



FINANCIAL MARKET SUPERVISION REPORT

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2016



FINANCIAL MARKET SUPERVISION  
REPORT 2016

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The Czech National Bank has issued a Financial Market Supervision Report since 2006<sup>1</sup> on the basis of Article 45d of Act No. 6/1993 Coll., on the Czech National Bank, as amended. The CNB is obliged to compile such a 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.

The Financial Market Supervision Report 2016 consists of three parts.

Part A gives information on CNB supervision, including supervision of compliance with the rules of consumer protection, on licensing and enforcement procedures, on changes in the Czech and EU legislation regulating the financial market and on the CNB's activities in the area of international cooperation.

Part B describes developments in the individual segments of the financial market supervised by the CNB, i.e. credit institutions, insurance companies and capital market entities, including pension funds.

Part C contains annexes relating to financial market supervision.

The Financial Market Supervision Report 2016 was discussed and approved by the CNB Bank Board on 15 June 2017.

It will be published on the CNB website in Czech and English.

<sup>1</sup> The Financial Market Supervision Reports for 2006–2015 are published on the CNB website at [www.cnb.cz/en](http://www.cnb.cz/en) > *Supervision, regulation* > *Aggregate information on the financial sector* > *Financial Market Supervision Reports*.

The basic framework for the CNB's financial market supervision was affected mainly by a further expansion of the range of supervised entities in 2016 compared with the previous period as a result of changes arising from the new Consumer Credit Act. There was a major change in the supervision of insurance companies connected with the transposition of the EU Solvency II directive, which gave rise not only to a fundamental change in risk management by insurance companies, but also to corresponding revisions of supervisory procedures. The implementation of an amendment to the Insurance Act brought risk management in the insurance sector significantly closer to that in the banking sector.

The CNB supervised 22 domestic banks, including five building societies, and 11 credit unions in 2016. To a limited extent, it also supervised 23 foreign bank branches from EEA countries. The CNB's off-site surveillance of credit institutions primarily involved checking compliance with prudential rules and regularly assessing the financial condition of individual entities. Thirteen examinations were also conducted directly in banks.

The aggregate balance-sheet total of the banking sector was CZK 5,960.8 billion at the end of 2016, a year-on-year increase of 9.0%. The total loans and receivables of the banking sector net of provisions were up by 14.5% compared with 2015 to CZK 3,753.9 billion. The liquidity situation of the banking sector remains positive due to a long-term excess of aggregate client deposits over accumulated client loans. Client deposits increased by CZK 258.8 billion to CZK 3,892.8 billion. The after-tax profit of the banking sector as a whole grew by 11.4% year on year to CZK 73.9 billion in 2016. The capitalisation of the banking sector in the Czech Republic has long been satisfactory. The sector's regulatory capital amounted to CZK 440.7 billion at the end of 2016, a rise of CZK 20.1 billion on a year earlier. The total capital ratio of banks operating in the Czech Republic was 18.4% at the end of 2016.

The CNB supervised 28 domestic insurance companies and, to a limited extent, also the Czech Insurers' Bureau and the Export Guarantee and Insurance Corporation. The supervised entities also included one reinsurance company. To a limited extent, 24 branches of foreign insurance companies were supervised. The main element of off-site prudential supervision was regular assessment of the financial and solvency situation of regulated insurance companies. In the conduct of business area, on-site examinations were conducted in five insurance companies.

The Czech insurance sector remained profitable in 2016, showing no major structural changes. An important factor was the need to adapt to the new Solvency II regulatory regime. The total assets of the insurance sector in the Czech Republic amounted to CZK 466.2 billion at the end of 2016, a year-on-year increase of 2.4%. Aggregate gross premiums written amounted to CZK 148.2 billion. Domestic insurance companies and branches of foreign insurance companies generated a net profit of CZK 12 billion. The median ratio of domestic insurance companies' eligible own funds to the solvency capital requirement was 214% at the end of 2016.

