans in default provided to individuals
(as of 31 December 2008)



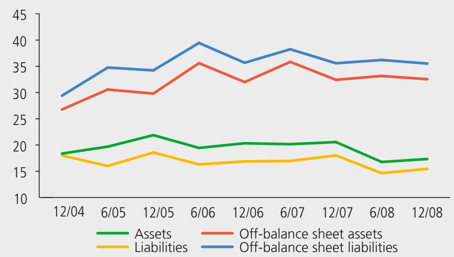
All sectors except financial institutions recorded a higher volume of default loans. In relative terms, the ratio of default loans to the investment portfolio fell for financial institutions and slightly also for households. The trades sector has long had the highest proportion of default receivables in its loan portfolio. Individuals account for about 35% of all resident default receivables.

In 2008, the rise in default receivables was most pronounced in the non-financial corporations sector. The value of these receivables rose by CZK 13.5 billion year on year. Default loans to individuals grew by CZK 3.7 billion year on year, mainly due to the worse outlook for the economy and the labour market. Bank lending to individuals was reflected in a flat ratio of default loans to total loans of 2.73% (compared to 2.74% a year earlier). As usual, housing loans recorded a low proportion of problem loans (1.63%). 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 decreased (by 6.73%). Consumer credit involves high numbers of loans of small amounts for various, often unspecified purposes, which are often used to repay default loans. The higher degree of risk of such credit is offset by the interest rate level. Default loans halved in the case of current account overdrafts and debit accounts.

2.4.2 Foreign exchange risk

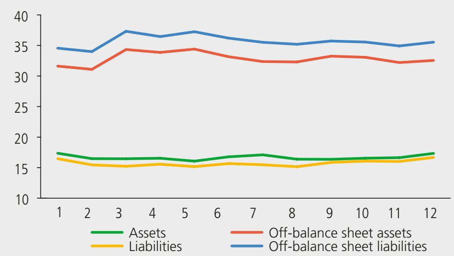
The exposure of the domestic banking sector to foreign exchange risk remains limited. In 2008, the absolute amounts of the sector's foreign currency assets and liabilities decreased by 8.9% and 7.5% respectively. Their shares in the sector's total assets also declined slightly, by 3.2 percentage points to 17.3% for assets and by 2.6 percentage points to 15.5% for liabilities. In absolute terms, foreign currency assets and liabilities totalled CZK 720.7 billion and CZK 624.9 billion respectively as of 31 December 2008. Off-balance sheet foreign currency assets and liabilities showed a different pattern. Their shares in off-balance sheet assets and liabilities have remained almost unchanged since the end of 2006, although they recorded higher levels (exceeding 32% 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 +101.8 billion) and short in the off-balance sheet (CZK -217.1 billion). The decline in foreign currency assets and liabilities was related to the assessment of foreign exchange risk and was also affected by the sharp appreciation of the koruna-euro exchange rate in the first half of 2008.

CHART II.23
Shares of foreign currencies in banking sector balance sheet and off-balance sheet
(in %)



Receivables, which increased by almost 9% in 2008, accounted for more than 70% of foreign currency assets. There was a year-on-year decrease in foreign currency receivables from banks of CZK 22.4 billion (9.4%) to CZK 216.2 billion, while foreign currency receivables from clients recorded an increase of CZK 18.7 billion (6.4%) to CZK 308.4 billion. Foreign currency securities (including ownership interests) held by the banking sector fell by CZK 56.9 billion to CZK 136.4 billion in 2008.

CHART II.24
Shares of foreign currencies in banking sector balance sheet and off-balance sheet in 2008
(in %)



The foreign exchange liabilities of the Czech banking sector saw decreases in all main components. Liabilities to banks declined by CZK 10.4 billion to CZK 253.2 billion and foreign currency client deposits fell by CZK 54.7 billion to CZK 273.9 billion.

Roughly 93% of the growth in the shares of off-balance sheet foreign exchange assets and liabilities was due to derivatives transactions. However, the open position in the off-balance sheet is not growing either.

CHART II.25

Shares of non-resident transactions in banking sector balance sheet and off-balance sheet

(in %)

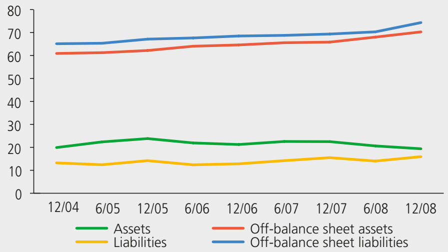


CHART II.26

Shares of non-resident transactions in banking sector balance sheet and off-balance sheet in 2008

(in %)

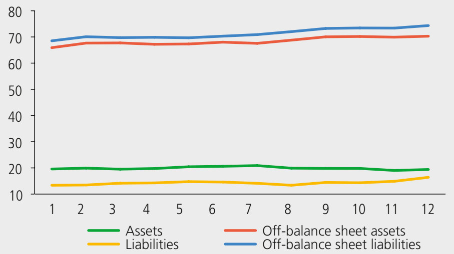


TABLE II.14

The ten countries with the largest exposures of the Czech banking sector as of 31 December 2008

(in CZK billions)

	Assets, total	Receivables from credit institutions	of which Receivables from clients	Bonds
United Kingdom	114.7	49.4	4.3	7.9
Netherlands	100.9	49.8	28.1	14.3
Slovakia	88.9	34.3	29.4	9.3
Austria	78.8	57.8	1.7	1.9
Germany	64.1	24.7	3.1	16.8
Poland	54.4	0.4	22.5	16.9
France	50.5	28.0	3.8	10.5
Belgium	36.4	9.6	3.8	0.6
Russian Federation	28.2	9.3	17.5	0.9
Greece	25.3	0.6	0.1	24.6

2.4.3 Territorial risk (country risk)

The local character of domestic banks, which focus on domestic clients, is also reflected in a relatively low and stable share of transactions with non-residents. 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 2008, non-resident assets amounted to CZK 805.9 billion, representing 19.4% of the banking sector's total assets. This is a slight decrease of CZK 59.3 billion compared to the end of 2007. By contrast, non-resident liabilities showed an increase of CZK 62.9 billion to CZK 644.3 billion in this period.

Interbank transactions dominate both non-resident assets and liabilities. At the end of 2008, liabilities to banks accounted for more than 51% of all financial liabilities of non-residents (CZK 313.0 billion). Receivables from banks (non-residents) were also predominant (63.0%), amounting to CZK 301.7 billion, despite falling by CZK 19.6 billion year on year. Receivables from non-resident clients declined as well, by CZK 9.0 billion to CZK 165.8 billion. The value of non-resident securities registered on the liabilities side, including ownership interests held by domestic banks, reached CZK 181.5 billion at the end of 2008 (down by CZK 77.3 billion year on year). Deposits from non-resident clients amounted to CZK 100.4 billion (a decrease of CZK 55.5 billion).

The geographical orientation of the domestic banking sector has long been stable, as shown by the list of ten countries to which the Czech banking sector has the largest exposures as measured by assets. The representations of the countries are virtually unchanged. Only Italy left this group at the end of 2008, replaced by the Russian Federation. Except for the Russian Federation, the ten countries to which the Czech banking sector had the largest exposures in this period were all EU countries. The exposure to these ten countries accounts for almost 80% of the total international exposure. The exposure to Slovakia dropped by CZK 59.9 billion year on year, mainly because of a sharp decline in client receivables (almost 50%). Bonds also recorded a significant decrease of two-thirds, while the very active interbank market rose by about 50%. Activities on the relevant markets are expanding. The list of countries to which domestic banks have the biggest liabilities has been almost identical in the last two years.[71] 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 54.4 billion), Austria (negative, CZK 36.6 billion) and Belgium (negative, CZK 30.9 billion) as of 31 December 2008. Austria and Belgium are represented in the Czech Republic through subsidiaries of their banks in the group of large banks.

71 In the case of liability transactions, only the Russian Federation and Italy are absent from the list of the ten largest countries. They are replaced by Luxembourg and Ireland.

2.4.4 Liquidity risk

In 2008, when the global financial markets were hit by a crisis manifesting itself also in liquidity shortages, the domestic banking sector still had sufficient liquid funds. The liquidity situation was very good and the liquidity sub-indicators were stable. Liquidity has long been monitored, but became subject to daily monitoring as a result of the financial crisis. Manifestations of the liquidity crisis resulting from insufficient liquidity in some European countries were not observed in the Czech Republic. Despite the impact of the crisis on some countries, quick assets[72] increased by CZK 33.6 billion (3.7%) year on year to CZK 932.7 billion. The annual decline in the ratio of quick assets to total assets was less than one percentage point. The increase in quick assets was due to growth in demand deposits with other banks, which were up by CZK 34.7 billion compared to the end of 2007. A rise was also recorded for debt securities held for trading issued by general government (up by CZK 24.0 billion). A modest rise in deposits with central banks (CNB) of CZK 3.3 billion year on year and on the contrary a marked decrease in debt securities held for trading issued by central banks of CZK 31.8 billion helped to stabilise quick assets.

The domestic banking sector as a whole recorded a shift from a net creditor position to a net debtor position on the interbank market (liabilities to banks exceeded receivables from banks by CZK 11.6 billion at the end of 2008).

2.5 CAPITAL ADEQUACY

Capital adequacy is of critical importance in banking regulation and supervision, especially at a time of potentially higher risks connected with the banking sector. 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 revised. 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.

72 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.

TABLE II.15
Selected liquidity indicators

	2006	2007	2008
TOTAL QUICK ASSETS (in CZK billions)	957	899	933
Total quick assets/total assets (in %)	30.4	24.0	23.1
Total quick assets/total client deposits (in %)	45.5	36.6	35.9
Cumulative net balance sheet position to 3 months net of 80% of demand deposits (in %)	-7.6	-10.9	-13.4
Position on interbank market (in CZK billions)	27	28	-12
receivables from banks	375	464	417
liabilities to banks	348	435	429
Loan coverage by primary funds (in %)	147.6	135.5	126.4
Share of demand deposits in total deposits, including banks (in %)	47.1	46.4	46.7

CHART II.27
Quick assets
(in CZK billions and %)

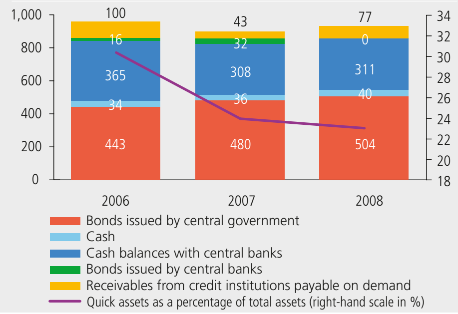


CHART II.28
Quick assets in 2008
(in CZK billions)

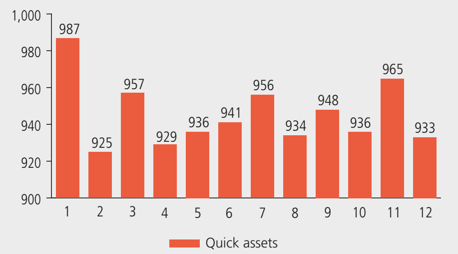


CHART II.29
Quick assets as a percentage of assets in 2008
(in %)

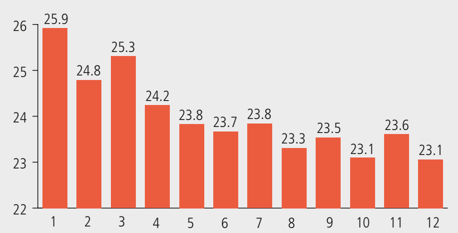


TABLE II.16

Banking sector capital structure

(in CZK billions)

	2006	2007	2008
A. TIER 1	164.5	190.4	220.1
Paid-up share capital registered in Commercial Register	67.4	70.9	73.6
Paid-up share premium	12.7	22.3	27.0
Reserve funds and retained earnings	96.6	110.0	133.0
mandatory reserve funds	27.5	28.3	29.3
other funds created from retained earnings	6.1	6.4	7.4
retained profits	63.1	75.7	96.2
profit for accounting period after tax	0.0	0.0	0.0
accumulated losses	0.0	0.1	0.1
other eligible items	0.0	-0.2	0.2
Items deductible from Tier 1	12.3	12.8	13.5
current year loss	0.1	0.0	0.1
goodwill	2.7	2.7	2.7
intangible assets other than goodwill	9.1	9.9	10.5
own shares	0.2	0.2	0.2
others	0.3	0.1	0.1
B. TIER 2	27.6	31.1	32.1
Subordinated debt	23.4	30.5	31.8
Other capital funds	4.2	0.7	0.4
Items deductible from Tier 1 and Tier 2	4.5	9.6	21.1
Cap. invest. > 10% in banks and fin. inst.	4.5	4.6	13.4
Cap. invest. < 10% in banks and fin. inst.	0.0	0.0	0.0
Others	0.0	5.0	7.7
C. TIER 3	0.0	0.0	0.0
CAPITAL, TOTAL	187.5	212.0	231.0

In the domestic banking sector, banks had the option of following the new Basel II framework to determine their capital requirements and capital adequacy from the second half of 2007.[73]

Total regulatory capital (i.e. capital adjusted for the purposes of the capital adequacy calculation) increased by CZK 19.1 billion (9.0%) to CZK 231.0 billion in 2008. This was due to the retention of part of the profit from previous years in the form of retained earnings and reserves totalling CZK 20.5 billion, which affected the increase in Tier 1. The rise in regulatory capital was quite significantly influenced by an increase in share premium (four banks in total) and a rise in share capital of CZK 2.7 billion. The increase in Tier 2 was due to the acceptance of subordinated debt in one bank and small corrections in several others. Tier 1 and Tier 2 are net of 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 7.6 billion at the end of 2008, and an increase in capital investment in banks and financial institutions of over 10% to CZK 12.4 billion.

Tier 1 increases regularly, and rose by 15.6% in 2008. Reserve funds and retained earnings in the banking sector recorded a year-on-year increase of 20.5%, which is 11.5 percentage points higher than the rise in regulatory capital. Total retained earnings rose by CZK 20.5 billion in 2008, compared to an increase of CZK 12.6 billion in 2007. Mandatory reserve funds rose by CZK 1.0 billion. Contributions to these funds have been broadly unchanged over recent periods (and rose by CZK 0.2 billion year on year in 2008).

Tier 2 also grew by 3.1%, owing chiefly to an increase in subordinated debt[74] of 4.1% compared to the end of 2007. In 2008, however, banks partly repaid their subordinated debt (four banks, of which one bank repaid it completely), thereby reducing the value of this capital component. Capital grew in six 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 13.9% at the end of 2008 compared to 14.7% a year earlier. Since 2007, the newly calculated shortfall in the coverage of expected credit losses on an individual basis for exposures using the internal ratings based (IRB) approach has been included in the items deductible from Tier 1 and Tier 2.[75]

Part of Tier 3 capital[76] was still not used in the domestic banking sector in 2008.

73 For more details, see part A, section 3.1.
74 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.
75 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.
76 Tier 3 capital consists of subordinated debt with a minimum fixed maturity of two years.

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. However, banks operating on the Czech banking market were allowed to keep using the Basel I methodology until the end of 2007,[77] and many of them took advantage of this option.

In 2008, the total capital requirements of the banking sector rose by CZK 3.0 billion (2.1%) to CZK 149.8 billion. Basel II is an entirely new approach to the identification of risk and entails new risk measurement methods. Credit risk remains the main risk facing the domestic banking sector. This is reflected in the weight of the capital requirement for this risk, which represented almost 87% of the total capital requirement at the end of 2008. Capital requirements for position, foreign exchange and commodity risk account for 3.5% of the capital requirement of the banking sector, while capital requirements for operational risk account for 9.4%.

The change in the structure of the total capital requirement in 2008 was due mainly to the new Basel II calculation methodology. The more precise risk measurement methods were reflected in a decrease in the capital requirement for credit risk of CZK 4.4 billion (3.2%) compared to the end of 2007. The capital requirements relating to credit risk are determined mainly by growth in the loan portfolio of the banking sector. The new methodology, consisting of more precise assessment of credit risk in banks, should lead to a lower risk assessment of both the investment and trading portfolios of banks and a corresponding decline in capital requirements. Capital requirements for credit risk are set depending on the credit risk measurement method used. Of the total capital requirement for credit risk, requirements relating to the part of the portfolio using the STA method account for 38.2% and those using the IRB method 61.8%. For both IRB and STA, the highest capital requirements were set for exposures to corporations, amounting to CZK 51.0 billion and CZK 24.3 billion respectively.

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 an assessment of the risks resulting from banks' operation. The capital requirements for operational risk were increased by almost 82% to CZK 14.0 billion. 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 2.0 billion (1.4%) in 2008, accounting for 96.3% of the total capital requirement of the banking sector as of 31 December 2008.

Regulatory capital rose faster than the capital requirements in 2008. The capital ratio of the banking sector edged up by 0.79 percentage point to 12.34%. All groups of banks except small banks recorded increases in their capital ratios (foreign bank branches do not report capital adequacy).

TABLE II.17

Capital requirements and capital adequacy of the banking sector

(in CZK billions and %)

	2006	2007	2008
TOTAL CAPITAL REQUIREMENTS	130.6	146.8	149.8
A. CAPITAL REQUIREMENT FOR CREDIT RISK	125.1	134.6	130.3
STA cap. req. for credit risk	125.1	81.1	49.8
IRB cap. req. for credit risk	0.0	53.5	80.5
B. CAPITAL REQUIREMENT FOR SETTLEMENT RISK	0.0	0.0	0.0
C. CAPITAL REQUIREMENT FOR POSIT., FOREX & COMMOD. RISK	4.7	3.9	5.3
D. CAPITAL REQUIREMENT FOR OPERATIONAL RISK	0.0	7.7	14.0
E. CAPITAL REQUIREMENT FOR TRAD. PORT. EXP. RISK	0.7	0.5	0.2
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	11.49	11.55	12.34

77 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.

All banks were compliant with the set minimum capital ratio of 8% during 2008. Three banks recorded a capital ratio of less than 10% at the end of 2008, 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 represents a new approach to risk assessment and a new risk measurement methodology enabling 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.

2.6 THE CREDIT UNION SECTOR

At the end of 2008, the credit union sector consisted of 17 active credit unions.[78] This number was down by two compared to 2007. The assets of the credit union sector exceeded CZK 12 billion as of 31 December 2008, representing almost 0.3% of the assets of the entire financial sector.[79] The number of credit union members fell to 35,921 in 2008, i.e. by 19.8%.

Table II.18
Number of CUs and their members

	2006	2007	2008
No. of active credit unions	20	19	17
No. of members	36,637	44,789	35,921

Compared to banks, the credit union form of business predefines certain specific features of the sector. Credit unions carry on activities for their members.[80] 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).

Table II.19
CU asset structure
(in CZK millions)

	2006	2007	2008
TOTAL ASSETS	6,809	8,947	12,061
Cash and deposits with central banks	161	122	341
Receivables from banks and CUs	2,334	3,342	4,428
Receivables from clients - CU members	4,133	5,189	6,718
Debt securities	0	0	0
Intangible assets	3	5	11
Tangible assets	106	145	430
Receivables from subsribed capital	31	77	9

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 80% of capital)[81] and liquidity. In connection with the 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)[82] certain actions taken by credit unions are subject to approval by the CNB as a regulator and supervisor of the financial market. This includes for example the approval of persons appointed to credit unions'

78 The merger of Moravský Peněžní Ústav – spořitelní družstvo and Privátní Peněžní Ústav – úvěrní družstvo 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. Komerční spořitelní a úvěrní družstvo DOMOV is in liquidation.

79 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.

80 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.

81 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.

82 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.

elected bodies (boards of directors, credit committees and audit 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.

The credit union sector has seen relatively rapid growth in recent years. The sector added another 34.8% (CZK 3.1 billion) in 2008. At the end of the year, its assets amounted to CZK 12.1 billion. Growth in assets is particularly visible in the four largest credit unions, which added more than 46% and whose share in the sector's assets rose by 6.5 percentage points last year. The trends across the sector are mixed – six credit unions recorded a decline in balance-sheet assets last year.

The concentration of the credit union sector is higher than that of the banking sector and is increasing every year. At the end of 2008, the three largest credit unions accounted for 75.0% – and the five largest credit unions for 85.4% – of the sector's total assets. The ten largest credit unions managed 94.6% of the sector's total assets. The Herfindahl index calculated from the total assets of the credit union sector rose from 0.209 to 0.233 in 2008. This indicates a further marked increase in the concentration of this sector.

Loans and other receivables from clients, in particular credit union members, are the main asset item for the majority of credit unions. This item accounted for 59.1% of the assets of the credit union sector at the end of 2008 and is associated with one of the credit unions' main activities, i.e. lending. In 2008, loans increased by almost 30%, from CZK 5.2 billion to CZK 6.7 billion. Receivables from credit institutions (banks and credit unions) are the second most significant item, accounting for almost 40% of the balance sheet. The shares of other asset items are insignificant.