The CNB supervised eight pension management companies, 27 participation funds and eight transformed funds at the end of 2016. Two on-site examinations focusing on the governance system were conducted in pension management companies. At the end of 2016, the CNB also registered 32 entities holding an investment firm licence, 27 management companies, 108 investment funds with legal personality and 201 mutual funds. The CNB also supervised bureaux-de-change licence holders in 2016; the supervision mainly took the form of on-site examinations and local investigations. Supervisory activities also focused on payment institutions, electronic money institutions, small-scale electronic money issuers, small-scale payment service providers, insurance and investment intermediaries, and consumer credit providers and intermediaries.

Another important area of CNB supervision was supervision of compliance with the obligations laid down in the Consumer Protection Act. This primarily involved supervision of compliance with the prohibition of unfair business practices, compliance with the duties and rules for the provision of information about the prices of services and compliance with the prohibition of discrimination against consumers.

Pension management companies were managing assets totalling CZK 402.1 billion in their third-pillar funds at the end of 2016, i.e. 7.8% more than in 2015, and generated a net after-tax profit of CZK 1.5 billion. The total capital of pension management companies rose by 1.2% year on year to CZK 8.9 billion, and a capital ratio of 119.9% was achieved. Investment firms carried out trades for their own account totalling CZK 49,449.4 billion in 2016, up by 19.0%



compared to 2015. Management companies generated a net after-tax profit of CZK 0.88 billion. The total volume of trades on the PSE stock market increased by just 0.1% year on year to CZK 168.0 billion in 2016. Total share trading on the other domestic regulated market, RM-S, amounted to CZK 3.4 billion in 2016.

In the area of regulation, the CNB contributed to the preparation of a number of important amendments to laws concerning the Czech financial market, for instance amendments to the Act on Banks and the Act on Credit Unions, an amendment to the Recovery and Resolution Act, and the aforementioned Consumer Credit Act. In conformity with its legal powers, the CNB also issued a series of decrees and official information documents. In its regulatory and supervisory work, it responded to technical standards issued by the European Commission, such as the one for the directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV). Similarly, the CNB responded to the publication of guidelines and recommendations by the European Supervisory Authorities (the EBA, the EIOPA and the ESMA).

In 2016, the CNB continued to be actively involved in the activities of European and international institutions engaged in financial market regulation and supervision. Of particular importance was the work within the European Supervisory Authorities. Ongoing cooperation with other national supervisory authorities of EU Member States, which takes place primarily within supervisory colleges for banking and insurance groups, is also becoming increasingly important.

PART A  
FINANCIAL MARKET SUPERVISION IN 2016

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## 1. THE CNB'S SUPERVISORY PRIORITIES IN 2016

The CNB's role as the integrated financial market supervisory authority includes the proper performance of a whole range of activities concerning not only on-site and off-site supervision, but also legislative and regulatory activities, licensing and enforcement activities and activities in the area of international cooperation. The key strategic framework for the CNB's supervisory work is the Core Principles for Effective Banking Supervision published by the Basel Committee on Banking Supervision in 2012. When supervising regulated entities, the CNB follows the Long-term Supervisory Strategy of the Czech National Bank,<sup>2</sup> published in October 2015. The CNB's supervisory work in 2016 was performed in a changing legislative framework and was based on the following priorities:

### **Major changes to legislation**

- completion of the transposition of Solvency II<sup>3</sup> into Czech law through an amendment to the Insurance Act,<sup>4</sup> which led to major changes in the regulatory framework and the conditions of supervision of institutions operating in the insurance industry;
- assistance in the preparation of a draft amendment to the Capital Market Undertakings Act<sup>5</sup> to implement MiFID II<sup>6</sup> and adapt to directly applicable EU regulations;
- assistance in the preparation of a major amendment to the Act on Banks,<sup>7</sup> which introduces rules for conversion of banks, establishes a shared CNB-run bank database for cyberattacks and incidents and tightens up the deposit insurance rules;
- assistance in the adoption of a new Consumer Credit Act<sup>8</sup> which introduces supervision of all consumer credit providers and intermediaries by the CNB;
- publication of implementing decrees on new and amended laws.