Liabilities to clients (mostly credit union members), which accounted for more than 85% of total liabilities at the end of 2008 (a rise of 6.7 percentage points year on year), are a dominant and still increasing item of credit unions' liabilities. They increased by more than 43% in 2008, from CZK 7.0 billion to CZK 10.3 billion. Confidence of clients, mainly credit union members, has been restored and the numbers and volumes of transactions are rising. Credit unions are expanding the range of services they offer. Equity capital, which consists of basic and other membership contributions, is the second most significant item on the liability side, accounting together with own capital for almost 12% of balance sheet liabilities. In the case of some credit unions, part of the capital is not paid up. Other liability items are insignificant in terms of volume.

CHART II.30
Basic CU sector indicators
(in CZK billions)

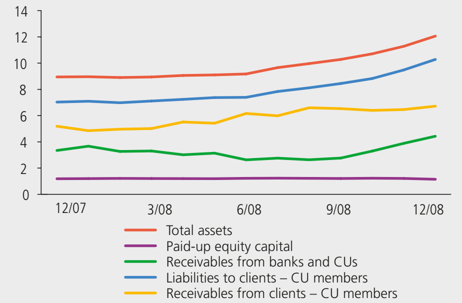


CHART II.31
Concentration of CU sector
(as of 31 December 2008; in %)

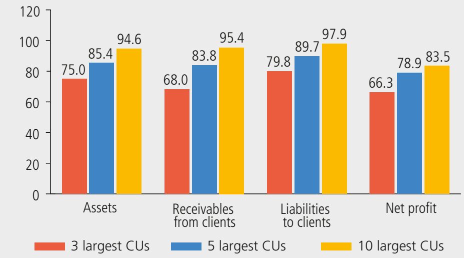


TABLE II.20
CU liabilities and own capital
(in CZK millions)

	2006	2007	2008
TOTAL LIABILITIES	6,809	8,947	12,061
Liabilities to banks and CUs	288	341	214
Liabilities to clients – CU members	5,217	7,031	10,282
Reserves	1	0	0
Equity capital	1,129	1,263	1,156
of which: Paid-up equity capital	1,099	1,186	1,147
Reserve funds and other funds created from profit	39	73	99
Retained profits (accumulated losses)	7	40	110
Profit (loss) for accounting period	82	83	76

TABLE II.21
CU sector performance
(selected items; in CZK millions)

	2006	2007	2008
Interest income and similar income	491	588	827
Interest expenses and similar expenses	266	309	424
Income from fees and commissions	51	41	69
Expenses from fees and commissions	40	6	13
Other operating income	126	13	26
Other operating expenses	130	16	33
Administrative expenses	108	193	354
Depreciation, creation and use of provisions and reserves for fixed assets	6	8	16
Impairment	12	17	14
Income tax	11	6	8
PROFIT (LOSS) FOR ACCOUNTING PERIOD	82	83	76

TABLE II.22
Quality of CU receivables
(in CZK millions)

	2006	2007	2008
TOTAL RECEIVABLES	6,514	8,563	11,188
standard receivables	6,387	8,255	10,451
watch receivables	31	157	529
substandard receivables	67	89	115
doubtful receivables	9	44	61
loss receivables	19	19	33
Sum of provisions	21	36	40
Ratio of default receivables to total volume (in %)	1.46	1.78	1.87

Credit unions saw another successful year in 2008. The sector posted a profit of CZK 75.6 million, although the rate of growth of profit generation was 8.6% lower than in 2007. The bulk of credit unions' income is generated in the interest 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 403.6 million. Net income from fees and commissions is a complementary source of profit (CZK 56.4 million). Of the total of 17 credit unions, 14 were profit-making and three were loss-making at the end of 2008. In 2007, 17 credit unions had been profitable, while two had recorded a loss.

The data reported by individual credit unions show that the credit portfolio of credit unions is of very good quality. Default receivables (substandard, doubtful and loss) amounted to CZK 208.7 million, i.e. only 1.9% of the total financial receivables of CZK 11.2 billion. The category of standard receivables (CZK 10.5 billion) is the largest in terms of volume, accounting for 93.4% 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 union sector increased by CZK 46.1 billion (3.2%) during 2008, to CZK 1,362.7 million. This is capital adjusted for the purposes of the capital adequacy calculation. Reserve funds increased by CZK 70.2 million year on year, mainly due to a rise in retained earnings, while the loss for the current year increased by CZK 10.1 million.

The credit union sector recorded relatively fast growth in financial activities in 2008, especially in the four largest credit unions. The previous year saw a rise in receivables from other clients of 28.6% (CZK 1,484 million). Mainly as a result of this, the capital requirements went up by a total of 45.9% (CZK 197.6 million). The capital of credit unions grew more slowly in the same period, specifically by 3.16% (CZK 41.8 million). The result was a fall in the capital adequacy of the credit union sector of 7.20 percentage points to 17.36%. All credit unions were compliant with the stipulated minimum capital ratio of 8% at the end of 2008 (a ratio below 10% was reported by one credit union).

3. THE CAPITAL MARKET

3.1 INVESTMENT FIRMS

3.1.1 Entities engaged in securities trading

The CNB registered 38 investment firms at the end of 2008, 11 of them banks, 14 branches of foreign banks and 3 organisational units of foreign investment firms. Six domestic management companies managing assets of clients under contract held investment firm licences at the end of 2008.

In the first half of 2008, one new investment firm licence was granted in joint proceedings to extend a banking licence and one non-bank investment firm's licence expired under the legislation in force due to a change in its objects of business during the year. In the second half of 2008, the CNB decided to withdraw one investment firm's licence due to failure to comply with licence requirements. The number of investment firms is shown in Chart III.1.

A total of 719 entities (of which 518 were non-banks and 201 were banks) using the option of providing investment services in the Czech Republic without establishing an organisational unit under the right of free movement of services (the single European licence) were registered at the start of 2008. By the end of 2008, 840 non-banks and 215 banks (a total of 1,055 entities) had provided notification of their intention to provide investment services in the Czech Republic under the single European licence without establishing an organisational unit. The number of foreign entities entitled to provide investment services in the Czech Republic under the single European licence is shown in Chart III.2.

As of 31 December 2008, investment firms[83] had 1.4 million registered clients (a year-on-year increase of 9.3%), of which almost 239,000 were active.[84] Investment firms had concluded more than 1.1 million mandate or consignment contracts (about 207,000 active ones), 22,000 management contracts (14,000 active ones) and about 270,000 other contracts (around 17,000 active ones).

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

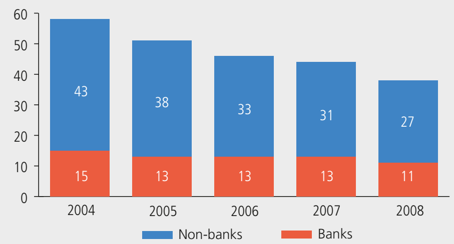
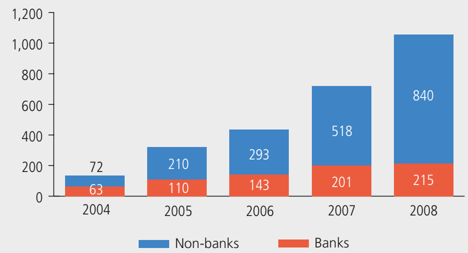


CHART III.2
Number of foreign entities authorised to provide investment services in the Czech Republic under the single European licence
(at end of period)



3.1.2 Trades carried out by investment firms

Investment firms (both banks and non-banks) carried out trades for their clients totalling CZK 9,376 billion[85] in 2008, a year on year rise of 1.6%. Of this total, non-management trades amounted to CZK 8,607 billion and management trades to CZK 769 billion. Share trades amounting to CZK 4,845 billion (down by 9.7% year on year) and bond trades amounting to CZK 3,791 billion (up by 29.4% year on year, reflecting an increase in total risk aversion related to the financial crisis) dominated the structure, followed by money market instrument trades totalling CZK 516 billion (down by 23.3% year on year) and trades in unit certificates and other securities amounting to CZK 224 billion (down by 12.9% year on year).

83 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.
84 An active client is one that requested an investment service at least once in the period under review.
85 The total trading volume excluding derivatives (data including branches and organisational units and excluding management companies).

CHART III.3
Structure of trades for clients
(in CZK billions; for half-year under review)

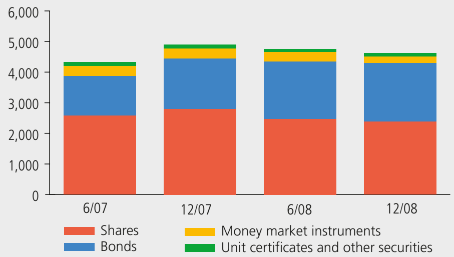


CHART III.4
Structure of trades for clients (non-management contracts)
(in CZK billions; for half-year under review)

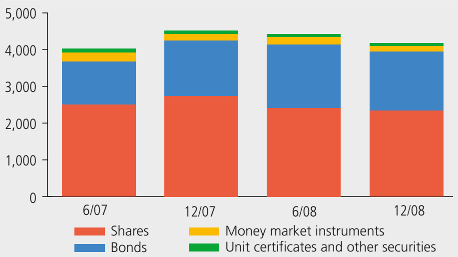


CHART III.5
Structure of trades for clients (management contracts)
(in CZK billions; for half-year under review)

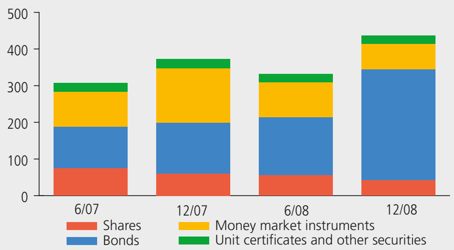
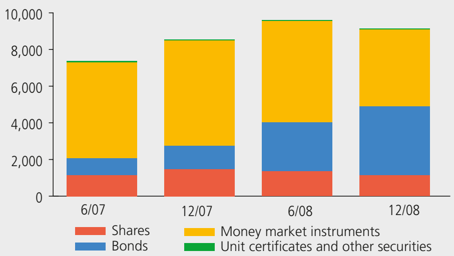


CHART III.6
Structure of trades for own account
(in CZK billions; for half-year under review)



The structure of trades for clients for the individual half-years of 2007 and 2008 as a whole is shown in Chart III.3, the structure of trades for clients with non-management (consignment, mandate etc.) contracts with investment firms is shown in Chart III.4, and the structure of trades provided by investment firms with which clients have management contracts is shown in Chart III.5.

Bank investment firms executed spot transactions for their clients totalling CZK 6,978 billion (up by 10.6% year on year), of which share trades accounted for CZK 3,219 billion, bond trades for CZK 3,217 billion, money market instrument trades CZK for 356 billion and trades in collective investment securities CZK for 186 billion. In the same period, they carried out derivative trades for their clients amounting to CZK 6,061 billion.

Non-bank investment firms executed spot transactions for their clients totalling CZK 2,398 billion (down by 17.8% year on year) in 2008, of which share trades accounted for CZK 1,627 billion, bond trades CZK for 574 billion and money market instrument trades for CZK 160 billion. Non-bank investment firms carried out derivatives trades for their clients amounting to CZK 733,624 billion in 2008, the majority of which were carried out by a single investment firm.[86]

In 2008, investment firms (both banks and non-banks) carried out spot trades for their own account totalling CZK 18,685 billion (an annual increase of 18.2%), of which share trades accounted for CZK 2,497 billion (an annual increase of 4.5%), bond trades for CZK 6,403 billion (an annual increase of 192.1%) and money market instrument trades for CZK 9,762 billion (an annual decline of 10.9%). The structure of trades for own account (excluding derivatives trades) is shown in Chart III.6.

Of the total 2008 volume, bank investment firms executed spot transactions for their own account totalling CZK 17,231 billion (up by 21.6% year on year), of which share trades accounted for CZK 1,088 billion, bond trades for CZK 6,400 billion, money market instrument trades CZK for 9,720 billion and trades in unit certificates for CZK 23 billion. Bank investment firms carried out derivatives trades for their own account amounting to CZK 46,022 billion in 2008.

Non-bank investment firms carried out spot trades for their own account amounting to CZK 1,455 billion (down by 11.4% year on year) in the same period, the majority of which were share trades (CZK 1,409 billion). Money market instrument trades accounted for CZK 42.4 billion and bond trades for just CZK 4.0 billion. Other spot trade volumes were negligible. Non-bank investment firms carried out derivatives trades for their own account amounting to CZK 51 billion in the same period.

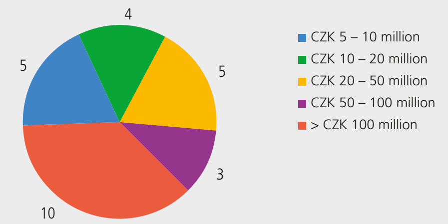
86 In the case of derivatives trades carried out by non-bank investment firms, the relatively high figure compared to the other volumes is due to the way in which the value of the underlying asset is reported. The figure is thus considerably distorted for trading at a relatively high frequency.

3.1.3 Capital adequacy of non-bank investment firms

The own capital of the 27 non-bank investment firms totalled CZK 2,851 million. Most investment firms had capital in the range of over CZK 100 million. A more detailed breakdown of non-bank investment firms by own capital is given in Chart III.7.

The volume of own funds of the 27 non-bank investment firms exceeded the required level as of 31 December 2008. Registered capital totalled CZK 2,851 million, while the capital requirements for the individual types of risks amounted to CZK 968 million. In aggregate terms, the capital adequacy ratio was about 24%. The highest capital requirements overall were for credit, settlement and position, foreign exchange and commodity risk (see Chart III.8).[87]

CHART III.7
Non-bank investment firms by own capital
(as of 31 December 2008)



3.1.4 Concentration of services provided by investment firms

Table III.1 contains concentration values for the investment firm sector calculated from various perspectives. Concentration is calculated in terms of the volume of transactions carried out by the individual firms in 2008 (more specifically, in terms of the volume of transactions for the investment firm's own account broken down into securities, derivatives and total, and the volume of securities transactions for clients excluding derivatives) and also in terms of the total volume of assets managed as of 31 December 2008 (at fair value).

As the table shows, concentration on the investment firm market varies with regard to individual activities (different concentrations for transactions for own account and transactions for a third party's account) and with regard to services provided to clients (different concentrations for transaction volume and asset management). It can be said that the investment firm market is relatively unconcentrated by volume of transactions but highly concentrated by assets managed.

CHART III.8
Capital requirement structure of non-bank investment firms
(as of 31 December 2008)

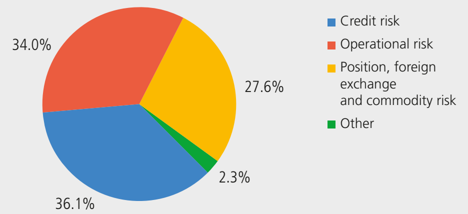


TABLE III.1
Concentration of investment firm market at end of 2008

	Top 3 a)	Top 5 a)	HHI b)
Volume of securities trades for clients	51.4	67.7	1,262
Volume of securities trades for own account	64.7	78.7	1,612
Volume of trades for own account, total (derivatives + securities)	40.5	61.4	1,022
Assets managed, total	82.3	94.7	2,663

a) Top 3 (5) - share of 3 (5) institutions with highest volume of given item in total volume of given item in sector (in %)
b) HHI – Herfindahl-Hirschman Index

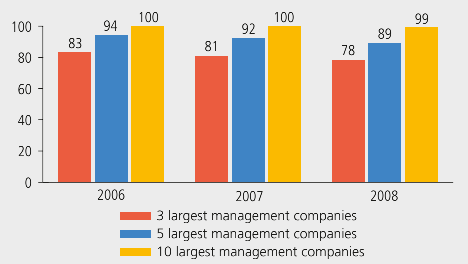
3.2 COLLECTIVE INVESTMENT

A change in the stock of assets of collective investment funds and related changes in trend in fund indicators linked with the global financial crisis occurred in 2008 (particularly the second half of the year).

3.2.1 Overview of collective investment undertakings

There were 18 active management companies (excluding those in liquidation or bankruptcy or those whose licences had been revoked) at the start of 2008. One licence of a new management company became effective during January, and the CNB licensed one more new management company during the year.

CHART III.9
Market shares in management company sector by volume of assets managed
(in %; at end of period)



87 An overview of all capital requirements for credit, market and operational risk under a special legal rule regulating the rules for capital adequacy.

At the end of 2008, there were 20 management companies licensed by the CNB active on the market. These companies managed 2 closed-end mutual funds and 142 open-end mutual funds, 41 of them standard funds and 101 special funds. The shares of management companies in the domestic collective investment market by assets managed in mutual funds are shown in Chart III.9. In 2008, 30 mutual funds were newly licensed, whereas 9 mutual funds closed down.

The number of active closed-end investment funds increased from 7 to 16 in 2008.[88] All the funds are special funds intended for qualified investors.

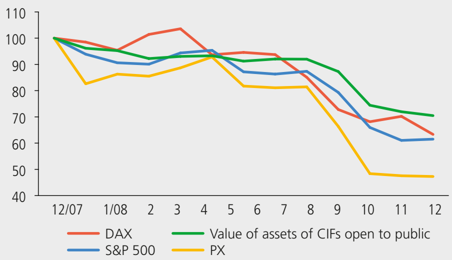
During 2008, the CNB received 271 announcements from foreign regulators of notifications of the cross-border provision of collective investment fund securities and services for 4 management companies. One management company and 181 foreign collective investment funds terminated their activities. A total of 1,569 funds and 40 management companies had made valid notifications as of 31 December 2008.

3.2.2 Assets in domestic open-end mutual funds

Chart III.10

Assets of domestic mutual funds open to the public and selected stock indices

(12/2007 = 100%)



Domestic mutual funds open to the public managed assets amounting to CZK 122.9 billion as of 31 December 2008. During the year, domestic mutual funds open to the public lost assets amounting to CZK 51.4 billion, which represents an annual decline of 29.5%. The largest declines in the assets held by funds were recorded in October and September, when they dropped by 14.7% (CZK 22.4 billion) and 5.1% (CZK 8.2 billion) respectively. These falls coincided with the largest shocks to global financial markets and the biggest falls on capital markets, linked mainly with the bankruptcy of US investment bank Lehman Brothers, mergers of other large US investment banks and problems in major financial institutions.

Chart III.10, which compares the volume of assets in domestic open-end mutual funds and selected stock indices (with the end-2007 values taken as the starting levels), shows that the assets in domestic open-end mutual funds largely tracked developments in the capital markets.

Table III.2

Year-on-year changes in volume of assets by fund type

	2007	2008	Change	
	(in CZK millions)	(in CZK millions)	(in CZK millions)	(in %)
Money market	77,228.8	56,194.5	-21,034.4	-27.2
Bond	20,895.2	14,086.1	-6,809.0	-32.6
Equity	16,280.6	7,755.5	-8,525.1	-53.8
Mixed	35,404.6	25,179.9	-10,224.7	-27.8
Funds of funds	23,206.2	17,940.4	-5,265.8	-22.7
Real estate	1,246.9	1,716.0	469.2	37.6
OMFs, total	**174,262.2**	**122,872.5**	**-51,389.7**	**-29.5**

Note: Data taken as historical time series, i.e. including entities which terminated their activities before 31 December 2008

The largest volume of assets is administered by money market funds, whose total assets amounted to CZK 56.2 billion at the end of 2008. They accounted for 45.8% of the total assets of domestic mutual funds. Assets of mixed funds amounted to CZK 25.2 billion (accounting for 20.5% of the assets of mutual funds), followed by funds of funds (CZK 17.9 billion, or 14.6%) and bond funds (CZK 14.1 billion, or 11.5%). By contrast, real estate funds had a negligible share, accounting for just 1.4% (CZK 1.7 billion).

88 Two of these newly established funds had not been incorporated as of 31 December 2008.

The largest absolute fall in asset value was recorded by money market funds, whose assets fell by CZK 21 billion in 2008. The negative net value of purchases and sales of units amounted to CZK 19.6 billion. Given the capital market developments, equity funds recorded the worst results in 2008, losing 53.8% of their asset value. However, the full-year balance of purchases and sales of their units was positive to the tune of CZK 140.2 million. Growth in asset volume was recorded only by real estate funds. The year-on-year changes in the asset volumes of the individual fund types are shown in Table III.2. Sales and purchases of open-end mutual fund units are given in Table III.3. The assets of domestic mutual funds by fund type during 2008 are shown in Chart III.11.

TABLE III.3

Unit sales and purchases in 2008

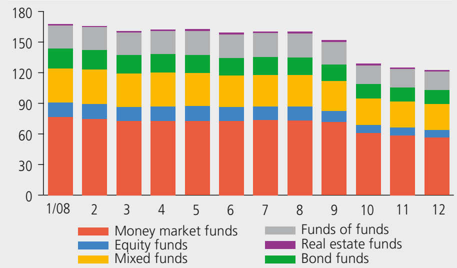
(in CZK millions)

	Units issued	Units purchased	Balance
Money market	20,064.4	39,674.4	-19,610.0
Bond	4,005.3	7,747.7	-3,742.5
Equity	4,015.6	3,875.4	140.2
Mixed	3,384.6	5,468.4	-2,083.8
Funds of funds	5,260.1	7,052.0	-1,792.0
Real estate	945.7	516.9	428.8
OMFs, total	**37,675.6**	**64,334.9**	**-26,659.3**

CHART III.11

Assets of domestic mutual funds open to the public by fund type

(in CZK billions; at end of period)



3.2.3 Structure of assets in domestic open-end mutual funds

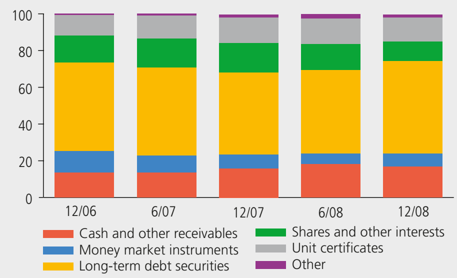
About half of all the funds of domestic open-end mutual funds are invested in long-term debt securities. Cash and other receivables account for 17% of assets, followed by unit certificates (13%), shares and other interests (11%) and money market instruments (7%).

The largest decline in asset value in the period under review was recorded for investments in shares and other interests, whose value at the end of 2008 was 46% of that at the end of 2007. Long-term debt securities showed the smallest fall, dropping to 80% of their end-2007 value. The structure of investments in domestic mutual funds in percentage terms is shown in Chart III.12.

CHART III.12

Asset structure of domestic mutual funds open to the public

(in %; at end of period)



3.2.4 Funds for qualified investors

At the end of 2008, licences had been granted to 47 special funds for qualified investors, of which 37 had launched and actively carried on activities.[89] Special funds for qualified investors managed assets of 194 investors having their registered office or address in the Czech Republic, 1 investor having its registered office or address abroad, and 8 investors that were members of a group for which consolidated financial statements are produced.

The value of the assets managed at the end of 2008 was CZK 23.6 billion, of which CZK 29.2 million (0.12%) pertained to investors having their registered office or address abroad and the majority (99.2%) to investors having their registered office or address in the Czech Republic.

89 For mutual funds, the date of commencement of activities is the date of issuance of units, while for investment funds it is the date of incorporation. Only 37 active funds were obliged to fulfil the information duty to the CNB.

CHART III.13
Number of planholders
(in thousands; at end of period)

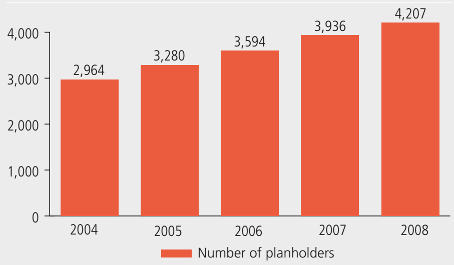


CHART III.14
Total assets and profit of pension funds
(in CZK billions; at end of period)

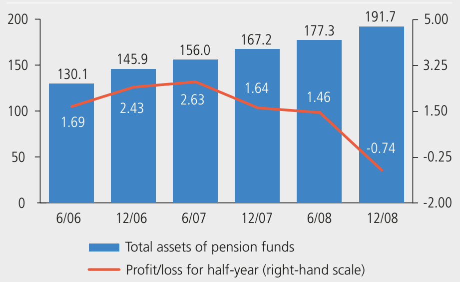


CHART III.15
Market shares in pension fund sector by volume of planholders' funds
(in %; at end of period)

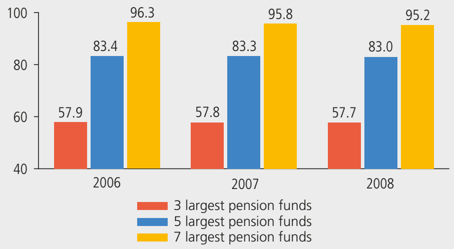
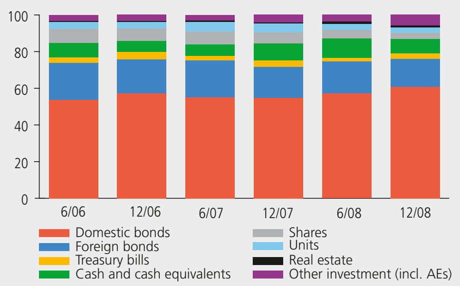


CHART III.16
Structure of placement of pension fund assets
(at end of period)



3.3 PENSION FUNDS

The 2008 global financial crisis was reflected above all in the value of pension funds' own capital. As with the other supervised entities, the CNB introduced extraordinary measures for pension funds, in the form of both an extraordinary reporting duty and supervision of the required capital adequacy of individual funds. As from the second half of 2007, the ability of pension funds to cover their liabilities to planholders was also carefully monitored to ensure that the net asset value of each fund at least equalled the planholders' funds maintained in that fund.

3.3.1 Number of licensed entities

As of 31 December 2008, a total of 10 pension funds were operating on the private pension scheme market in the Czech Republic, i.e. the same number of active entities as at the start of 2008. The number of private pension planholders increased again in 2008. The threshold of 4 million planholders was exceeded for the first time, confirming the upward trend in the number of private pension planholders over the past few years (see Chart III.13; end-December data).

3.3.2 Structure of pension fund assets

The total assets managed by pension funds amounted to CZK 191.7 billion at the end of 2008, up by around CZK 24.5 billion compared to the end of 2007. The growth in pension fund assets and profit over the past few years is shown in Chart III.14. Chart III.15 shows the concentration ratios in the pension fund sector according to the volumes of planholders' funds recorded in pension funds' liabilities. As can be seen from the chart, the private pension market is highly concentrated; the 3 largest pension funds contain more than 50% of the funds accepted from private pension planholders, while half of the active pension funds contain more than 80% of such funds.

Chart III.16 illustrates the allocation of pension fund investments by asset type. Chart III.17 gives a year-on-year comparison of the allocations expressed as percentage movements (between 2006 and 2007, and between 2007 and 2008). Given the financial market situation, the largest fluctuations were obviously recorded by investments in shares and units (a year-on-year decline) on the one hand and investments in receivables and deposits (an increase) on the other. The total asset volume grew at a similar pace as in the previous period.

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 of the financial stability of pension funds. The 2008 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 3.9 billion as of 31 December 2007 to CZK 3.3 billion as of 31 December 2008. This decrease was due mainly to the valuation differences item, in response to the deterioration in market conditions.

Chart III.18 shows the main items of own capital for the pension fund sector in the last three years in greater detail. It is apparent that the volume of own capital is mainly affected by valuation differences. The value of valuation differences (more than CZK -8 billion) was almost 4.3% of total assets on 31 December 2008. In response to the development of own capital, the capital of pension funds was increased by CZK 6.3 billion during 2008 at the CNB's instigation.[90]

The profit of pension funds decreased from CZK 4.4 billion to CZK 0.7 billion in the same period. The sector's real performance was negative, owing to the substantial decline in valuation differences (see Chart III.18).

3.3.3 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 186.7 billion at the end of 2008. This represented an increase of CZK 26 billion compared to 2007. Planholders' funds recorded in pension funds' liabilities and the values of planholders' contributions are shown in Chart III.19.

3.4 REGULATED MARKETS

3.4.1 Trading on regulated markets

At the end of 2008, a total of 28 issues were traded on the Prague Stock Exchange (PSE), a decrease of 4 compared to the end of 2007. The number of domestic equity issues declined by 6. There were 10 foreign equity issues traded on the PSE at the end of the year, i.e. up by 2 compared to 2007. The numbers of equity and bond issues traded on the stock exchange since 2001 are shown in Chart III.20. Trading in shares decreased by 15.9% year on year, from CZK 1,013.0 billion to CZK 852.0 billion. Trades conducted in SPAD accounted for 94.7% of the total volume of share trades. The ČEZ share issue accounted for 45.3% of the total volume. The five most traded issues accounted for 85.9% and the 10 most traded issues for 98.6% of the total volume.

The number of bond issues traded on the PSE declined from 132 in 2007 to 121 in 2008. However, the total volume of bond trades increased by 26.4% compared to 2007, from CZK 508.9 billion to CZK 643.1 billion. Trading in government bonds accounted for almost 96% of the total trading volume. The monthly volumes of share and bond trades on the PSE and the evolution of the PX index are shown in Chart III.21.

90 Capital was increased mostly in the second half of the year (CZK 4.7 billion). Funds increased their own capital through increases in equity capital as well as in other ways (capital funds, share premium). Only three funds did not increase their capital for this reason in 2008.

CHART III.17
Year-on-year changes in structure of pension fund assets
(in %)

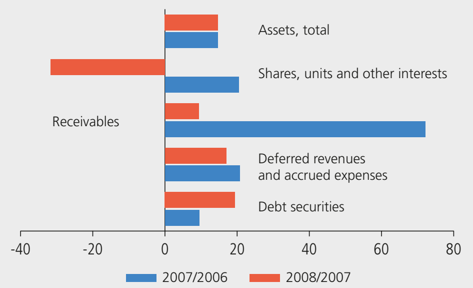


CHART III.18
Selected items of own capital
(in CZK millions; at end of period)

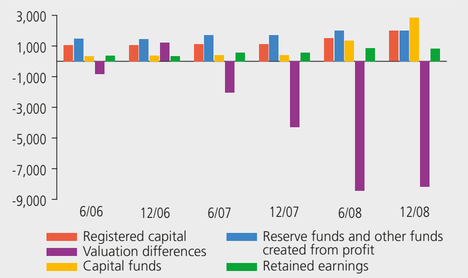


CHART III.19
Planholders' funds
(in CZK billions; at end of period)

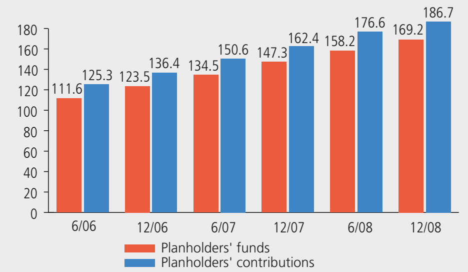


CHART III.20
Numbers of equity and bond issues on PSE
(as of 31 December 2008)

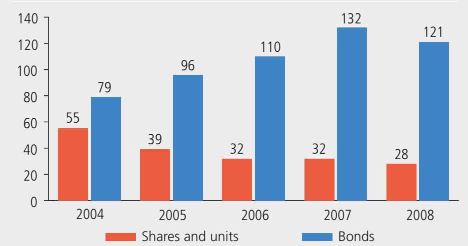


CHART III.21
Monthly trading volumes on PSE and PX index in 2008
(in CZK billions)

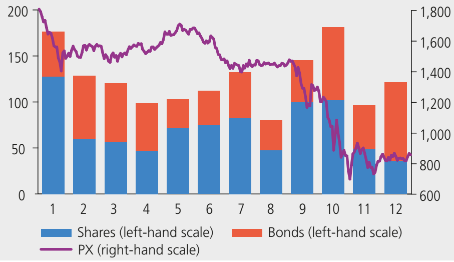
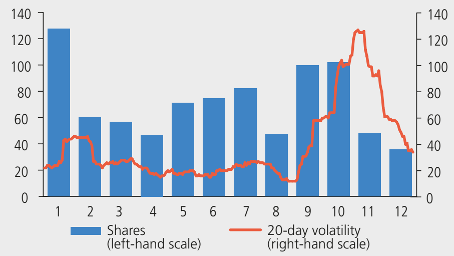


CHART III.22
Historical volatility of PX index (20D) and monthly share trading volumes in 2008
(in CZK billions) (in %)



Derivatives trading on the PSE again recorded a relatively small volume of less than CZK 1.2 billion in 2008. The offer of derivatives at the end of 2008 comprised 6 issues of futures, 2 issues of warrants and 46 issues of investment certificates.

The PSE's PX index closed 2008 at 858.2 points, compared to 1,815.1 points at the end of 2007. This represented a substantial decline of 52.7%. The global economic crisis negatively affected the domestic capital market. The PX index recorded its yearly maximum of 1,808.6 points on the first business day of 2008 and its yearly minimum of 699.8 points on 27 October 2008. A year before, on 29 October 2007, the index had recorded a historical high of 1,936.1 points. The monthly share trading volumes on the PSE in 2008 and the 20-day historical volatility of the PX index are shown in Chart III.22.

The market capitalisation of shares traded on the PSE was CZK 1,091.7 billion on 31 December 2008, down by 40.7% compared to the end of 2007. Domestic shares accounted for 72.2% (CZK 788.7 billion) of the market capitalisation, while the ČEZ issue accounted for 42.6%. The year-on-year changes in the prices of the individual share issues fluctuated within a range of about -92% to 11%.

The number of share issues traded on the other domestic market, RM-SYSTÉM, česká burza cenných papírů a.s. (RM-S), into which the OTC market RM-Systém, a.s. was converted on 1 December 2008, was 71 in 2008. The total annual trading volume in 2008 declined from CZK 7.7 billion to CZK 6.9 billion. Share trading accounted for almost all this figure. The share of RM-S in the total trading volume on the domestic regulated markets declined in 2008, accounting for around 0.2% compared to 0.5% in 2007.

The RM index fell from the 3,404.4 points recorded at the end of 2007 to 1,943.9 points at the end of 2008, or by 42.9%. The market capitalisation of shares traded on RM-S also fell in year-on-year terms, from CZK 4,306.4 billion to CZK 2,805.0 billion, or by 34.9%.

3.4.2 Trading off the regulated markets

Securities transactions executed off the regulated markets[91] totalled CZK 4,009.8 billion in 2008, an increase of 13% compared to 2007. UNIVYC transactions rose by 13%, from CZK 3,544.3 billion to CZK 4,005.9 billion. Transactions settled through the Czech Securities Centre increased by 30% to CZK 3.9 billion.

91 Transactions executed off the regulated markets are transactions where, in the case of securities transfers executed at the Czech 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.

4. THE INSURANCE MARKET

4.1 INSURANCE MARKET STRUCTURE

A total of 35 domestic insurance undertakings and 18 branches of foreign insurance undertakings, of which 17 were from EU countries, were operating on the Czech market at the end of 2008. The number of domestic insurance undertakings excludes the Czech Insurers' Bureau[92] and AIG CZECH REPUBLIC pojišťovna, a.s., which went into liquidation and its authorisation to carry on insurance activities was withdrawn in 2008.

In 2008, the number of domestic insurance undertakings increased by one despite the fact that AIG CZECH REPUBLIC pojišťovna, a.s., terminated its activities. Two entities were granted licences to provide non-life insurance services by the CNB in May 2008: AXA pojišťovna a.s., which specialises in motor, household and liability insurance, and Wüstenrot pojišťovna a.s., which provides mainly family insurance protection and motor vehicle insurance.

As in 2007, AXA životní pojišťovna a. s. provided insurance also through its branches in Slovakia and Norway. In 2008, AXA pojišťovna a.s. also started providing services through its Slovak branch. The number of domestic insurance undertakings authorised to carry on insurance services in other EU or EEA countries under the freedom to provide services remained unchanged at 15 at the end of 2008. AIG CZECH REPUBLIC pojišťovna, a.s., entered into liquidation, but Hasičská vzájemná pojišťovna, a.s., was newly authorised to provide services.

The number of branches of foreign insurance undertakings operating on the Czech insurance market was the same as in 2007, although some developments were observed even here. A branch of the Austrian insurance undertaking Skandia Lebensversicherung AG, focusing on life insurance, was established in the Czech Republic in 2008. HDI Hannover Versicherung AG, organizační složka and HDI - Gerling Industrie Versicherung AG, organizační složka merged to form HDI Versicherung AG, organizační složka, in 2008. There was also a change in the only branch of an insurance undertaking from a non-EU/EEA country operating on the Czech market. The branch of the Swiss Elvia Reiseversicherung – Gesselschaft AG was renamed Mondial Assistance International AG – organizační složka. Austrian insurance undertakings enjoy the largest representation via branches in the Czech insurance market (5 branches), followed by insurance undertakings from the United Kingdom and Slovakia (3 branches). As regards the orientation of insurance activities, branches focusing on non-life insurance prevail among the branches of foreign insurance undertakings (12 of the total of 18). Four insurance undertakings focus on life insurance, while two carry on both life insurance and non-life insurance activities.

TABLE IV.1
Market structure by type of insurance undertaking

	2006	2007	2008
NUMBER OF DOMESTIC INSURANCE UNDERTAKINGS	33	34	35
of which:			
non-life	15	16	17[b]
life	3	3	3
both life and non-life	15	15	15
NUMBER OF BRANCHES OF INSURANCE UNDERTAKINGS FROM EU AND THIRD COUNTRIES	16	18	18
of which:			
non-life	11	13	12
life	3	3	4
both life and non-life	2	2	2
TOTAL NUMBER OF INSURANCE UNDERTAKINGS[a]	49	52	53
of which:			
non-life	26	29	29
life	6	6	7
both life and non-life	17	17	17

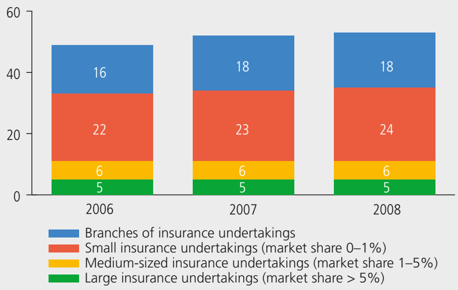
a) excluding insurance undertakings from Member States operating in the Czech Republic under the freedom to provide services
b) AIG CZECH REPUBLIC pojišťovna, a. s., went into liquidation in 2008 and is no longer included among the active insurance undertakings

92 The Czech Insurers' Bureau (Česká kancelář pojistitelů, ČKP) is a professional organisation of insurers licensed to provide motor third party liability insurance. Its activity is governed by Act No. 168/1999 Coll., on Vehicle Liability Insurance, as amended. 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 www.ckp.cz.

The number of insurance undertakings and branches of insurance undertakings from other EU or EEA countries offering insurance in the Czech Republic under the freedom to provide services continued to climb in 2008. There were 554 such undertakings and branches at the end of 2008, a rise of 76 year on year. Most of these insurance undertakings carry on non-life insurance activities. A total of 137 notified entities are based in the United Kingdom. It is followed by Ireland (79) and Germany, Austria, France and the Netherlands, each with more than 30 notified entities.[93]

VIG RE zajišťovna, a.s., opened for business in Prague at the start of September 2008, becoming the first licensed reinsurance undertaking in the Czech Republic. It was granted approval to carry on reinsurance activities by the CNB in August 2008. It is authorised to assume reinsurance risks in all segments of both the life insurance and non-life insurance markets as well as to carry on related activities such as consultancy, intermediation, training and examination of reinsurance cases.

CHART IV.1
Number of insurance undertakings by group



Insurance undertakings operating on the Czech insurance market are divided into four groups for analytical purposes: large, medium-sized and small insurance undertakings and branches of foreign insurance undertakings.[94] The division into large, medium-sized and small insurance undertakings is based on the amount of annual gross premiums written.

The criterion for inclusion in large insurance undertakings is a share of 5% or more in total premiums written in the Czech Republic. Five domestic insurance undertakings met this requirement in 2008. These large insurance undertakings offer a broad range of life and non-life insurance products. With the exception of one insurer, non-life insurance premium collection prevails in insurance undertakings in this group. The large insurance undertakings belong to major international financial groups. Generali PPF Holding, which will operate in Central and Eastern Europe and contains, among others, Generali Pojišťovna a.s. and Česká pojišťovna a.s., opened for business in January 2008. This holding company is one of the largest insurance groups in Central and Eastern Europe.

Medium-sized insurance undertakings comprise six entities having market shares in premiums written of between 1% and 5%. These are again universal insurers. Unlike the large insurance undertakings, however, life premiums written prevail in this group. Four of these insurers focus mainly on life insurance products. Foreign ownership predominates in five medium-sized insurance undertakings, while domestic capital is more important in one.

Small insurance undertakings contain 24 domestic entities with market shares of 1% or less. Most of the small insurance undertakings specialise exclusively in non-life insurance. There are 17 such insurers on the Czech market. Three insurance undertakings are only active on the life insurance market, while four are universal insurers. Foreign capital predominates in 14 small insurance undertakings,

93 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 is available on the CNB website.
94 A list of the individual insurers assigned to these categories is given in Annex 4.

while domestic capital is important in 10. The range of products offered is narrower in small insurance undertakings. They focus on specialised insurance products such as credit and guarantee insurance, travel insurance, legal protection insurance and investment life insurance.

Branches of foreign insurance undertakings are the last group. It comprises 18 insurers, 17 of which are registered in the EU. Twelve branches are active in non-life insurance and four in life insurance, while two carry on both life insurance and non-life insurance activities. ING Životní pojišťovna N.V., pobočka pro Českou republiku, has a specific position among the branches of foreign insurance undertakings, ranking second by premiums written in life insurance in the whole insurance market.