### **Priorities in the area of financial market supervision**

- preparation for the takeover of supervisory powers over non-bank consumer credit providers and intermediaries in connection with the entry into effect of Act No. 257/2016 Coll., on Consumer Credit, which significantly extended the CNB's supervisory responsibilities on the financial market. The CNB contributed to the legislative process of adopting this law and prepared related implementing decrees and provisions, regarding in particular the receipt of applications for authorisation and registration to provide or intermediate consumer credit;
- in on-site examinations in credit institutions, a focus on examining property financing, i.e. mortgage loans for house purchase and commercial property financing; high attention also paid to project and acquisition financing, i.e. transactions in which property often serves as a substantial part of collateral;
- in the area of professional care of credit institutions, a focus on the area of investment services, information duties pertaining to payment services and also examinations of banks' bureau-de-change activities;

2 [http://www.cnb.cz/en/supervision\\_financial\\_market/long-term\\_supervisory\\_strategy/](http://www.cnb.cz/en/supervision_financial_market/long-term_supervisory_strategy/)

3 Act No. 277/2009 Coll., on Insurance, as amended.

4 Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II).

5 Act No. 256/2004 Coll., on Capital Market Undertakings, as amended.

6 Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments.

7 Act No. 21/1992 Coll., on Banks, as amended.

8 Act No. 257/2016 Coll., on Consumer Credit.

- monitoring of insurance companies' preparedness to comply with the Solvency II regulatory regime and examination of insurance companies' compliance with the statutory duty to ensure that claims arising from vehicle liability insurance can be settled any time. In the area of professional care of insurance companies, a focus on the management of the quality of distribution activities and on insurance companies' duties regarding loss adjustment;
- in accordance with technological trends, assessment of risks associated with the provision of FinTech financial services;
- services of non-bank bureau-de-change operators, in particular proper compliance with all information duties to clients;
- supervision of the activities of small-scale payment service providers in the form of both on-site and off-site supervision;
- multiple use of preliminary measures issued simultaneously with the opening of administrative proceedings to ensure stability of the credit institution sector. The aim of such preliminary measures was to limit the activities of the institutions concerned.

### ***Priorities in international cooperation***

- active CNB participation in the meetings of the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA);
- finalisation of level-three regulations, i.e. technical standards and guidelines on the implementation of CRD IV,<sup>9</sup> BRRD,<sup>10</sup> MiFID II, Solvency II and other EU legislation;
- participation in the EU-wide stress tests of banks and insurance companies;
- CNB involvement in the activities of the European Systemic Risk Board (ESRB), relating, for example, to property market risks, particularly in the residential property sector, and in the activities of ECB committees, where the CNB participated, for example, in the completion of a database of macroprudential measures in EU Member States;
- CNB involvement in discussions within the EU Council and its structures, in particular on the issue of the banking union and the European Deposit Insurance Scheme (EDIS) and on draft legislation to reduce risk in the EU banking sector prepared by the European Commission (Commission).

<sup>9</sup> Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

<sup>10</sup> Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms.

## 2. REGULATIONS IN THE CZECH REPUBLIC IN 2016

In 2016, the Czech National Bank contributed to changes in the regulatory framework in the financial market area in the Czech Republic. These arose primarily from the implementation of rapidly changing EU regulations. The CNB's activities in the area of preparation of new legislation included working mainly with the Czech Ministry of Finance and also with other state administration bodies. In connection with new laws and changes to laws, the CNB prepared implementing decrees and issued a number of explanatory and methodological opinions on the application of regulatory requirements pertaining to financial market participants. The structure of this section reflects the most important changes in the legislative framework in the area of financial market regulation.