The group structure of domestic insurance undertakings is stable. Compared to 2007, no insurance undertakings moved from one group to another. AXA pojišťovna a.s. and Wüstenrot pojišťovna a.s joined the group of small insurance undertakings. On the other hand, AIG CZECH REPUBLIC pojišťovna, a.s., left the group after going into liquidation in 2008. The number of branches of foreign insurance undertakings operating on the Czech insurance market remained at the previous year's level.[95]

The total registered capital of domestic insurance undertakings is fairly stable and its rate of growth has been falling in recent years. Equity capital rose by 3.3% compared to 2007, following growth of 3.7% in 2007 and as much as 6.3% in 2006. Foreign capital accounts for three-quarters of the total. The Czech share in the total registered capital of domestic insurance undertakings fell by 4.2 percentage points compared to 2007, to 24.8%. Shareholders from the Netherlands and Austria have larger holdings than domestic ones. The large share of the Netherlands is due mainly to the fact that a direct shareholder of Česká spořitelna has its registered office there. The increase in the share of Dutch shareholders in the total registered capital of insurance undertakings of 1.8 percentage points in 2008 was due to the transfer of Generali Pojišťovna a.s., owned by Italian shareholders, to the newly established Generali PPF Holding B.V., registered in the Netherlands. Česká pojišťovna a.s. is part of the same holding. Austrian shareholders account for more than a quarter of the registered capital of domestic insurance undertakings, mainly due to their interests in two large insurance undertakings (an almost 90% share in Kooperativa pojišťovna, a.s., Vienna Insurance Group and a 100% stake in Allianz pojišťovna, a.s.). Their share rose by a further 2.7 percentage points year on year following the transfer of a majority stake in Pojišťovna České spořitelny, a.s. to its Austrian owner. Shareholders from Belgium account for more than 5% through their majority ownership of ČSOB pojišťovna a.s. French shareholders now have an equal participation after doubling their share in the registered capital of domestic insurance undertakings by investing in AXA životní pojišťovna a.s. and establishing AXA pojišťovna a.s. in 2008.

CHART IV.2
Ownership structure of domestic insurance undertakings

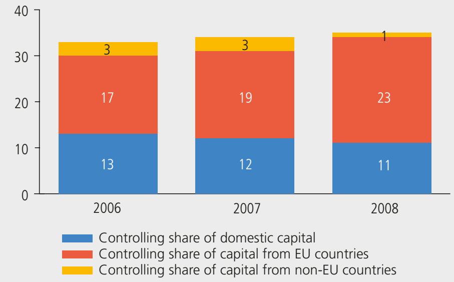
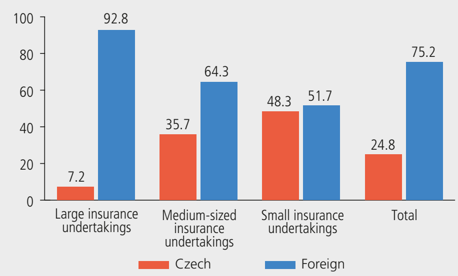


TABLE IV.2
Ownership structure of domestic insurance undertakings by share in registered capital as of 31 December 2008

Country	Amount of participation (CZK thous.)	Share in total registered capital (%)
Czech Republic	4,710,178	24.8%
Netherlands [a)]	5,212,000	27.5%
Austria	4,947,017	26.1%
Belgium	1,218,300	6.4%
France	1,104,412	5.8%
Germany	526,678	2.8%
United Kingdom	435,850	2.3%
Slovenia	360,000	1.9%
Switzerland	243,150	1.3%
USA	106,000	0.6%
Italy	66,000	0.3%
Denmark	55,500	0.3%
TOTAL CAPITAL	**18,985,085**	**100.0%**

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

CHART IV.3
Domestic insurance undertakings by origin of capital
(in %; as of 31 December 2008)



95 The indicators relating to the categories of insurance undertakings in 2007 and 2006 in the following sections are based on the numbers of insurance undertakings in these categories in 2008 (except branches).

CHART IV.4
Gross premiums written
(in CZK billions)

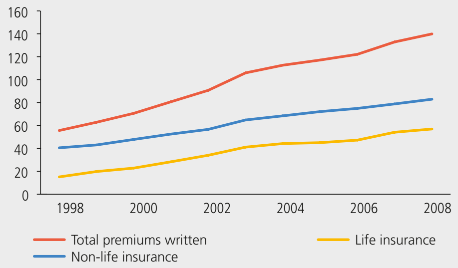


CHART IV.5
Gross premiums written
(in CZK billions)

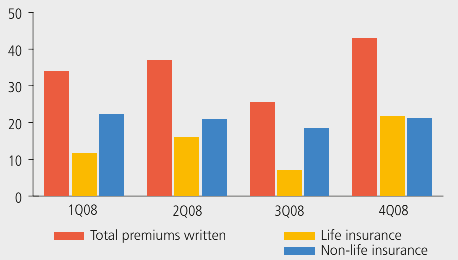
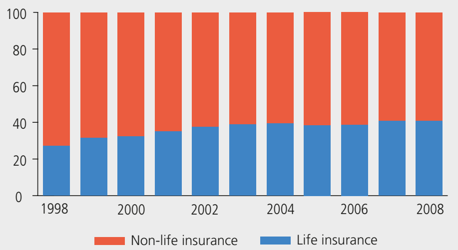


CHART IV.6
Shares of life insurance and non-life insurance in total premiums written
(in %)



Large insurance undertakings are dominated by foreign shareholders, whose share increased slightly further. At the end of 2008, foreign owners held 92.8% of all the shares. Unlike in 2007, foreign capital also dominates in medium-sized and small insurance undertakings, accounting for 64.3% in the former and 51.7% in the latter. This means that the ratio of domestic capital to foreign capital reversed among medium-sized and small insurance undertakings in 2008 in favour of foreign owners. This switch was due mainly to the establishment of two new insurance undertakings wholly owned by foreign entities (AXA pojišťovna a.s. and Wüstenrot pojišťovna a.s.), the passage of a majority stake in Pojišťovna České spořitelny, a.s. into foreign hands, and to capital increases in two other insurers fully controlled by foreign shareholders (AXA životní pojišťovna a.s. and Triglav pojišťovna a.s.). Of the total of 35 domestic insurance undertakings, 18 were wholly foreign owned at the end of 2008. Czech shareholders held 100% of the registered capital in 11 insurance undertakings.

4.2 BASIC INDICATORS OF THE INSURANCE MARKET

Gross premiums written are one of the basic indicators of the insurance market. Their value has been rising constantly over the past decade in line with rising incomes and economic growth. However, besides heightened uncertainty in the financial and labour markets, 2008 was also characterised by a slowdown in the relatively high rate of growth of premiums written recorded in 2007 (8.8%). This indicator rose by 5.2% to CZK 139.9 billion in 2008. The decrease in the growth rate of total gross premiums written was largely due to a relatively marked decline in the rate of growth of life insurance, which moderated from 14.6% to 5.1%.

Premiums written in life insurance increased by CZK 2.8 billion year on year to CZK 56.9 billion at the end of 2008. A decline in the rate of growth of premiums written in life insurance in 2008 of almost 10 percentage points was due mainly to a decrease of 1.5% in single premium payments. Single premium payments had recorded growth of 34.2% a year earlier. Single premium payments amounted to CZK 14.2 billion in 2008, accounting for almost 25% of total premiums written in life insurance. Regular premiums increased by 7.6%.

The growth in non-life insurance was relatively stable compared to 2007, rising by just 0.1 percentage point to 5.3%. Total gross premiums written amounted to CZK 82.9 billion in non-life insurance. This represents an annual rise of CZK 4.2 billion.

Non-life insurance accounted for 59.3% of total premiums written and life insurance for 40.7%. This ratio was unchanged at the 2007 level. The share of life insurance is still below the usual level in advanced EU insurance markets.

A proportion of premiums written is ceded to reinsurers. The aim of reinsurance is to mitigate the risks arising from potential large-scale losses in situations where higher insurance claims could jeopardise the financial stability and solvency of insurance undertakings. Reinsurance is used mainly in the non-life insurance segment, which is exposed to the risk of unexpectedly high insurance claims, especially in the event of natural disasters such as floods, to a much larger extent than life insurance products. Following an annual fall of 7.2% in 2007, non-life insurance premiums ceded to reinsurers increased by 7.1% to CZK 23.4 billion in 2008. This represents 28.2% of total non-life insurance premiums written. The share of life insurance premiums written ceded to reinsurers was about ten times lower at 2.6% at the end of 2008. In absolute terms, this represents CZK 1.5 billion. The volume of life insurance premiums ceded to reinsurers rose by 6.4% year on year. This increased its share in gross life insurance premiums written by 0.1 percentage point.

Although insurance market concentration (as measured by premiums written) is quite high in historical terms in the Czech Republic, it is gradually decreasing as a result of growing competition. The total market share of the 3 largest insurance undertakings declined by 1.2 percentage points year on year in 2008, while the shares of the 5 and 10 largest insurance undertakings decreased by 0.8 and 0.2 percentage point respectively. In the analysed groups of the 3, 5 and 10 largest insurers on the whole insurance market, and also separately on the life insurance and non-life insurance markets, an increase of 0.4% in market share was recorded only for the 3 largest entities on the life insurance market. All the other analysed groups recorded falls in market share for all segments. The largest decline in concentration was recorded for the 3 largest entities operating on the non-life insurance market, with a decline of 1.9 percentage points to 68.5%. Generally, the market is more concentrated in non-life insurance, but concentration there is decreasing at a faster pace than that on the life insurance market. The share of the 10 largest insurers was an exception, declining by 0.6 percentage point in the life insurance market, compared to a slighter decline of 0.3 percentage point on the non-life insurance market.

The share of premiums written by large insurance undertakings in total premiums written was 70.8% in 2008, down by 0.8 percentage points from a year earlier. Large insurance undertakings have a larger share of the non-life insurance market, where they account for 80.6%, while having a share of just 56.5% on the life insurance market. Both these shares have been declining steadily. By contrast, the share of medium-sized insurance undertakings has long been increasing, and 2008 was no exception as regards premiums written as a whole and in non-life insurance. The share of medium-sized insurance undertakings on the life insurance market declined slightly. Despite that, they accounted for 26.1%, compared to a substantially smaller share of only 9.6% of the non-life insurance market. In small insurance undertakings, the rising share in premiums written observed in previous years did not continue. Their shares grew in inverse proportion to those of medium-sized insurance undertakings. In 2008, small insurance undertakings recorded an increase in share only in life insurance, where their share rose slightly to 3.5% from 3.1% a year earlier. However, they had a more significant share of 7.0% of the non-life insurance market. Branches of foreign insurance undertakings were the only group to gain in strength on both the life and non-life insurance markets, although their market share is small. Their share is more significant on the life insurance market, reaching 13.9%, owing mainly to ING Životní pojišťovna N.V., pobočka pro Českou republiku. In absolute terms, premiums written increased in 2008 in all groups except for small insurance undertakings on the non-life insurance market, where premium receipts decreased by CZK 183 million to CZK 5.8 billion.

The most important category of the non-life insurance market, despite its slightly decreasing share, is still motor third party liability insurance. It accounted for 29.1% of non-life insurance premiums written in 2008. Premiums written in motor third

CHART IV.7

Concentration in insurance market by premiums written

(in %; as of 31 December 2008)

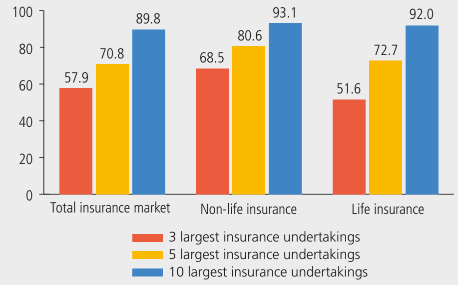


TABLE IV.3

Premiums written by insurance group

	Amount (CZK millions)			Share (%)
	2006	2007	2008	2008
TOTAL PREMIUMS WRITTEN	122,121	132,896	139,852	100.0
Large insurance undertakings	90,530	95,166	99,043	70.8
Medium-sized insurance undertakings	18,077	21,238	22,846	16.3
Small insurance undertakings	6,760	7,641	7,761	5.5
Branches of insurance undertakings	6,754	8,851	10,202	7.3
PREMIUMS WRITTEN – NON-LIFE INSURANCE	74,888	78,768	82,943	100.0
Large insurance undertakings	62,511	64,307	66,878	80.6
Medium-sized insurance undertakings	6,187	6,926	8,002	9.6
Small insurance undertakings	5,375	5,959	5,776	7.0
Branches of insurance undertakings	815	1,576	2,287	2.8
PREMIUMS WRITTEN – LIFE INSURANCE	47,233	54,128	56,909	100.0
Large insurance undertakings	28,019	30,859	32,165	56.5
Medium-sized insurance undertakings	11,890	14,312	14,844	26.1
Small insurance undertakings	1,385	1,682	1,985	3.5
Branches of insurance undertakings	5,939	7,275	7,915	13.9

TABLE IV.4

Premiums written by insurance class

Insurance classes	Amount (CZK millions)			Change (%)
	2006	2007	2008	2008/2007
TOTAL LIFE INSURANCE	47,233	54,128	56,909	5.1
Assurance on death or survival, marriage assurance, capital operations	27,684	27,481	26,710	-2.8
Annuity assurance	2,768	2,577	2,439	-5.4
Investment life assurance	11,357	18,394	21,591	17.4
Supplementary personal accident and sickness insurance	5,424	5,676	6,169	8.7
TOTAL NON-LIFE INSURANCE	74,888	78,768	82,943	5.3
Liability insurance for damage arising out of use of motor vehicle	22,454	23,376	24,140	3.3
Insurance against damage to or loss of property	17,873	17,735	18,825	6.1
Insurance against damage to or loss of land vehicles	15,507	16,214	16,872	4.1
General liability insurance for damage[a)]	9,734	10,418	11,385	9.3
Accident and sickness insurance	3,337	3,725	4,102	10.1
Other non-life insurance	5,983	7,300	7,619	4.4

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

Chart IV.8
Shares of classes of non-life insurance in premiums written
(in %)

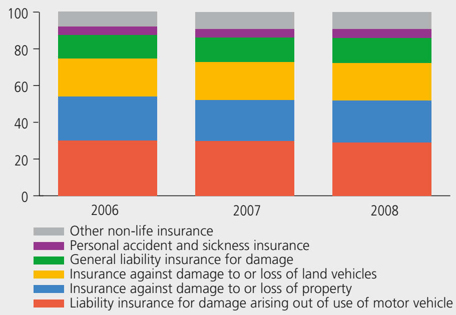


Chart IV.9
Shares of classes of life insurance in premiums written
(in %)

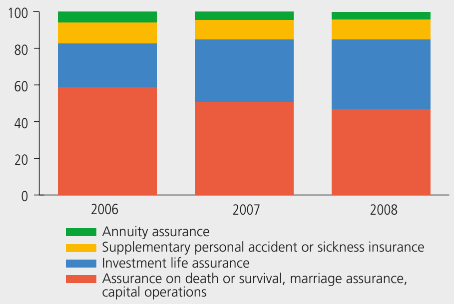


Chart IV.10
Shares of premiums written in GDP
(in %)

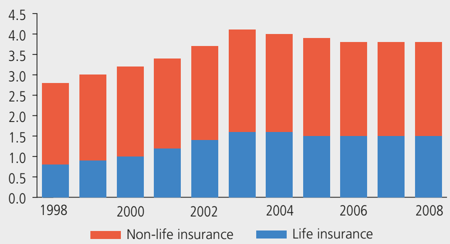


Table IV.5
Total insurance penetration in the Czech Republic

	Amount (CZK billions)			Change (%)
	2006	2007	2008	2008/2007
Premiums written	122	133	140	5.3
GDP (at current prices)	3,215	3,530	3 706	5.0
		%		
Premiums written/GDP	3.8	3.8	3.8	x

party liability insurance amounted to CZK 24.1 billion in 2008. Other important categories of non-life insurance include insurance against damage to or loss of property and insurance against damage to or loss of land vehicles, which accounted respectively for 22.7% and 20.3% of total non-life insurance premiums. Premiums written recorded the largest increase in accident and sickness insurance in 2008 (up by 10.1%). Premiums in general third party indemnity insurance rose by 9.3%. Unlike in previous years, other non-life insurance categories recorded a lower average relative increase in premiums compared to the growth for the whole non-life insurance market. This was due mainly to a halt in growth in premiums in credit insurance and insurance against various financial losses. None of the above-mentioned non-life insurance classes recorded an absolute fall in premiums.[96]

Traditional products such as assurance on death, assurance on survival or earlier death and insurance of benefits for child maintenance (marriage assurance) still predominate on the life insurance market. Their share in life insurance premiums written has long been declining and fell below 50% for the first time in 2008. These types of insurance are also recording a decline in premiums written in absolute terms. The share of investment life insurance is rising, mainly at the expense of traditional life insurance products. It grew by 17.4% in 2008, with premiums written increasing to CZK 21.6 billion. Nonetheless, this insurance category is also showing signs of a slowdown linked with the declining economic growth and with households' flight to more conservative investment alternatives. The share of investment life insurance in total premiums collected on the life insurance market increased to 37.9% in 2008. The advantage of investment life insurance for clients is that, in contrast to traditional products, they can choose where the saving part of premiums will be invested, according a preferred investment strategy. On the other hand, the investment risk is borne by the policyholder, not the insurer. Supplementary personal accident or sickness insurance also recorded growth in 2008. Its premiums written rose by 8.7% and its share in life insurance thus increased by 0.3 percentage point to 10.8%.

Total insurance penetration, as measured by the ratio of gross premiums written to GDP at current prices, is an important insurance market indicator. Insurance penetration on the Czech insurance market has been stable over recent years, at around 3.8%. However, in contrast to 2007, premiums written rose somewhat faster than GDP and the insurance penetration ratio thus increased slightly. Insurance penetration in the Czech Republic is low compared to Western European countries.

Claim settlement costs totalled CZK 69.2 billion in 2008, rising by 12.5% year on year. In this section, claim settlement costs are given on a gross basis, including the reinsurer's share. In 2008, claim settlement costs increased in both life and non-life insurance. Life insurance claim settlement costs rose by 21.3%, after having grown by 33.8% a year earlier. One of the factors behind this relatively large rise was the continued phasing-out of short-term single-payment insurance policies with a saving component signed by clients at the start of the new millennium. Having declined by 4.1% in 2007, claim settlement costs in non-life insurance recorded year-on-year growth of 6.4%. The losses caused by natural disasters in 2008 mainly included losses due to gales at the start of the year. Insurers recorded around 38,000 gale-related insurance losses, with estimated claim settlement costs of CZK 1.4 billion.[97]

96 Annex 22 contains a breakdown of gross premiums written by life insurance and non-life insurance.
97 Source: Czech Insurance Association.

The share of reinsurers in non-life insurance claim settlement costs slightly exceeded CZK 10 billion in 2008, having risen by almost 10% from CZK 9.1 billion in 2007. The share of reinsurers in total non-life insurance claim settlement costs thus reached 26.0% in 2008, which is roughly in line with their share in premiums written. Reinsurers accounted for just 1% of life insurance claim settlement costs. In absolute terms, they accounted for CZK 299 million of such costs, representing a year-on-year decline of 8.4%.

The share of large insurance undertakings in total claim settlement costs fell by 2.3 percentage points year on year to 72.5%. Their shares of both the life and non-life insurance markets decreased, but a larger decline (of 2.2 percentage points) was recorded on the life insurance market. Large insurance undertakings have a larger share in claim settlement costs in non-life insurance, where they account for almost 85% despite a gradual decline. The share of medium-sized insurance undertakings in total claim settlement costs rose by 2.4 percentage points compared to 2007, to 18.4%. The shares of the individual groups of insurance undertakings in claim settlement costs roughly correspond to their shares in premiums written. The shares of large and medium-sized insurance undertakings in claim settlement costs are slightly higher than those in premiums written. This proportion is opposite for small insurance undertakings and branches of foreign insurance undertakings. A decline in absolute claim settlement costs was recorded only for small insurance undertakings, where total claim settlement costs fell by CZK 39 million due to lower claim settlement costs on the non-life insurance market.

4.3 BALANCE SHEET AND FINANCIAL RESULTS OF THE INSURANCE SECTOR

The total assets of insurance undertakings stood at CZK 370 billion as of 31 December 2008. This represents an annual rise of 7.2%. The growth in total assets had been slightly slower a year earlier (6.9%). Of the groups analysed, only the assets of branches of foreign insurance undertakings grew at a slower pace than the sector's total assets, increasing by just 2.7%. The total assets of large insurance undertakings increased by 7.4 percentage points. Medium-sized and small insurance undertakings recorded growth in total assets of more than 8%. The share of all groups of domestic insurance undertakings in the sector's total assets thus increased slightly at the expense of branches of foreign insurance undertakings, whose share shrank from 10.5% to 10.0%. Large insurance undertakings have the largest share in total assets, accounting for 64.8% of the insurance sector's total assets.

As regards the types of insurance undertakings, the biggest contributors to total assets were again universal insurers, which increased their share by 0.5 percentage point compared to 2007, to 83.0%. The share of life insurance undertakings in total assets fell to 10.6% over the same period. The share of non-life insurance undertakings remained broadly unchanged at 6.4%. In 2008, the strongest growth in assets was recorded by undertakings carrying on both life insurance and non-life insurance (7.8%). A year earlier the growth had been 6.7%. By contrast, the rate of growth of the assets of life insurance and non-life insurance undertakings decreased compared to 2007. These undertakings increased their total assets by 2.9% and 7.1% respectively.

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

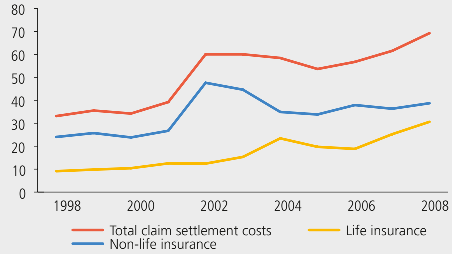


TABLE IV.6
Claim settlement costs by insurance group

	Amount (CZK millions) 2006	2007	2008	Share (%) 2008
TOTAL CLAIM SETTLEMENT COSTS	56,735	61,532	69,228	100.0
Large insurance undertakings	46,415	46,044	50,199	72.5
Medium-sized insurance undertakings	5,855	9,888	12,756	18.4
Small insurance undertakings	1,936	2,239	2,200	3.2
Branches of insurance undertakings	2,529	3,361	4,073	5.9
CLAIM SETTLEMENT COSTS – NON-LIFE INSURANCE	37,898	36,336	38,652	100.0
Large insurance undertakings	33,392	31,188	32,830	84.9
Medium-sized insurance undertakings	2,724	2,991	3,502	9.1
Small insurance undertakings	1,664	1,841	1,676	4.3
Branches of insurance undertakings	118	316	644	1.7
CLAIM SETTLEMENT COSTS – LIFE INSURANCE	18,837	25,196	30,576	100.0
Large insurance undertakings	13,023	14,856	17,369	56.8
Medium-sized insurance undertakings	3,131	6,897	9,254	30.3
Small insurance undertakings	272	398	524	1.7
Branches of insurance undertakings	2,411	3,045	3,429	11.2

TABLE IV.7
Shares of individual insurance groups in total assets

	Amount (CZK millions) 2006	2007	2008	Share (%) 2008
TOTAL ASSETS	322,776	345,119	369,997	100.0
Large insurance undertakings	211,381	223,328	239,899	64.8
Medium-sized insurance undertakings	53,289	58,665	63,757	17.2
Small insurance undertakings	24,207	27,004	29,242	7.9
Branches of insurance undertakings	33,899	36,122	37,099	10.0

CHART IV.12
Shares of insurance undertakings in total assets by type
(in %)

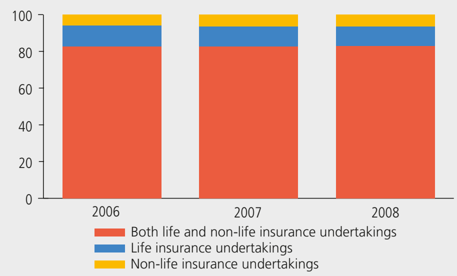


TABLE IV.8
Assets of domestic insurance undertakings

	Amount (CZK millions) 2006	2007	2008	Share (%) 2008
TOTAL ASSETS	288,877	308,997	332,898	100.0
Financial placements (investment)	247,680	260,132	278,151	83.6
of which:				
real estate	8,770	4,921	5,266	1.6
participating interests	11,314	11,649	14,358	4.3
shares, variable-yield securities	29,396	27,152	22,700	6.8
bonds and other fixed-income securities	169,802	181,844	202,964	61.0
deposits at financial institutions	25,164	25,936	28,123	8.4
other financial placements	3,234	8,630	4,740	1.4
Financial placements of unit-linked life insurance	11,515	17,804	19,835	6.0
Debtors (receivables)	16,891	17,807	21,270	6.4
Other assets	12,791	13,254	13,642	4.1

CHART IV.13
Investments of domestic insurance undertakings arising from technical provisions
(in %)

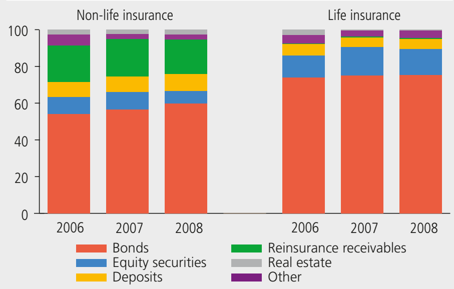


TABLE IV.9
Liabilities of domestic insurance undertakings

	Amount (CZK millions) 2006	2007	2008	Share (%) 2008
TOTAL LIABILITIES	288,877	308,997	332,898	100.0
Shareholder's equity	51,080	52,898	59,826	18.0
Technical provisions[a)]	199,850	211,444	222,164	66.7
Provision for unit-linked life insurance [a)]	11,479	17,740	19,651	5.9
Creditors (liabilities)	17,349	17,661	22,550	6.8
Other liabilities	9,119	9,254	8,707	2.6

a) net amount

Financial placement (investment)[98] is the most important asset item in the balance sheet of domestic insurance undertakings. However, its share is falling gradually. As of 31 December 2008, financial placement accounted for 83.6% of total assets. This share recorded an annual decline of 0.6 percentage points, mostly due to a marked decline in the value of shares and other variable-yield securities and other financial placements, which fell by 16.4% and 45.1% respectively year on year. While shares and other variable-yield securities in financial placements lost 7.6% of their value in 2007, other financial placements recorded a sizeable increase of 166.9%. Debt securities are the largest financial placement item. Their value increased by 11.6% compared to 2007 and their share in total assets rose by 2.2 percentage points to 61.0%. Following extensive sales of real estate by large insurance undertakings in 2007, when their value in financial placement had decreased by almost 44%, this trend halted and this item recorded an increase of 7.0% in 2008. Owing to growing interest in investment life insurance, despite a sizeable slowdown compared to 2007, financial placements of unit-linked life insurance rose by a further 11.4% and their share in total assets increased to 6.0%.

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. Investments arising from technical provisions for non-life insurance are made up of more liquid financial placement items, such as deposits and treasury bills, than investments arising from life insurance technical provisions. Reinsurance receivables, including reinsurers' share in technical provisions, also have a significant share.

The investments of domestic insurance undertakings arising from technical provisions are dominated by bonds. This applies to investments arising from technical provisions for both life insurance and non-life insurance. Bonds account for 59.7% of investments arising from technical provisions for non-life insurance. This share is gradually rising. It was 56.6% in 2007 and 54.0% in 2006. Reinsurance receivables are the second-largest investment item arising from technical provisions for non-life insurance, with a share of 18.9%. Deposits (9.1%) and equity securities (7.0%) are also represented, but their shares declined by more than 2 percentage points year on year.

Bonds are more dominant in the investments of domestic insurance undertakings arising from technical provisions for life insurance than in the case of non-life insurance, accounting for 75.4%. Equity securities have a significant 14.1% share. The shares of the individual investment items relating to technical provisions for life insurance remained broadly unchanged year on year. Reinsurance receivables have a negligible share of less than 0.5%. Investments arising from technical provisions for life insurance also include items linked with investment life insurance.

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

The most important item in insurance undertakings' liability structure 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 or as to the date on which they will arise. The types of technical provisions and their creation and use 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 unit-linked life insurance. The share of net technical provisions (excluding provisions for unit-linked life insurance) in the total liabilities of domestic insurance undertakings fell by 1.7 percentage points year on year to 66.7% at the end of 2008. In line with the increase in the financial placement item of unit-linked life insurance, the share of net technical provision for unit-linked life insurance in total liabilities of domestic insurance undertakings also recorded a rise, to 5.9%.

TABLE IV.10

Technical provisions of domestic insurance undertakings

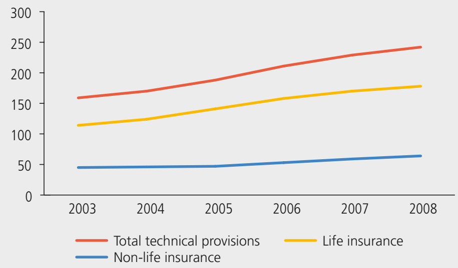
	Amount (CZK millions)			Change (%)
	2006	2007	2008	2008/2007
TOTAL GROSS TECHNICAL PROVISIONS	234,374	252,284	266,022	5.4
of which:				
non-life insurace	75,330	81,375	87,194	7.2
life insurance	159,044	170,909	178,828	4.6
TOTAL NET TECHNICAL PROVISIONS	211,329	229,185	241,814	5.5
of which:				
non-life insurace	53,267	59,246	63,991	8.0
life insurance	158,062	169,939	177,823	4.6

Besides technical provisions, equity is an important liability item, accounting for 18.0% of total liabilities of domestic insurance undertakings. This is up by 0.9 percentage point on a year earlier. Equity recorded an annual increase of 13.1%, up by almost 10 percentage points on 2007. This relatively high rate of growth is due to a considerable increase in almost all components of equity. Retained earnings rose by 50.2% (or CZK 3.9 billion), other capital funds by 31.7% (or CZK 2.1 billion) and the reserve fund and other funds created from profit by 26.8% (or CZK 2.1 billion), while the share premium account more than doubled (up by CZK 0.9 billion), albeit from a much lower base. Share capital, which recorded an annual increase of 3.3%, accounts for most of equity (31.7%). The only component of equity to see a decline compared to 2007 was profit for the current accounting period, which decreased by almost one-quarter to CZK 8.9 billion.

CHART IV.14

Net technical provisions of domestic insurance undertakings

(in CZK billions))



Compared to 2007, there was a sharper, 27.7% increase in the creditors (liabilities) item, the share of which in total liabilities rose to 6.8%. This was due to a sizeable rise in other liabilities. The decrease in the share of the remaining liabilities in total liabilities of 0.4 percentage point to 2.6% was chiefly due to a decline in accrued expenses and revenues.

At the end of 2008, the total gross technical provisions of domestic insurance undertakings, including provisions for unit-linked life insurance, were up by 5.4% year on year to CZK 266.0 billion. The rate of growth of gross technical provisions decreased by 2.2 percentage points compared to the previous period. Gross technical provisions for life insurance and non-life insurance increased by 4.6% and 7.2% respectively. The total net technical provisions of domestic insurance undertakings rose by about 5.5% during 2008, i.e. somewhat faster than gross technical reserves, due to a slight decline in reinsurers' share in technical provisions. The share of gross and net technical provisions for life insurance in total gross and net technical provisions is gradually declining. At the end of 2008, it was 67.2% for gross technical reserves and 73.5% for net technical reserves.

TABLE IV.11
Net technical provisions by insurance group

	Amount (CZK millions) 2006	2007	2008	Share (%) 2008
TOTAL NET TECHNICAL PROVISIONS	211,329	229,185	241,814	100.0
Large insurance undertakings	159,307	170,389	179,458	74.2
Medium-sized insurance undertakings	43,776	49,149	51,260	21.2
Small insurance undertakings	8,246	9,646	11,096	4.6
NET TECHNICAL PROVISIONS – NON-LIFE INSURANCE	53,267	59,246	63,991	100.0
Large insurance undertakings	43,361	47,898	50,469	78.9
Medium-sized insurance undertakings	4,786	5,536	6,325	9.9
Small insurance undertakings	5,120	5,812	7,197	11.2
NET TECHNICAL PROVISIONS – LIFE INSURANCE	158,062	169,939	177,823	100.0
Large insurance undertakings	115,946	122,491	128,989	72.5
Medium-sized insurance undertakings	38,990	43,613	44,935	25.3
Small insurance undertakings	3,126	3,835	3,899	2.2

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

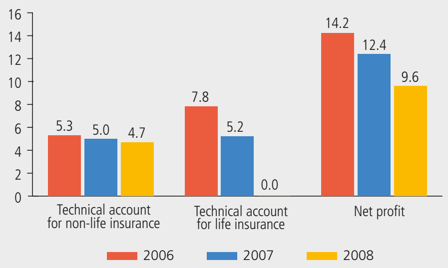


TABLE IV.12
Profit by insurance group

	Amount (CZK millions) 2006	2007	2008	Share (%) 2008
TOTAL NET PROFIT	14,209	12,390	9,583	100.0
Large insurance undertakings	11,215	9,768	8,403	87.7
Medium-sized insurance undertakings	1,191	1,111	372	3.9
Small insurance undertakings	846	649	91	0.9
Branches of insurance undertakings	957	862	717	7.5

The shares of domestic insurance undertakings in net technical provisions depending on their size are relatively stable. As in the case of premiums written and claim settlement costs, the share of large insurers in total net technical provisions is gradually declining. On 31 December 2008, large insurers accounted for 74.2%, down by 0.1 percentage point from a year earlier. Large insurers recorded a decline of almost 2 percentage points to 78.9% on the non-life insurance market, while their share in net technical provisions for life insurance increased by 0.4 percentage point to 72.5%. The shares of large insurers in total net technical provisions and in net technical provisions for life insurance are higher than their share in premiums written. The opposite is true for non-life insurance. The largest relative annual increase in net technical provisions for non-life insurance was recorded by small insurers (up by 23.8%), followed by medium-sized insurers (up by 14.3%). All groups of insurance undertakings recorded growth in net technical provisions for both life and non-life insurance.

Despite the adverse financial market situation and slowing economic growth in the Czech Republic in 2008, insurance undertakings operating on the Czech insurance market (domestic insurers including branches of foreign insurers) recorded a relatively high net profit (CZK 9.6 billion). Net profit fell by 22.6% year on year. The technical account[99] for non-life insurance declined by 6.4% year on year to CZK 4.7 billion. Following a profit of CZK 5.2 billion in 2007, the technical account for life insurance ended in a loss of CZK 41 million.

As in the previous year, all groups of insurance undertakings showed an annual decline in net profit in 2008. The largest absolute fall was recorded by large insurers, where net profit fell by CZK 1.4 billion to CZK 8.4 billion. In relative terms, small insurers were hardest hit by the decrease in net profit, recording an annual decline of 86.0%. Medium-sized insurers showed a fall in net profit of 66.5% compared to 2007. No group of insurance undertakings showed a loss in 2008. The net profit recorded by the sector as a whole was chiefly due to large insurers, which accounted for 87.7% of the total. This share increased by 8.9 percentage points year on year as a result of the large falls in profit recorded by medium-sized and small insurers. Branches of foreign insurance undertakings accounted for 7.5% of the total net profit.

The worse financial results of domestic insurance undertakings than in previous years adversely affected their profitability and efficiency indicators. Return on assets, as measured by the ratio of net profit to assets, decreased from 3.7% reported in 2007 to 2.7%. The ratio of net profit to shareholder's equity decreased by 7 percentage points year on year to 14.8%, while the ratio of net profit to earned premiums[100] fell by 3.1 percentage points to 8.5%. All these indicators are below 60% of their 2006 values.

99 The profit and loss account of insurance undertakings is subdivided by type of business into a technical account for non-life insurance, a technical account for life assurance and a non-technical account, which comprises income and expenses that cannot be assigned to life or non-life insurance.

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

As regards non-life insurance, the ratio of profit on the technical account for non-life insurance to earned premiums fell by 1.1 percentage point to 8.1%. The ratio of claims incurred, including change in technical provisions, to earned premiums, improved slightly further, falling by 1.2 percentage points. By contrast, the ratio of net operating costs to earned premiums increased by 0.4 percentage point, mainly due to a rise in acquisition costs for insurance contracts.

The technical account for life insurance turned negative (CZK -0.9 billion), as did the ratio of the technical account for life insurance to earned premiums. Compared to 2007, this ratio declined by 10.9 percentage points to -1.9%. The ratio of life insurance claims incurred, including change in technical provisions, to earned premiums deteriorated (up by 8.9 percentage points). The ratio of net operating expenses to earned premiums increased by 1.2 percentage points, chiefly due, as in the case of non-life insurance, to rising acquisition costs for insurance contracts.

TABLE IV.13

Selected profitability and efficiency indicators (%)

	2006	2007	2008
Net profit/assets (RoA)	4.6	3.7	2.7
Net profit/shareholder's equity (RoE)	25.9	21.8	14.8
Net profit/earned premiums	14.7	11.6	8.5
NON-LIFE INSURANCE			
Profit on technical account for non-life insurance/earned premiums	10.6	9.2	8.1
Claims incurred, including change in TPs/earned premiums	59.2	56.3	55.1
Net operating costs/earned premiums	26.3	27.6	28.0
Acquisition costs for insurance contracts/earned premiums	21.0	21.1	21.3
Administrative expenses/earned premiums	16.8	16.1	15.8
LIFE INSURANCE			
Profit on technical account for life insurance/earned premiums	16.7	9.0	-1.9
Claims incurred, including change in TPs/earned premiums	41.0	48.6	57.5
Net operating costs/earned premiums	22.7	22.7	23.9
Acquisition costs for insurance contracts/earned premiums	13.8	14.3	16.4
Administrative expenses/earned premiums	9.7	9.1	8.3

4.4 SOLVENCY OF INSURANCE UNDERTAKINGS

Solvency is the ability of an insurance undertaking to meet all its liabilities arising from insurance activities on an ongoing basis. Insurance undertakings are required to have available own funds equal to at least the required solvency margin over the entire duration of their activities. Specific procedures for calculating solvency are laid down in Decree No. 303/2004 Coll., implementing certain provisions of Act No. 363/1999 Coll., on Insurance, as amended. The Decree stipulates which items are eligible for inclusion in insurance undertakings' own funds, including any limitations relating to the solvency calculation. It thus de facto defines the composition of the regulatory capital of insurance undertakings, referred to as the available solvency margin (ASM). The Decree also stipulates the algorithm used to calculate the required solvency margin (RSM), which is, in essence, the capital requirement. Another important regulatory requirement contained in the Decree is the separate calculation of solvency for life insurance and non-life insurance. Two separate calculations must therefore be performed for undertakings carrying on both life insurance and non-life insurance. The relevant calculation methods are also given in the Decree.

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 2008 had been submitted by all domestic insurance undertakings. All of them reported that they were compliant with the RSM and therefore their financial stability and their ability to meet their obligations was not at risk.

Table IV.14
Aggregate solvency – non-life insurance
(CZK thousands)

	2006	2007	2008
ASM	30,935,740	34,840,987	42,229,876
RSM	8,400,454	8,847,782	9,171,965

ASM – available solvency margin
RSM – required solvency margin

Table IV.15
Aggregate solvency – life insurance
(CZK thousands)

	2006	2007	2008
ASM	24,784,809	24,419,057	22,697,251
RSM	7,882,583	8,582,565	9,131,998

ASM – available solvency margin
RSM – required solvency margin

Table IV.16
ASM/RSM ratios
– non-life insurance

Number of insurance undertakings	2006	2007	2008
< 100%	0	0	0
100%–150%	2	3	2
150%–200%	2	1	2
200%–250%	2	1	1
250%–300%	2	6	2
300%–400%	2	0	5
400%–500%	2	0	2
> 500%	18	20	18
TOTAL	**30**	**31**	**32**

Table IV.17
ASM/RSM ratios
– life insurance

Number of insurance undertakings	2006	2007	2008
< 100%	0	0	0
100%–150%	3	3	3
150%–200%	1	3	2
200%–250%	2	3	3
250%–300%	3	2	2
300%–400%	3	3	2
400%–500%	2	0	2
> 500%	4	4	4
TOTAL	**18**	**18**	**18**

Tables V.14 and V.15 show the aggregate ASMs and RSMs of all domestic insurance undertakings over the past three years, separately for life insurance and non-life insurance. While the ASM/RSM ratio for non-life insurance is gradually increasing, the opposite trend applies for life insurance.

Tables V.16 and V.17 show the numbers of insurance undertakings according to percentage ASM/RSM ratios, divided into life and non-life insurance. The solvency of undertakings carrying on both life insurance and non-life insurance is incorporated into the respective tables for life insurance and non-life insurance. It is worth noting that most of the ASM/RSM ratios in non-life insurance are concentrated in the band above 500%, whereas life insurance shows a more even distribution. The band above 500% mainly contains small non-life insurers. This group has smaller ratios of premiums written and claims incurred to shareholders' equity than large and medium-sized insurers.