### 2.1 CHANGES TO LAWS

In accordance with the agreement on cooperation in the preparation of draft national legislation concerning the financial market<sup>11</sup> signed by the CNB and the Ministry of Finance in May 2006, the CNB is involved in the preparation of laws and government decrees in the financial market area, for which the Ministry of Finance has primary responsibility. The CNB is also the official commenting authority for such legislation in the legislative process.

#### 2.1.1 Acts promulgated in the Collection of Laws in 2016

The following laws, to the preparation of which the CNB contributed, were finalised and promulgated in 2016:

##### ***Amendment to the Capital Market Undertakings Act (No. 148/2016 Coll.)***

An amendment to the Capital Market Undertakings Act which primarily implements the regulation on central depositories (CSDR) and the directive on transparency of listed companies (TD) was issued in 2016. The amendment was promulgated in the Collection of Laws on 17 May 2016 and took effect 15 days after its promulgation date.

##### ***Consumer Credit Act (No. 257/2016 Coll.)***

The Consumer Credit Act transposes the directive on credit agreements for consumers relating to residential immovable property (MCD) and replaces the old Consumer Credit Act transposing the directive on credit agreements for consumers (CCD). The Consumer Credit Act applies to all consumer credit provided by businesses to consumers and entrusts the CNB with supervision of all consumer credit providers and intermediaries, including the conduct of licensing proceedings, during which compliance with the conditions for granting a licence is examined. The Act specifies in detail the information duties to consumers and some other rights and duties in the area of consumer credit which improve the consumer's position (e.g. the possibility of early loan repayment, the assessment of creditworthiness, restrictions on penalties for overdue loan repayments and restrictions on the exercise of the right of pledge). It was promulgated in the Collection of Laws on 5 August 2016 and took effect on 1 December 2016.

##### ***Amendment to the Act on Insurance Intermediaries (No. 295/2016 Coll.)***

An amendment to the Act on Insurance Intermediaries and Independent Loss Adjusters introduces regulation of the payment of commissions and the surrender value of life and some non-life insurance policies. The aim of the amendment is to curb negative phenomena on the life insurance market – frequent over-insurance and the low surrender values that clients receive upon early termination of a capital-forming insurance policy (typically unit-linked and endowment life insurance). The new legislation governing surrender values contains a rule on mandatory distribution of an insurance company's life insurance policy acquisition costs over five years so that clients can be paid a higher surrender value than they receive at present upon early termination of a policy. The amendment was promulgated in the Collection of Laws on 19 September 2016 and took effect on 1 December 2016.

11 [http://www.cnb.cz/cs/legislativa/postaveni\\_cnb/download/dohoda\\_CNB\\_MF.pdf](http://www.cnb.cz/cs/legislativa/postaveni_cnb/download/dohoda_CNB_MF.pdf) (in Czech only)

**Act on the Central Register of Accounts (No. 300/2016 Coll.)**

The Act on the Central Register of Accounts (CRA) establishes a central database of basic information on the accounts managed by credit institutions (banks, foreign bank branches and credit unions). The CRA will enable specified public authorities (law enforcement authorities, the Financial Analytical Unit, the tax and customs administration and intelligence services) to find out easily, and in one place, which credit institutions a specific individual has or had an account at or which account he or she was authorised to operate. This will eliminate blanket enquiries at tens of credit institutions, minimise the risk of information leaks and considerably speed up the processing of applications for information from authorised bodies without changing the scope of interference in banking secrecy. The CRA will be run by the CNB. The act was promulgated in the Collection of Laws on 21 September 2016. Given the technical preparations that need to be made before the CRA can start operating, it will take effect to the full extent on 1 January 2018.

**Amendment to the Insurance Act (No. 304/2016 Coll.)**

An amendment to the Insurance Act transposed the directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) into Czech law. The aim is to implement better protection of insured parties and bolster financial stability by, among other things, introducing a new risk-oriented regulatory and supervisory regime in the insurance industry. The Insurance Act newly defines the conditions for carrying on insurance and reinsurance activities and supervision of the insurance sector. This mainly involves requirements for the governance systems of insurance and reinsurance companies, asset and liability valuation methods, methods for determining capital requirements and rules for setting technical provisions. At the same time, some provisions governing administrative offences, remedial measures and licence revocation were changed on the basis of the supervisory practice of the CNB, which initiated the changes. The amendment was promulgated in the Collection of Laws on 23 September 2016 and took effect on its promulgation date.