ABBREVIATIONS

AEs	accrued expenses
AKAT	Czech Capital Market Association
AMA	Advanced Measurement Approaches
AML	anti-money laundering
ASA	Alternative Standardised Approach
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
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
EFCC	European Financial Conglomerates Committee
EGCR	Expert Group on Capital Requirements
EU	European Union
EUR	euro
FESE	Federation of European Securities Exchanges
FINREP	Financial Reporting

FSC	Financial Services Committee
FDI	Foreign Direct Investment
FV	fair value
GDP	gross domestic product
HI	Herfindahl Index (measuring concentration)
HUF	Hungarian forint
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IC	investment certificate
ICS	internal control system
IF	investment fund
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
PC	personal computer
P/L	profit/loss
PLN	Polish zloty
p.p.	percentage point
PSE	Prague Stock Exchange (Burza cenných papírů Praha, a. s.)
PX	PSE stock exchange index
QA	quick assets
QIS	Quantitative Impact Study
RM	RM-S index
RM-S	RM-Systém, a. s. (an OTC market operator)
RoA	return on assets
RoE	return on equity
SDNS	Non-bank Data Collection System
SKK	Slovak koruna
SON	Subgroup on Operational Networking
SPAD	Share and Bond Market Support System
STA	Standardized Approach

STC	Statistical Committee
SVYT	Transaction Settlement System
TREM	Transaction Reporting Exchange Mechanism
UCITS	Undertakings for Collective Investment in Transferable Securities
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

USEFUL WEBSITES

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 Securities Centre	www.scp.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 Arbitrator of the Czech Republic	www.finarbitr.cz
Ministry of Finance of the Czech Republic	www.mfcr.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 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 Pension Supervisors	www.iopsweb.org
International Organization of Securities Commissions	www.iosco.org
Occupational Pensions Supervisors	www.ceiops.org
Organisation for Economic Cooperation and Development	www.oecd.org
World Bank	www.worldbank.org
World Federation of Exchanges	www.world-exchanges.org

PART C – ANNEXES

Annex 1

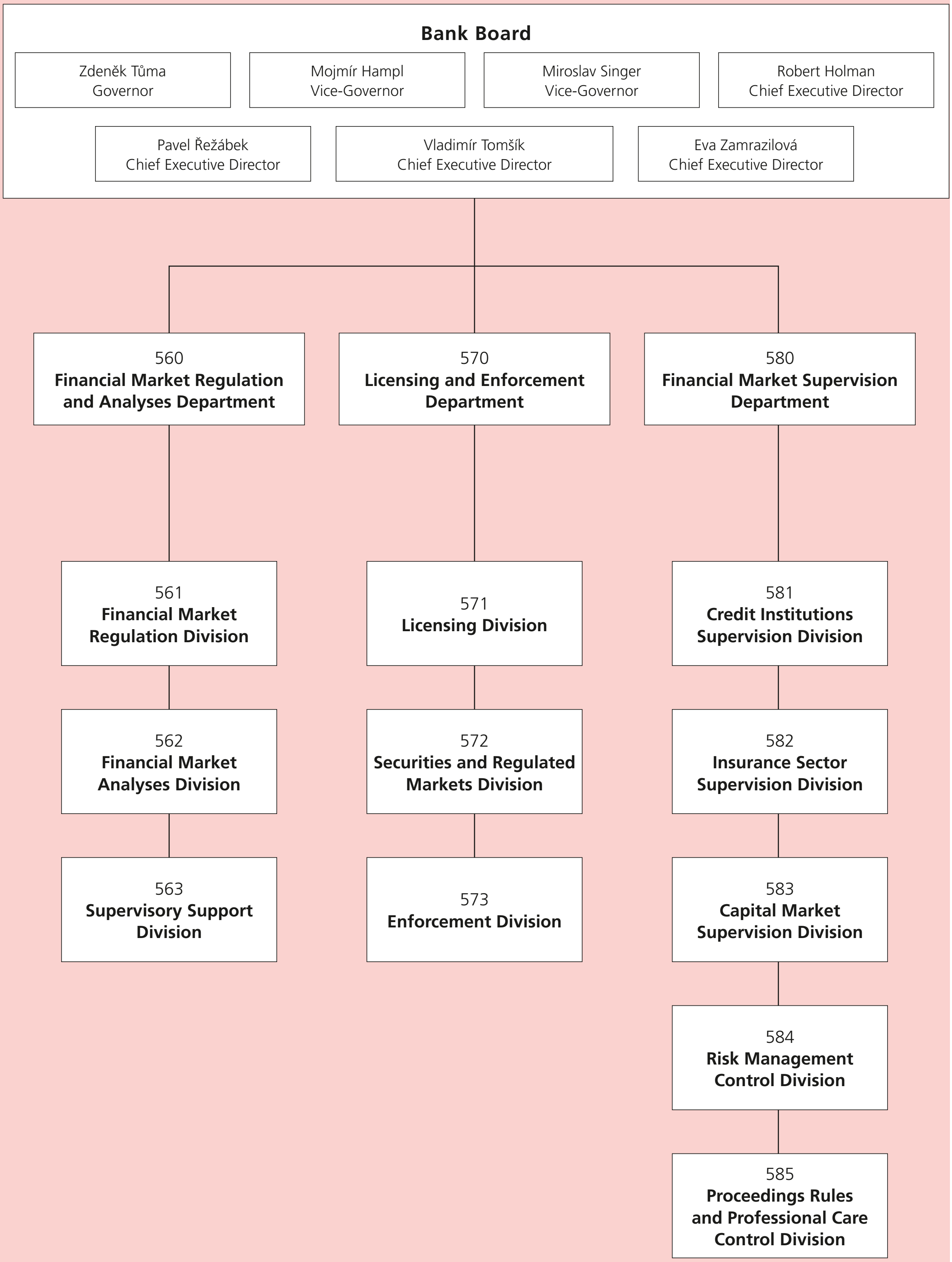
Main indicators of monetary and economic developments in the Czech Republic

		2004	2005	2006	2007	2008
Gross domestic product [1), 2)]	Volume (in CZK billions)	2,814.8	2,983.9	3,215.6	3,530.2	3,705.9
	Increase (in per cent)	4.5	6.3	6.8	6.0	3.2
Output – percentage increase [2)]	Industry	9.9	8.1	11.6	10.8	0.1
	Construction	4.5	3.7	13.9	7.4	-1.1
Prices [3)]	Inflation rate (in per cent)	2.8	1.9	2.5	2.8	6.3
Unemployment [4)]	Unemployment rate (in per cent)	9.2	9.0	8.1	6.6	5.5
Foreign trade [2)]	Exports of goods and services (in per cent)	20.7	11.6	15.8	14.9	6.9
	Imports of goods and services (in per cent)	17.9	5.0	14.2	14.2	4.6
Average wage [2)]	Nominal (in per cent)	6.6	5.3	6.5	7.3	8.5
	Real (in per cent)	3.7	3.3	3.9	4.4	2.1
Balance of payments	Current account (in CZK billions)	-147.5	-39.8	-82.2	-111.3	-113.9
	Financial account (in CZK billions)	177.3	154.8	92.4	125.8	151.2
Exchange rate [5)]	CZK/USD	25.70	23.95	22.61	20.31	17.04
	CZK/EUR	31.90	29.78	28.34	27.76	24.94
Average interbank	7-day	2.23	1.97	2.18	2.87	3.59
deposit rate (PRIBOR)	3-month	2.36	2.01	2.30	3.09	4.04
in per cent [5)]	6-month	2.48	2.05	2.42	3.21	4.11
Discount rate	(in per cent)	1.50	1.00	1.50	2.50	1.25
Lombard rate	(in per cent)	3.50	3.00	3.50	4.50	3.25
2W repo rate	(in per cent)	2.50	2.00	2.50	3.50	2.25
PX capital market index		1,032.0	1,473.0	1,588.9	1,815.1	858.2

Source: CZSO (macroeconomic indicators), PSE, CNB
1) Current prices
2) Percentage increase on a year earlier in real terms
3) Inflation rate, average
4) Average registered unemployment rate; based on existing methodology since 2004
5) Annual averages from monthly averages

Annex 2

Organisational structure of CNB Financial Market Supervision
as of 31 December 2008



Annex 3

BREAKDOWN OF BANKS INTO GROUPS
(as of 31 December 2008)

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. Citibank, a. s.
II. Medium-sized banks	6. COMMERZBANK Aktiegesellschaft, pobočka Praha
1. Českomoravská záruční a rozvojová banka, a. s.	7. Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka
2. GE Money Bank, a. s.	8. Fortis Bank SA/NV, pobočka Česká republika
3. Hypoteční banka, a. s.	9. HSBC Bank plc - pobočka Praha
4. Raiffeisenbank a. s.	10. ING Bank N.V.
	11. Oberbank AG pobočka Česká republika
III. Small banks	12. PRIVAT BANK AG der Raiffeisenlandesbank Oberösterreich, pobočka Česká republika
1. Banco Popolare Česká republika, a. s.	13. Raiffeisenbank im Stiftland eG pobočka Cheb, odštěpný závod
2. Česká exportní banka, a. s.	14. Straumur-Burdaras Investment Bank hf - organizační složka x)
3. Evropsko-ruská banka, a. s.	15. Všeobecná úverová banka a.s., pobočka Praha
4. J&T BANKA, a.s.	16. Waldviertler Sparkasse von 1842 AG
5. LBBW Bank CZ a.s.	
6. PPF banka a. s.	**V. Building societies**
7. Volksbank CZ, a. s.	1. Českomoravská stavební spořitelna, a. s.
8. Wüstenrot hypoteční banka a. s.	2. Modrá pyramida stavební spořitelna, a. s.
	3. Raiffeisen stavební spořitelna a. s.
	4. Stavební spořitelna České spořitelny, a. s.
	5. Wüstenrot - stavební spořitelna a. s.

x) In the first quarter of 2009 this bank was heading towards de-passportisation and termination of exercise of the right of establishment in the Czech Republic (closure of the branch). Such actions are being undertaken in all EU Member States in which it operates. The bank was nationalised by the Icelandic government in Iceland after suffering large losses in the financial market crisis.

Annex 4

BREAKDOWN OF INSURANCE UNDERTAKINGS INTO GROUPS
(as of 31 December 2008)

I. Large insurance undertakings	**IV. Branches of foreign insurance undertakings**
1. Allianz pojišťovna a.s.	1. ACE European Group Ltd, organizační složka
2. Česká pojišťovna a.s.	2. AIG EUROPE, S.A., pobočka pro Českou republiku
3. ČSOB Pojišťovna, a.s., člen holdingu ČSOB	3. Atradius Credit Insurace N. V., organizační složka
4. Generali Pojišťovna a.s.	4. CG Car-Garantie Versicherungs-Aktiengesellschaft
5. Kooperativa pojišťovna, a.s., Vienna Insurance Group	organizační složka pro Českou republiku
	5. Coface Austria Kreditversicherung AG, organizační složka Česko
II. Medium-sized insurance undertakings	6. DEUTSCHER RING Lebensversicherungs-Aktiengesellschaft,
1. AXA životní pojišťovna a.s.	pobočka pro Českou republiku
2. Česká podnikatelská pojišťovna, a.s., Vienna Insurance Group	7. HDI Versicherung AG, organizační složka
3. Komerční pojišťovna, a.s.	8. ING Životná poisťovňa, a.s., pobočka pro Českou republiku
4. Pojišťovna České spořitelny, a.s.	9. ING Životní pojišťovna N.V., pobočka pro Českou republiku
5. PRVNÍ AMERICKO - ČESKÁ POJIŠŤOVNA, a.s.	10. INTER PARTNER ASSISTANCE, organizační složka
(FIRST AMERICAN CZECH INSURANCE COMPANY)	11. Mondial Assistance International AG - organizační složka
6. UNIQA pojišťovna, a.s.	12. Niederösterreichische Versicherung AG, organizační složka
	13. Österreichische Hagelversicherung - Versicherungsverein
III. Small insurance undertakings	auf Gegenseitigkeit, organizační složka
1. AEGON Pojišťovna, a. s.	14. QBE INSURANCE (EUROPE) LIMITED, organizační složka
2. Aviva životní pojišťovna, a.s.	15. QBE poisťovňa, a.s., pobočka
3. AXA pojišťovna a.s.	16. Skandia Lebensversicherungs AG, organizační složka
4. Cestovní pojišťovna ADRIA Way družstvo	17. Wüstenrot pojišťovna, pobočka pro Českou republiku
5. Česká pojišťovna ZDRAVÍ a.s.	18. XL INSURANCE COMPANY LIMITED, organizační složka
6. D.A.S. pojišťovna právní ochrany, a.s.	16. Skandia Lebensversicherungs AG, organizační složka
7. DIRECT Pojišťovna, a.s.	17. Wüstenrot pojišťovna, pobočka pro Českou republiku
8. Euler Hermes Čescob, úvěrová pojišťovna, a.s.	18. XL INSURANCE COMPANY LIMITED, organizační složka
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. ING pojišťovna, a.s.	
14. Komerční úvěrová pojišťovna EGAP, a.s.	
15. MAXIMA pojišťovna, a.s.	
16. POJIŠŤOVNA CARDIF PRO VITA, a.s.	
17. Pojišťovna VZP, a.s.	
18. Servisní pojišťovna a.s.	
19. Slavia pojišťovna a.s.	
20. Triglav pojišťovna,a.s.	
21. VICTORIA VOLKSBANKEN pojišťovna, a.s.	
22. Vitalitas pojišťovna, a.s.	
23. Wüstenrot pojišťovna a.s.	
24. Wüstenrot, životní pojišťovna, a.s.	

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 2008

	Total number			
Home country of head office of financial institution	**Banks**	**Insurance undertakings**	**Funds**	**Management companies**
Austria	46	35	155	10
Belgium	2	13	166	2
Bulgaria	-	2	-	-
Cyprus	2	0	-	-
Denmark	2	9	-	-
Estonia	1	2	-	-
Finland	4	6	-	-
France	18	36	3	4
Germany	39	40	10	5
Gibraltar	5	6	-	-
Greece	1	0		-
Hungary	9	10	2	2
Iceland	3	0	-	-
Ireland	12	79	133	-
Italy	5	20	-	-
Latvia	-	1	-	-
Liechtenstein	3	12	-	-
Lithuania	1	4	-	-
Luxembourg	16	27	1,092	11
Malta	4	7	-	-
Netherlands	10	34	-	-
Norway	2	3	-	-
Poland	2	14	-	-
Portugal	1	0		
Romania	-	4	-	-
Slovakia	2	10	8	2
Slovenia	-	5	-	-
Spain	3	16	-	-
Sweden	1	22	-	1
Total	**252**	**417**	**1,569**	**40**
UK	58	137	-	3

Annex 6

Banking sector balance sheet
(including foreign bank branches; CZK thousands)

	31 December 2006	31 December 2007	31 December 2008		
	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	3,151,809,889	3,750,648,869	4,156,597,316	112,204,856	4,044,392,460
Cash and deposits with central banks	398,691,727	344,521,401	351,256,162	0	351,256,162
Cash	33,543,566	36,417,588	39,805,018		39,805,018
Deposits with central banks	365,148,161	308,103,813	311,451,145	0	311,451,145
Financial assets held for trading	225,237,653	366,308,943	360,155,861		360,155,861
Derivatives held for trading (positive FV)	69,256,948	88,388,040	192,891,485		192,891,485
Equity instruments held for trading	11,798,080	3,516,308	1,175,088		1,175,088
Debt instruments held for trading	144,182,625	150,758,181	129,410,740		129,410,740
Loans and advances held for trading		123,646,413	36,678,548		36,678,548
Loans and advances held for trading to credit institutions		119,181,229	31,259,323		31,259,323
Loans and advances held for trading to clients		4,412,665	5,361,380		5,361,380
Other loans and advances held for trading (not divided by sector)		52,519	57,846		57,846
Financial assets designated at FV through P/L		66,247,278	62,068,213		62,068,213
Equity instruments designated at FV through P/L		10,308,356	8,114,809		8,114,809
Debt instruments designated at FV through P/L		55,102,494	51,023,573		51,023,573
Loans and advances designated at FV through P/L		836,426	2,929,830		2,929,830
Loans and advances designated at FV through P/L to credit institutions		0	2,796,752		2,796,752
Loans and advances designated at FV through P/L to clients		836,426	133,078		133,078
Other loans and advances designated at FV through P/L (not divided by sector)		0	0		0
Available-for-sale financial assets	234,237,474	284,553,761	335,551,605	55,521	335,496,084
Available-for-sale equity instruments	1,361,367	1,886,862	12,566,174	55,521	12,510,653
Available-for-sale debt instruments	232,876,107	282,666,899	322,985,433		322,985,433
Available-for-sale loans and advances		0	0		0
Available-for-sale loans and advances to credit institutions		0	0		0
Available-for-sale loans and advances to clients		0	0		0
Other available-for-sale loans and advances (not divided by sector)		0	0		0
Loans and receivables	1,845,021,180	2,215,544,943	2,518,846,963	47,343,385	2,471,503,578
Debt instruments	29,310,392	41,978,114	30,175,147	0	30,175,147
Loans and advances	1,815,710,788	2,173,566,829	2,488,671,817	47,343,385	2,441,328,432
Loans and advances to credit institutions	375,363,320	342,060,361	380,871,368	24,855	380,846,513
Loans and advances to clients	1,423,835,988	1,802,278,977	2,086,585,737	46,425,908	2,040,159,829
Other loans and advances (not divided by sector)	16,511,480	29,227,491	21,214,714	892,625	20,322,089
Held to maturity investments	320,654,258	326,843,516	287,459,439	614,453	286,844,986
Debt instruments held to maturity	320,654,258	317,087,511	276,621,960	402,208	276,219,752
Loans and advances held to maturity		9,756,005	10,837,479	212,245	10,625,234
Loans and advances held to maturity to credit institutions		2,400,855	2,176,715	72,547	2,104,168
Loans and advances held to maturity to clients		7,355,149	8,660,764	139,698	8,521,066
Other loans and advances held to maturity (not divided by sector)		0	0	0	0
Derivatives – hedge accounting (positive FV)	12,524,174	10,914,042	20,620,814		20,620,814
Derivatives – hedge accounting of FV (positive FV)		107,722	77,415		77,415
Derivatives – hedge accounting of cash flows (positive FV)		8,072,083	8,901,569		8,901,569
Derivatives – hedge accounting of net investments in foreign units (positive FV)		0	0		0
Derivatives – hedge accounting of interest rate risk – FV (positive FV)		618,560	1,115,009		1,115,009
Derivatives – hedge accounting of interest rate risk – cash flows (positive FV)		2,115,678	10,526,821		10,526,821
FV changes of the hedged items in portfolio hedge of interest rate risk	1,829,044	0	0		0
Tangible assets	34,290,161	33,376,273	72,191,112	39,245,459	32,945,653
Property, plant and equipment	34,290,161	33,101,884	71,411,799	38,745,448	32,666,351
Investment property		274,390	779,311	500,010	279,301
Intangible assets	12,302,599	12,978,760	36,803,114	23,268,558	13,534,556
Goodwill	2,868,927	2,805,075	3,062,837	317,675	2,745,162
Other intangible assets	9,433,673	10,173,686	33,740,275	22,950,882	10,789,393
Investments in associates, subsidiaries and joint ventures	45,578,049	66,488,214	71,921,014	710,070	71,210,944
Tax assets	1,490,900	3,712,095	3,987,655		3,987,655
Current tax assets	184,171	676,026	1,631,850		1,631,850
Deferred tax assets	1,306,729	3,036,067	2,355,804		2,355,804
Other assets	19,952,667	18,190,263	34,221,186	2,875	34,218,311
Noncurrent assets and disposal groups classified as held for sale		969,383	1,514,171	964,530	549,641

Annex 6

Banking sector balance sheet (continued)
(including foreign bank branches; CZK thousands)

	31 December 2006	31 December 2007	31 December 2008		
	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	3,151,809,890	3,750,648,870			4,044,392,462
Liabilities, total	2,917,979,105	3,493,955,238			3,752,271,929
Deposits, loans and other financial liabilities vis-à-vis central banks	30,570	11,205			38,043,972
Financial liabilities held for trading	75,812,685	101,949,568			216,256,629
Derivatives held for trading (negative FV)	64,831,614	79,892,292			189,950,769
Short positions	10,981,071	9,726,088			4,139,054
Deposits, loans and other financial liabilities held for trading		12,331,187			22,166,808
Deposits, loans and other financial liabilities held for trading from credit institutions		6,346,106			10,100,933
Deposits, loans and other financial liabilities held for trading from clients		5,985,081			12,060,058
Other financial liabilities held for trading (not divided by sector)		0			5,817
Debt certificates (incl. bonds intended for repurchase in short term)		0			0
Financial liabilities designated at FV through P/L		149,771,816			67,315,333
Deposits, loans and other financial liabilities designated at FV through P/L		142,680,888			59,300,606
Deposits, loans and other financial liabilities designated at FV through P/L from credit institutions		103,192,023			19,493,256
Deposits, loans and other financial liabilities designated at FV through P/L from clients		39,477,271			39,793,899
Other financial liabilities designated at FV through P/L (not divided by sector)		11,594			13,451
Debt certificates (including bonds) designated at FV through P/L		7,090,927			8,014,726
Subordinated liabilities designated at FV through P/L		0			0
Financial liabilities measured at amortised cost	2,762,080,302	3,156,087,476			3,357,412,420
Deposits, loans and other financial liabilities measured at amortised cost	2,468,001,279	2,774,223,678			2,967,368,424
Deposits, loans and other financial liabilities measured at amortised cost from credit institutions	348,321,415	325,693,070			399,012,777
Deposits, loans and other financial liabilities measured at amortised cost from clients	2,102,215,944	2,414,428,411			2,545,138,930
Other financial liabilities measured at amortised cost (not divided by sector)	17,463,920	34,102,200			23,216,719
Debt certificates (including bonds) measured at amortised cost	267,784,229	346,631,395			356,391,582
Subordinated liabilities measured at amortised cost	26,294,794	35,232,403			33,652,412
Financial liabilities associated with transferred assets		0			0
Derivatives - hedge accounting (negative FV)	4,974,242	9,171,900			13,464,150
Derivatives – hedge accounting of FV (negative FV)		1,914,104			1,795,865
Derivatives – hedge accounting of cash flows (negative FV)		3,200,653			4,438,386
Derivatives – hedge accounting of net investments in foreign units (negative FV)		0			0
Derivatives – hedge accounting of interest rate risk – FV (negative FV)		967,124			766,611
Derivatives – hedge accounting of interest rate risk – cash flows (negative FV)		3,090,019			6,463,288
FV changes of the hedged items in portfolio hedge of interest rate risk	1,193,294	0			0
Provisions	11,023,215	11,619,869			10,814,808
Provisions for restructuring		139,766			291,471
Provisions for taxes and litigation	319,869	3,630,039			3,025,732
Provisions for pensions and similar liabilities	404	101,898			102,440
Provisions for off-balance-sheet items	4,118,242	4,152,330			4,331,033
Provisions for disadvantageous contracts		366,327			158,895
Other provisions	6,584,698	3,229,510			2,905,237
Tax liabilities	1,278,700	1,094,856			1,378,181
Current tax liabilities	328,938	1,032,596			533,239
Deferred tax liabilities	949,762	62,260			844,943
Other liabilities	61,586,097	64,248,556			47,586,429
Equity of credit unions payable on demand					
Liabilities included in disposal groups classified as held for sale		0			0
Equity, total	233,830,801	256,693,632			292,120,539
Issued capital	70,732,975	74,276,659			74,014,124
Paid-up capital	70,326,946	73,870,630			73,608,095
Non-paid-up capital	406,029	406,029			406,029
Share premium	13,588,498	23,140,396			26,955,165
Other equity	4,234,516	42,444			52,366
Equity component of financial instruments		24			24
Other equity instruments	4,234,516	42,420			52,342
Revaluation reserves and other valuation differences	6,109,041	-3,462,230			11,637,811
Valuation differences from tangible assets	15,994	0			0
Valuation differences from intangible assets		0			0
Hedge accounting of net investments in foreign units	-198,205	51,112			142,896
Hedge accounting of cash flows	4,070,839	-1,556,536			2,977,185
Valuation differences from available-for-sale financial assets	2,220,411	-1,971,644			6,645,444
Valuation differences from noncurrent assets and discontinued operations classified as held for sale		0			0
Other valuation differences		14,837			1,872,285
Reserves	34,036,008	35,184,324			36,676,949
Retained earnings	67,270,533	80,674,969			97,479,834
Treasury shares (minus)	150,379	150,379			150,379
Net income from current year	38,009,609	46,987,447			45,454,663

Annex 7

Banking sector profit and loss account
(including foreign bank branches; CZK thousands)

	31 December 2006	31 December 2007	31 December 2008
Financial and operating income and expenses	116,864,367	134,392,065	138,150,275
Interest income	124,114,384	156,436,218	191,913,865
Interest on cash balances with central banks	12,558,482	11,330,934	13,360,235
Interest on financial assets held for trading		9,215,279	7,516,933
Interest on financial assets designated at FV through P/L		2,549,048	2,927,250
Interest on available-for-sale financial assets		8,951,488	11,655,852
Interest on loans and receivables	80,317,897	103,160,492	133,109,459
Interest on held to maturity investments	24,650,479	12,717,345	12,049,136
Profit on interest rate derivatives – hedge accounting	6,587,526	8,319,855	10,666,922
Interest on other assets		191,776	628,074
Interest expenses	52,567,121	71,738,070	93,870,957
Interest on deposits, loans and other financial liabilities vis-à-vis central banks	51,004	12,415	75,129
Interest on financial liabilities held for trading	214,963	536,839	1,319,618
Interest on financial liabilities designated at FV through P/L		5,281,766	4,432,220
Interest on financial liabilities measured at amortised cost	47,671,050	56,915,502	75,732,800
Loss on interest rate derivatives – hedge accounting	4,630,104	6,600,626	10,121,858
Interest on other liabilities		2,390,922	2,189,332
Expenses on equity payable on demand		0	0
Dividend income	1,675,508	5,886,359	3,730,221
Dividend income on financial assets held for trading		19,135	22,819
Dividend income on financial assets designated at FV through P/L		553,676	867,759
Dividend income on available-for-sale financial assets		183,902	505,522
Dividend income from associates	1,675,508	5,129,645	2,334,121
Fee and commission income	41,092,657	44,830,033	46,778,440
Fees and commissions from financial instrument transactions for clients	758,742	1,712,971	1,666,046
Fees and commissions for arranging issues	325,972	57,314	68,375
Fees and commissions for procuring financial instruments	341,591	1,548,739	1,458,306
Fees and commissions for consulting activities	91,179	106,919	139,363
Fees and commissions from clearing and settlement		569,294	502,560
Fees and commissions for asset management	173,183	207,627	163,071
Fees and commissions for custody of values	786,166	745,613	722,224
Fees and commissions from commitments and guarantees		2,463,726	2,512,902
Fees and commissions from payments	26,941,178	25,666,276	27,072,108
Fees and commissions from structured financing		24,745	60,836
Fees and commissions from securitisation		0	0
Fees and commissions from other services	12,433,390	13,439,782	14,078,697
Fee and commission expenses	8,174,518	8,989,178	10,655,430
Fees and commissions for financial instrument transactions	463,955	571,139	606,727
Fees and commissions for asset management		0	25,645
Fees and commissions for custody of values		45,200	40,894
Fees and commissions for securitisation		334,368	363,029
Fees and commissions for clearing and settlement		35,400	36,236
Fees and commissions for other services	7,710,561	8,003,066	9,582,900
Realised gains (losses) on financial assets & liabilities not measured at FV through P/L, net	44,711	-158,362	-943,043
Gains (losses) on available-for-sale financial assets	371,795	45,553	-894,005
Gains (losses) on loans and receivables	-359,696	-637,638	-300,536
Gains (losses) on held to maturity investments	32,612	33,201	-13,398
Gains (losses) on financial liabilities measured at amortised cost		163,340	-17,716
Gains (losses) on other liabilities		237,181	282,609

Annex 7

Banking sector profit and loss account (continued)
(including foreign bank branches; CZK thousands)

	31 December 2006	31 December 2007	31 December 2008
Gains (losses) on financial assets and liabilities held for trading, net	6,510,735	4,421,852	-2,606,223
Gains (losses) on equity instruments and equity derivatives	-109,017	-86,566	-351,981
Gains (losses) on interest rate instruments (including interest rate derivatives)	-559,505	790,459	-3,553,830
Gains (losses) on foreign currency instruments (including foreign currency derivatives)	6,945,038	3,402,673	774,939
Gains (losses) on credit instruments (including credit derivatives)	-883	266,892	276,059
Gains (losses) on commodities and commodity derivatives	235,103	48,392	248,588
Gains (losses) on other instruments, including hybrid instruments		0	0
Gains (losses) on financial assets and liabilities designated at FV through P/L, net		-2,203,315	-11,191,133
Gains (losses) from hedge accounting, net	-389,873	-535,540	-271,903
Exchange differences, net	4,211,622	7,760,103	11,937,741
Gains (losses) on derecognition of assets other than held for sale, net	1,673,608	252,557	4,191,464
Other operating income	2,507,451	2,218,472	3,094,042
Other operating expenses	3,834,799	3,789,061	3,956,819
Administration costs	55,652,001	59,672,597	61,690,409
Staff expenses	28,976,240	30,917,646	31,172,821
Wages and salaries	20,387,646	21,476,655	22,380,497
Social and health insurance	7,233,961	7,165,454	6,562,520
Pensions and similar expenses		461,025	479,042
Temporary employee expenses		148,892	202,685
Remunerations - equity instruments		5,973	52,668
Other staff expenses	1,354,637	1,659,646	1,495,406
Other administration costs	26,675,765	28,754,953	30,517,591
Advertising costs	3,582,171	4,179,620	4,451,998
Consultancy costs	915,070	1,399,033	1,516,254
IT costs		4,757,714	5,523,628
Outsourcing costs	4,111,454	4,234,671	5,423,952
Rent	3,584,352	3,461,055	3,503,977
Other administration costs	14,482,717	10,722,853	10,097,776
Depreciation	8,357,275	7,904,206	7,344,003
Depreciation of property, plant and equipment	4,773,627	4,188,855	3,857,842
Depreciation of real estate investments		0	3,808
Depreciation of intangible assets	3,583,648	3,715,347	3,482,356
Provisions	-1,335,718	1,116,869	533,381
Impairment	5,162,699	6,524,995	15,486,108
Impairment on financial assets not measured at FV through P/L	5,295,779	6,932,494	15,471,562
Impairment on financial assets at acquisition price	56	0	0
Impairment on available-for-sale financial assets		115	513,407
Impairment on loans and receivables	5,295,723	6,932,379	14,588,293
Impairment on held to maturity investments	0	0	369,862
Impairment on non-financial assets	-133,080	-407,499	14,547
Impairment on property, plant and equipment	-148,388	-144,566	-224,569
Impairment on real estate investments		0	0
Impairment on goodwill	61,317	554	554
Impairment on intangible assets	11,221	13,419	-32,732
Impairment on shares in associates and joint ventures	-57,230	-276,905	262,293
Impairment on other non-financial assets		0	9,000
Negative goodwill immediately recognised in P/L		0	0
Share of P/L of associates and joint ventures	113,576	0	0
Profit or loss from noncurrent assets and disposal groups		27,158	722,499
Total profit or loss before tax from continuing operations	49,141,674	59,200,559	53,818,872
Tax expense	11,132,068	12,213,109	8,364,209
Profit or loss from continuing operations after taxation		46,987,448	45,454,663
Profit or loss from discontinued operations after taxation		0	0
Total profit or loss after taxation	38,009,609	46,987,448	45,454,663

Annex 8

Balance sheet – domestic insurance undertakings
(total excluding the Czech Insurers' Bureau; CZK millions)

	31 December 2006	31 December 2007	31 December 2008		
	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	288,877	308,997	357,697	24,799	332,898
Receivables for subscribed share capital	0	74	0	0	0
Long-term intangible assets	3,596	2,819	10,987	8,830	2,156
Start-up costs	5	12	47	39	8
Goodwill	1,586	888	3,591	3,397	194
Financial placement (investments)	247,680	260,132	278,151	0	278,151
Land and buildings (real estate),	8,770	4,921	5,267	0	5,266
Real estate used in operations	2,853	3,684	4,324	0	4,324
Financial placements in third-party companies	11,314	11,649	14,358	0	14,358
Participating interests in affiliates	9,615	9,378	12,499	0	12,499
Bonds and loans – affiliated companies	229	213	24	0	24
Participating interests with substantial influence	1,010	1,569	1,321	0	1,321
Bonds – companies with substantial influence	461	489	514	0	514
Other financial placements	227,502	243,562	258,526	0	258,526
Shares and other variable-yield securities, other interests	29,396	27,152	22,700	0	22,700
Bonds and other fixed-income securities	169,802	181,844	202,964	0	202,964
Financial placements in investment associations	459	972	510	0	510
Other loans	2,029	6,677	2,990	0	2,990
Deposits with financial institutions	25,164	25,936	28,123	0	28,123
Other financial placements	652	982	1,238	0	1,238
Deposits with ceding undertakings	93	1	1	0	1
Financial placement of unit-linked life assurance where policyholders bear the investment risk	11,515	17,804	19,835	0	19,835
Debtors	16,891	17,807	33,423	12,153	21,270
Receivables arising out of direct insurance operations	9,179	9,634	16,009	4,719	11,289
Policyholders	8,994	9,381	15,199	4,340	10,859
Intermediaries	185	254	810	380	430
Receivables arising out of reinsurance operations	4,256	4,566	3,105	89	3,016
Other receivables	3,455	3,607	14,310	7,345	6,965
Other assets	4,184	3,574	6,744	3,815	2,929
Long-term tangible assets other than land, buildings (real estate) and stocks	1,914	2,179	5,234	3,814	1,419
Cash at financial institutions and cash in hand	2,269	1,388	1,469	0	1,468
Other assets	1	8	42	0	42
Temporary accounts of assets	5,012	6,786	8,557	0	8,557
Interest and annuities	83	102	70	0	70
Deferred acquisition costs for insurance contracts	3,439	5,032	6,372	0	6,372
in life assurance	1,729	3,030	4,132	0	4,132
in non-life insurance	1,709	2,002	2,240	0	2,240
Other temporary accounts of assets	1,491	1,652	2,115	0	2,115
Estimated receivables	626	739	977	0	977

Annex 8

Balance sheet – domestic insurance undertakings (continued)

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

	31 December 2006	31 December 2007	31 December 2008		
	Net	Net	Gross	Reinsurers' share in TPs	Net
Total liabilties	288,877	308,997			332,898
Shareholders' equity	51,080	52,898			59,826
Share capital	17,729	18,380			18,985
Movements in share capital	10	126			0
Own stocks or own interim certificates, own business shares	0	0			0
Share premium account	881	881			1,817
Revaluation reserve fund	0	0			1
Other capital funds	10,010	6,619			8,717
Reserve fund and other profit funds	5,765	7,807			9,899
Retained earnings	3,444	7,683			11,541
Profit (loss) for the accounting period	13,252	11,528			8,867
Subordinated liabilities	0	252			253
Technical provisions	199,850	211,444	246,371	24,208	222,164
Provision for unearned premiums	14,808	16,787	22,265	4,267	17,998
related to life assurance	1,966	1,750	1,731	112	1,619
related to non-life insurance	12,842	15,037	20,535	4,155	16,379
Life assurance provision	134,929	143,731	148,380	42	148,338
Outstanding claims provision	33,197	36,909	59,543	19,530	40,012
related to life assurance	3,191	3,584	4,996	848	4,147
related to non-life insurance	30,006	33,325	54,547	18,682	35,865
Provision for bonuses and rebates	1,189	1,223	1,516	40	1,476
related to life assurance	453	513	450	1	449
related to non-life insurance	735	710	1,066	39	1,027
Equalisation provision	4,555	4,870	5,223	0	5,223
Provision for the fulfilment of the commitments from the technical interest rate applied	6,040	2,582	3,562	0	3,562
Non-life insurance provision	192	246	284	1	284
related to life assurance	5	38	58	1	58
related to non-life insurance	187	207	226	0	226
Provisions for the fulfilment of the commitments from the guarantee of the CIB	4,942	5,097	5,597	327	5,270
Other provisions	0	0	0	0	0
related to life assurance	0	0	0	0	0
related to non-life insurance	0	0	0	0	0
Technical provision for unit-linked life assurance	11,479	17,740	19,651	0	19,651
Provision for other risks and losses	1,817	1,610			1,634
Provision for pensions and similar liabilities	7	6			3
Tax provision	1,474	1,010			1,132
Other provisions	336	595			499
Passive reinsurance deposits	211	183			178
Creditors	17,349	17,661			22,550
Liabilities arising out of direct insurance	5,893	7,141			8,303
Liabilities arising out of reinsurance	6,674	6,090			5,571
Debenture loans	0	0			0
Convertible loans	0	0			0
Liabilities to financial institutions	528	13			1
Other liabilities	4,254	4,416			8,676
Tax liabilities and payables due to social security insurance institutions	1,826	903			525
Guarantee fund of the Czech Insurers' Bureau	0	0			0
Temporary accounts of liabilities	7,091	7,208			6,642
Accrued expenses and revenues	3,540	2,984			2,418
Other temporary accounts of liabilities	3,551	4,224			4,224
Estimated payables	3,539	4,214			4,187

Annex 9

Profit and loss account – domestic insurance undertakings

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

Technical account for non-life insurance	31 December 2006	31 December 2007	31 December 2008
Result of technical account for non-life insurance	5,239	4,940	4,641
Earned premiums, net of reinsurance	49,644	53,924	57,190
Premiums written, net of reinsurance	51,093	56,155	58,526
Gross premium written	74,073	77,192	80,656
Gross premium written ceded to reinsurers	-22,980	-21,037	-22,130
Change in provision for unearned premiums, net of reinsurance	-1,449	-2,232	-1,335
Change in the gross provision for unearned premiums	-1,480	-2,343	-1,559
Change in the gross provision for unearned premiums, reinsurance share	31	112	224
Allocated investment return transferred from the non-technical account	1,043	861	383
Other technical income, net of reinsurance	2,568	1,562	3,058
Claims incurred including change in provision, net of reinsurance	-29,411	-30,359	-31,538
Claims incurred, net of reinsurance	-28,527	-27,005	-28,263
Gross claims paid	-37,780	-36,021	-38,008
Claims paid – reinsurers' share	9,253	9,016	9,745
Change in provision for claims, net of reinsurance	-884	-3,354	-3,275
Change in gross provision for claims	-1,646	-3,918	-3,615
Change in provision for claims – reinsurers' share	762	563	339
Change in other technical provisions, net of reinsurance	-212	-192	-213
Bonuses and rebates, net of reinsurance	-759	-1,250	-1,809
Operating expenses, net amount	-13,053	-14,866	-16,034
Acquisition expenses for insurance contracts	-10,558	-11,670	-12,281
Change in deferred acquisition expenses	149	293	89
Administrative expenses	-8,325	-8,706	-9,035
Reinsurance commissions and profit participation	5,681	5,218	5,194
Other technical expenses, net of reinsurance	-4,414	-4,410	-6,044
Change of equalisation provision	-167	-329	-353

Technical account for life assurance	31 December 2006	31 December 2007	31 December 2008
Result of technical account for life assurance	6,721	4,107	-917
Earned premiums, net of reinsurance	40,200	45,714	47,682
Premiums written, net of reinsurance	39,991	45,498	47,551
Gross premium written	41,294	46,853	48,994
Gross premium written ceded to reinsurers	-1,303	-1,355	-1,443
Change in provision for unearned premiums, net of reinsurance	209	216	131
Change in gross provision for unearned premiums	215	207	123
Change in provision for unearned premiums – reinsurers' share	-6	9	8
Income from financial placements	18,233	19,260	23,189
Income from participating interests	207	140	159
Income from other financial placements	7,451	8,416	7,626
Income from land and buildings (real estate)	311	244	120
Income from other investments (except real estate)	7,140	8,171	7,506
Change in value of financial placements - income	1,518	156	444
Gains on the realisation of financial placements	9,057	10,548	14,960
Unrealised gains on financial placements	4,210	-586	8,396
Other technical income, net of reinsurance	546	725	985
Claims incurred including change in provision, net of reinsurance	-16,472	-22,219	-27,408
Claims paid, net of reinsurance	-16,104	-21,825	-26,850
Gross claims paid	-16,426	-22,151	-27,146
Claims paid – reinsurers' share	322	325	297

Annex 9

Profit and loss account – domestic insurance undertakings (continued)

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

Technical account for life assurance	31 December 2006	31 December 2007	31 December 2008
Change in provision for claims, net of reinsurance	-368	-394	-559
Change in gross provision for claims	-421	-371	-597
Change in provision for claims – reinsurers' share	53	-23	38
Change in other technical provisions, net of reinsurance	-15,493	-11,762	-7,570
Change in balance of life assurance provision, net of reinsurance	-12,673	-9,346	-4,845
Change in balance of gross life assurance provision	-12,600	-9,350	-4,840
Change in balance of life assurance provision – reinsurers' share	-73	5	-5
Change in balance of other technical provisions (except life assurance provision), net of reinsurance	-2,820	-2,416	-2,725
Bonuses and rebates, net of reinsurance	-65	-106	-103
Operating expenses, net amount	-9,118	-10,360	-11,407
Acquisition expenses for insurance contracts	-5,918	-7,869	-8,836
Change in deferred acquisition expenses	360	1,311	1,024
Administrative expenses	-3,898	-4,148	-3,963
Reinsurance commissions and profit participation	337	346	369
Expenses related to financial placements	-11,077	-11,073	-17,483
Administration expenses on financial placements, including interest	-1,338	-1,193	-781
Change in value of financial placements - expenses	-59	-205	-1,905
Realisation expenses on financial placements	-9,680	-9,675	-14,797
Unrealised losses on financial placements	-3,266	-4,583	-15,727
Other technical expenses, net of reinsurance	-583	-606	-934
Transfer of income from financial placement to the non-technical account	-393	-296	-537

Non-technical account	31 December 2006	31 December 2007	31 December 2008
Profit or loss for the accounting period	13,252	11,528	8,867
After-tax profit or loss on ordinary activities	13,232	11,644	8,875
Result of technical account for non-life insurance	5,239	4,940	4,641
Result of technical account for life assurance	6,721	4,107	-917
Income from financial placements	10,327	11,515	15,579
Income from participating interests	2,180	2,321	504
Income from other financial placements	1,954	2,461	2,426
Income from land and buildings (real estate)	54	135	140
Income from other investments (except real estate)	1,899	2,327	2,286
Changes in value of financial placements - revenues	1,132	1,208	1,762
Gains on the realisation of financial placements	5,061	5,525	10,888
Transferred income from financial placements from technical account for life assurance	393	296	537
Expenses related to financial placements	-5,495	-5,123	-8,192
Administration expenses on financial placements, including interest	-603	-453	-308
Change in value of financial placements - expenses	-1,135	-1,261	-2,679
Realisation expenses on financial placements	-3,757	-3,409	-5,205
Transfer of income from financial placements to non-life technical account	-1,043	-861	-383
Other income	2,491	1,367	2,259
Other expenses	-1,782	-1,507	-2,933
Income tax on ordinary activities	-3,619	-3,091	-1,715
Extraordinary profit or loss	74	65	48
Extraordinary income	87	609	61
Extraordinary expenses	-13	-544	-13
Income tax on extraordinary activities	-9	-7	-7
Other taxes	-45	-174	-50

Annex 10

Pension fund sector balance sheet
(CZK millions)

	31 December 2006 Data adjusted for provisions and reserves	31 December 2007 Data adjusted for provisions and reserves	31 December 2008 Data adjusted for provisions and reserves
Total assets	145,939	167,198	191,722
Cash and deposits with central banks	1	1	1
Receivables from banks and credit unions	9,334	16,069	17,569
payable on demand	4,670	7,963	6,343
other receivables	4,664	8,106	11,226
Receivables from non-banking institutions	11	17	23
payable on demand	0	0	0
other receivables	11	17	23
Debt securities	115,792	126,787	151,325
issued by government institutions	90,269	98,590	121,306
issued by other entities	25,523	28,197	30,019
Shares, units and other interests	14,434	17,383	11,893
Shares	9,616	9,922	5,730
Units and other interests	4,818	7,462	6,163
Substantial interests	0	0	0
in banks	0	0	0
in other entities	0	0	0
Controlling interests	0	0	0
in banks	0	0	0
in other entities	0	0	0
Long-term intangible assets	123	130	116
Start-up costs	0	1	0
Goodwill	0	0	0
Other long-term intangible assets	123	128	116
Long-term tangible assets	1,438	1,424	1,741
Land and buildings for operations	151	152	147
Other long-term tangible assets	1,287	1,272	1,593
Receivables from state budget – state contribution	919	1,006	877
Other assets	1,007	906	2,617
Receivables from subscribed registered capital	0	0	1,495
Deferred revenues and accrued expenses	2,880	3,475	4,066
Acquisition expenses for pension plans	2,870	3,450	4,036
Other deferred revenues and accrued expenses	10	25	30

Annex 10

Pension fund sector balance sheet (continued)

(CZK millions)

	31 December 2006 Data adjusted for provisions and reserves	31 December 2007 Data adjusted for provisions and reserves	31 December 2008 Data adjusted for provisions and reserves
Total liabilities	145,939	167,198	191,722
Liabilities to banks and credit unions	0	0	0
payable on demand	0	0	0
other receivables	0	0	0
Liabilities to non-banking institutions	3	5	6
payable on demand	0	0	0
other receivables	3	5	6
Planholders' money	136,405	162,445	186,699
Planholders' contributions	123,534	147,296	169,159
Planholders' own contributions	90,590	108,485	121,391
Contributions paid by employer	13,750	16,682	22,704
Contributions paid by third parties for planholder	204	257	361
State contributions	18,991	21,872	24,703
Financial means for pension payments	188	233	302
Revenues on planholders' contributions	11,988	14,202	16,025
Unallocated planholders' contributions	517	578	636
Payables from eligible unpaid lump sums	178	136	577
Liabilities to state budget – state contribution	74	75	232
Liabilities to state budget – tax liabilities	70	35	54
Other liabilities	596	656	1,073
Deferred revenues and accrued expenses	13	12	11
Provisions	60	63	74
Provisions for pensions and similar payables	58	60	72
Provisions for taxes	0	0	0
Other provisions	2	3	2
Subordinated liabilities	0	0	300
Registered capital	1,063	1,133	1,989
Paid up capital	1,063	1,133	1,989
Own shares	0	0	0
Share premium account	149	149	3,036
Reserve funds and other funds created from profit	1,465	1,698	1,997
Statutory reserve funds and risk funds	1,117	1,349	1,573
Other reserve funds	0	0	0
Other funds created from profit	348	349	424
Pension reserve fund	173	169	237
Revaluation reserve fund	0	0	0
Capital funds	365	393	2,869
Valuation differences	1,207	-4,297	-8,181
Valuation differences from assets and liabilities	1,158	-4,285	-7,399
Valuation differences from hedging derivatives	49	-12	-782
Valuation differences from recalculated shares	0	0	0
Other valuation differences	0	0	0
Retained earnings (accumulated losses)	344	562	845
Profit (loss) for the accounting period	4,125	4,269	718

Annex 11

Pension fund sector profit and loss account
(CZK millions)

	31 December 2006	31 December 2007	31 December 2008
Interest income and similar income	3,847	4,753	6,242
debt securities	3,618	4,429	5,597
other assets	229	324	646
Interest expenses and similar expenses	0	0	9
debt securities	0	0	0
other liabilities	0	0	9
Income from shares and other equity instruments	365	456	318
substantial interests	0	0	0
controlling interests	0	0	0
other	365	456	318
Fees and commission income	2	2	4
Fees and commission expenses	1,095	1,285	1,524
Expenses associated with care for safety and administration of securities	340	306	281
Expenses associated with sale or other disposal of securities	14	22	17
Expenses for pension plans	717	933	1,200
Other fees and commission expenses	24	23	26
Profit (loss) from financial operations	1,989	1,392	-3,116
Other operating income	190	166	360
Other operating expenses	26	12	277
Administrative expenses	1,000	1,113	1,184
Personnel expenses	333	344	367
Social security and health insurance	79	82	83
Wages and remuneration – employees and statutory bodies	242	249	268
Other social expenses	12	13	16
Other administrative expenses	666	768	817
Release of provisions and allowances for tangible and intangible assets	0	0	3
Depreciation, creation and use of provisions and allowances for tangible and intangible assets	152	72	74
Depreciation of tangible assets	98	38	35
Creation and use of provisions and allowances for tangible assets	1	-1	0
Depreciation of intangible assets	34	22	27
Creation and use of provisions and allowances for intangible assets	18	13	13
Release of provisions and allowances for receivables and guarantees, recoveries of receivables previously written off	8	0	0
Depreciation, creation and use of provisions and allowances for receivables and guarantees	2	5	1
Release of allowances for interests with substantial and controlling influence	0	0	0
Losses from the transfer of interests with substantial and controlling influence, creation and use of allowances for interests	0	0	0
Release of other provisions, including pension provisions	8	7	2
Creation and use of other provisions, including pension provisions	12	14	19
Shares of profits (losses) from interests with substantial and controlling influence	0	0	0
Profit (loss) for the accounting period before taxation	4,123	4,275	727
Extraordinary income	5	0	0
Extraordinary expenses	0	0	0
Extraordinary profit (loss) for the accounting period before taxation	5	0	0
Income tax	3	6	9
Profit (loss) for the accounting period after taxation	4,125	4,269	718

Annex 12

Collective investment fund sector balance sheet

(CZK millions)

	31 December 2006 Data adjusted for provisions and reserves	31 December 2007 Data adjusted for provisions and reserves	31 December 2008 Data adjusted for provisions and reserves
Total assets	158,028	174,262	122,873
Cash	0	0	0
Receivables from banks	21,359	27,255	17,962
payable on demand	7,580	9,622	7,890
other receivables	13,779	17,633	10,072
Receivables from non-banking institutions	103	363	2,642
payable on demand	57	22	16
other receivables	46	341	2,625
Debt securities	94,302	91,160	71,089
issued by government institutions	34,028	31,785	27,941
issued by other entities	60,274	59,375	43,148
Shares, units and other interests	40,983	52,909	29,161
Shares	23,896	28,195	13,042
Units	17,086	24,714	15,933
Other interests	0	0	187
Interests with substantial and controlling influence	0	745	760
Long-term intangible assets	0	0	0
Start-up costs	0	0	0
Goodwill	0	0	0
Other long-term intangible assets	0	0	0
Long-term tangible assets	0	0	40
Land and buildings for operating activities	0	0	0
Other long-term tangible assets	0	0	40
Other assets	1,250	1,808	1,195
Receivables from shareholders for subscribed capital	0	0	0
Deferred expenses and accrued income	32	21	22

Note: Data taken as historical time series, i.e. including entities that terminated their activities before 31 December 2008

Annex 12

Collective investment fund sector balance sheet (continued)

(CZK millions)

	31 December 2006 Data adjusted for provisions and reserves	31 December 2007 Data adjusted for provisions and reserves	31 December 2008 Data adjusted for provisions and reserves
Total liabilities	158,028	174,262	122,873
Liabilities to banks	13	12	0
payable on demand	13	12	0
other liabilities	0	0	0
Liabilities to non-banking institutions	103	194	229
payable on demand	47	19	66
other liabilities	56	175	163
Other liabilities	1,117	1,193	1,404
Accrued expenses and deferred income	75	83	54
Provisions	28	32	54
Provisions for pensions and similar liabilities	0	0	0
Provisions for taxes	3	3	3
Other provisions	25	29	50
Subordinated liabilities	0	0	0
Registered capital	0	0	0
Paid up capital	0	0	0
Treasury shares	0	0	0
Share premium account	23,873	24,212	10,444
Reserve funds and other funds from profit	9,383	10,791	12,205
Statutory reserve funds and risk funds	0	0	0
Other reserve funds	0	0	0
Other funds from profit	9,383	10,791	12,205
Revaluation reserve fund	0	0	0
Capital funds	113,205	128,342	112,228
Valuation differences	238	298	-54
Valuation differences from assets and liabilities	238	170	-54
Valuation differences from hedging derivatives	0	0	0
Valuation differences from recalculated shares	0	0	0
Other valuation differences	0	127	0
Retained earnings (accumulated losses)	5,470	6,888	6,737
Profit (loss) for the accounting period	4,526	2,217	-20,429

Note: Data taken as historical time series, i.e. including entities that terminated their activities before 31 December 2008

Annex 13

Collective investment fund sector profit and loss account
(CZK millions)

	31 December 2006	31 December 2007	31 December 2008
Interest income and similar income	3,939	4,928	5,061
debt securities	2,873	3,401	3,420
other assets	1,066	1,527	1,641
Interest expenses and similar expenses	382	347	783
Income from shares and other equity instruments	689	820	1,005
substantial and controlling interests	0	0	0
other	689	820	1,005
Fees and commission income	2	2	6
Fees and commission expenses	1,401	1,608	1,383
Profit or loss from financial operations	2,419	-778	-23,665
Other operating income	91	3	5
Other operating expenses	22	11	12
Administrative expenses	485	553	485
Personnel expenses	0	0	0
Wages and salaries of employees	0	0	0
Social security and health insurance of employees	0	0	0
Other social expenses	0	0	0
Other administrative expenses	485	553	485
Release of provisions and allowances for tangible and intangible assets	0	0	0
Depreciation, creation and use of provisions and allowances for tangible and intangible assets	0	0	0
Release of provisions and reserves for receivables and guarantees, recoveries of receivables previously written off	1	4	11
Depreciation, creation and use of provisions and allowances for receivables and guarantees	68	-10	5
Release of allowances for interests with substantial and controlling influence	0	0	0
Losses from transfers of interests with substantial and controlling influence, creation and use of allowances for interests	8	0	0
Release of other provisions	0	0	0
Creation and use of other provisions	0	4	22
Share of profits (losses) from interests with substantial and controlling influence	0	0	0
Profit (loss) for the accounting period before taxation	4,773	2,466	-20,266
Extraordinary income	0	0	0
Extraordinary expenses	0	0	0
Extraordinary profit (loss) for the accounting period before taxation	0	0	0
Income tax	248	249	163
Profit (loss) for the accounting period after taxation	4,526	2,217	-20,429

Note: Data taken as historical time series, i.e. including entities that terminated their activities before 31 December 2008.

Annex 14

Listed bonds issued in 2008

Issue date	ISIN	Issuer	Maximum size
22 December 2008	CZ0003701799	Československá obchodní banka, a. s.	CZK 100 million
7 November 2008	CZ0003501603	Dalkia Česká republika, a. s.	CZK 1 billion
26 November 2008	CZ0002002058	Raiffeisenbank a. s.	CZK 3 billion
10 December 2008	CZ0002002066	Raiffeisenbank a. s.	CZK 4 billion
Total			CZK 8.1 billion
28 January 2008	CZ0001002158	MINISTERSTVO FINANCÍ ČR	CZK 36 billion
27 October 2008	CZ0001002331	MINISTERSTVO FINANCÍ ČR	CZK 42 billion
Total			CZK 78 billion

Annex 15

Listed share issues/tranches admitted in 2008

Issuer	ISIN	Face value	Size
Hypoteční banka, a. s.	CZ0008030509	CZK 500	max. CZK 3.5 billion

Annex 16

Listed investment certificate issues admitted as of 31 December 2008

Issuer	ISIN	Name
Barclays Bank PLC	XS0322226415	KOMODITY PLUS
Osterrei. Volksbanken AG	AT000B055918	ELEKTGAR2VB-AFT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054564	ALT ENERG GAR II
Österreichische Volksbanken-Aktiengesellschaft	AT000B054739	BUX VB-AFT
Österreichische Volksbanken-Aktiengesellschaft	AT000B053517	CECE BONUS III
Österreichische Volksbanken-Aktiengesellschaft	AT000B054705	CECE VB-AFT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054358	CROX INDEX CERT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054085	CSS INDEX CERT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054457	DAX REV BONUS II
Österreichische Volksbanken-Aktiengesellschaft	AT000B055488	ELEKTRINAGARVB-AFT
Österreichische Volksbanken-Aktiengesellschaft	AT000B054861	EUROPA BONUS CZK
Österreichische Volksbanken-Aktiengesellschaft	AT000B054275	CHINA BONUS III
Österreichische Volksbanken-Aktiengesellschaft	AT000B054721	PX INDEX CERT.
Raiffeisen Centrobank AG	AT0000489778	BRENT CRUDE OIL
Raiffeisen Centrobank AG	AT0000A0BNW5	BRENT TL 30
Raiffeisen Centrobank AG	AT0000A09JM2	BRENT TS 151,07
Raiffeisen Centrobank AG	AT0000A0BP88	BRENT TS 70
Raiffeisen Centrobank AG	AT0000A0BL33	CECE OIL TL 500
Raiffeisen Centrobank AG	AT0000A083W2	CECE TEL. TL 750
Raiffeisen Centrobank AG	AT0000467964	CECE TL 989,66
Raiffeisen Centrobank AG	AT0000A07MN8	CECE TS 3450
Raiffeisen Centrobank AG	AT0000A00M07	CECEXT
Raiffeisen Centrobank AG	AT0000A0BL58	CEZ TL 500
Raiffeisen Centrobank AG	AT0000454186	CTX
Raiffeisen Centrobank AG	AT0000340146	DJ EURO STOXX 50
Raiffeisen Centrobank AG	AT0000489398	GOLD
Raiffeisen Centrobank AG	AT0000A08S11	GOLD 1165 TS
Raiffeisen Centrobank AG	AT0000A00BQ9	GOLD TURBO LONG
Raiffeisen Centrobank AG	AT0000A07N66	INDUSTRY BASKET
Raiffeisen Centrobank AG	AT0000A0BLE7	KB TL 1700
Raiffeisen Centrobank AG	AT0000A07KU7	NASDAQ 2530 TS
Raiffeisen Centrobank AG	AT0000A0BMJ4	O2 TL 200
Raiffeisen Centrobank AG	AT0000A0BMK2	O2 TL 300
Raiffeisen Centrobank AG	AT0000A0AN81	PX BONUS 114+
Raiffeisen Centrobank AG	AT0000A0AN73	PX BONUS 125 CAP
Raiffeisen Centrobank AG	AT0000A0BUV2	PX BONUS 127 CAP
Raiffeisen Centrobank AG	AT0000A0BLZ2	PX TL 500
Raiffeisen Centrobank AG	AT0000481221	RDX
Raiffeisen Centrobank AG	AT0000A0BM40	ROTX TL 3800

Annex 17

Bond programmes approved in 2008

Issuer	Maximum size	Duration
UniCredit Bank Czech Republic, a. s.	CZK 100 billion	30 years
Raiffeisenbank, a. s.	CZK 50 billion	15 years

Annex 18

Publicly offered unlisted shares in 2008

Issuer/Offeror	Face value	Size
AGROZET, a. s.	CZK 31	CZK 18.7 million

Annex 19

Mandatory takeover bid after gaining control of a target company or acquiring a 2/3 or 3/4 share of the voting rights in a target company in 2008

Bidder	Target company	Decision
SUEZ ENVIRONNEMENT S.A.	Brněnské vodárny a kanalizace, a. s.	Approval linked with change in consideration amount

Annex 20

Squeeze-outs in 2008

Bidder (Main shareholder)	Target company	Decision
AGROCAPITAL PRAHA, a. s.	Otavské strojírny, a. s.	Approved
Čestmír Velíšek	LARM, a. s.	Approved
EKO-ZET, a. s.	Selekta Pacov, a. s.	Approved
GLOBin, s. r. o.	MAGNETON, a. s.	Approved
HATTISBURG ENTERPRISES LIMITED	Čechofracht, a. s.	Approved
Chvojka Josef	ARKUS, akciová společnost	Halted
Ing. Tomáš Tvrzský	TELEMATIX SERVICES, a. s.	Deferred
JUDr. Ing. Zdeněk Zemek	Hutní druhovýroba - reality, a. s.	Halted
KERAMOST, akciová společnost	KOVOHUTĚ ROKYCANY, a. s.	Halted
Kideva, s. r. o.	TESLA, akciová společnost	Approved
KOVOTEK, s. r. o.	PANAV, a. s.	Not approved
Královský pivovar Krušovice, a. s.	STAROBRNO, a. s.	Halted
LEXBURG ENTERPRISES LIMITED	ELITE, a. s.	Approved
Odien AV III, a. s.	Čedok, a. s.	Not approved
OMNIPOL, a. s.	Poličské strojírny, a. s.	Approved
S.M.K., a. s.	Stavební podnik Žďár nad Sázavou, a. s. v likv.	Approved
Spěváček Lubomír	KERAMOST, akciová společnost	Approved
UNIPETROL, a. s.	PARAMO, a. s.	Approved
Zakłady Azotowe ANWIL Spółka Akcyjna	SPOLANA, a. s.	Approved

Annex 21

Voluntary takeover bids and changes thereto in 2008

Bidder	Target company	Decision
Anthiarose Limited	Zentiva N.V.	Approved
Sanofi - Aventis Europe	Zentiva N.V.	Approved
Sanofi - Aventis Europe	Zentiva N.V.	Prolonged
Sanofi - Aventis Europe	Zentiva N.V.	Price increased
Sanofi - Aventis Europe	Zentiva N.V.	Prolonged
ECM Group N.V.	ECM REAL ESTATE INVESTMENTS A.G.	Approved
ECM Group N.V.	ECM REAL ESTATE INVESTMENTS A.G.	Shortened

Annex 22

Gross premiums written by classes of insurance in 2008
(total excluding the Czech Insurers' Bureau; CZK millions)

PART A		
CLASSES OF LIFE ASSURANCE		**Premiums written**
1.	Assurance on death only, assurance on survival only, assurance on survival or earlier death, joint life assurance, money back term assurance.	24,124
2.	Marriage assurance or insurance of benefits for child maintenance.	2,370
3.	Annuity assurance.	2,439
4.	Assurance referred to in 1 through 3 which is linked to an investment fund.	21,591
5.	Capital operations	215
6.	Personal accident and sickness insurance if supplementary to classes of insurance 1 through 5.	6,169
PART B		
CLASSES OF NON-LIFE INSURANCE		**Premiums written**
1.	Accident insurance	2,402
2.	Sickness insurance	1,700
3.	Insurance against damage to or loss of land vehicles other than railway rolling stock	16,872
4.	Insurance against damage to or loss of railway rolling stock.	15
5.	Insurance against damage to or loss of aircraft.	122
6.	Insurance against damage to or loss of vessels	16
7.	Insurance of goods in transit including luggage and other property irrespective of means of transport used.	471
8.	Insurance against damage to or loss of property other than referred to in 3 through 7 above.	11,245
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.	7,580
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.	24,140
11.	Liability insurance for damage arising out of ownership or use of aircraft, including carrier's liability.	74
12.	Liability insurance for damage arising out of ownership or use of inland or sea vessel, including carrier's liability.	8
13.	General liability insurance for damage other than referred to in classes 10 through 12	11,385
14.	Credit insurance	3,148
15.	Suretyship insurance	152
16.	Insurance of miscellaneous financial losses.	1,246
17.	Legal expenses insurance.	275
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).	2,079

Issued by:
CZECH NATIONAL BANK
Na příkopě 28
115 03 Praha 1
CZECH REPUBLIC

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

http://www.cnb.cz

Produced by: Jerome s.r.o.
Design: Jerome s.r.o.