**Amendment to the Act on Certain Measures against Money Laundering and Terrorist Financing (No. 368/2016 Coll.)**

An amendment to the Act on Certain Measures against Money Laundering and Terrorist Financing and other related laws transposes the directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the fourth AML directive<sup>12</sup>). In particular, the amendment introduces as transposed a new definition of politically exposed person, a duty to conduct a risk assessment and enter the beneficial owner in a public register, tighter requirements for customer identification and verification, a definition of risk factors, and harmonisation and tightening of sanctions. The amendment was promulgated in the Collection of Laws on 14 November 2016 and took effect on 1 January 2017.

**Amendment to the Building Savings Schemes Act (No. 461/2016 Coll.)**

An amendment to the Building Savings Schemes Act introduces more effective inspection of compliance with the conditions for the provision of state support to building savings schemes by the Ministry of Finance. The law will enable additional information (and an explanation of facts related to this inspection) to be demanded from building societies outside the inspection code regime. A few minor changes were also made in the area of the transfer of information about returned state support between building societies and the Ministry of Finance. The amendment was promulgated in the Collection of Laws on 30 December 2016.

<sup>12</sup> Directive 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC.

### 2.1.2 Acts prepared in 2016

The following laws regulating the business activities of financial institutions and other entities subject to regulation and supervision were prepared in 2016 with the active involvement of the CNB.

#### ***Amendment to the Capital Market Undertakings Act and other related regulations***

A draft of another amendment to the law implementing the directive and the regulation on markets in financial instruments (MiFIR/MiFID II), the market abuse regulation (MAR), the directive on criminal sanctions for market abuse (CSMAD) and the implementing directive on MAR as regards reporting to competent authorities of actual or potential infringements of that regulation (whistleblowing) was prepared in 2016. The CNB made comments on the draft. In particular, it requested a change in the definition of management body and the taking into account of the cross-sectoral consensus on the basic requirements for the management body. All the major comments made by the CNB were approved. The government discussed the bill and submitted it to the Chamber of Deputies in July 2016. The CNB was subsequently involved in preparing a comprehensive revision reflecting the implementing measures on MiFID II adopted at the EU level and other related EU regulations (for example an adaptation of the benchmark regulation and the regulation on transparency of securities financing transactions), which cannot be incorporated in any other way due to short transposition periods. The debate of the bill in the Chamber of Deputies had not been completed by the end of 2016.

#### ***Amendment to the Act on Management Companies and Investment Funds***

Together with the amendment to the Capital Market Undertakings Act (see above), changes to the Act on Management Companies and Investment Funds were proposed. They included in particular the transposition of the directive regulating collective investment undertakings (UCITS V<sup>13</sup>), but also changes to other areas, such as the rules for the offering of units by a management company, the rules for calculating the fund capital of funds with variable capital, the rules for calculating the reference limit of registered administrators below the limit, the possibility to suspend issuance and redemption of equities in the case of a "technical break" at the end of the year and the possibility for collective investment funds to change investment strategy. The CNB worked closely on the preparation of the draft with the Ministry of Finance and proposed a number of changes which were incorporated into the amendment. The debate of the bill in the Chamber of Deputies had not been completed by the end of 2016.

#### ***Amendment to the Act on Banks and the Act on Credit Unions***

The aim of the draft amendment to the Act on Banks and the Act on Credit Unions, the preparation of which was initiated by the CNB, is to harmonise the current legislation with the other sector-specific laws and to take on board the experience with the current legislation. The CNB contributed significantly to the preparation of the bill and the related justification and impact study. Among other things, this amendment unifies terminology across laws, harmonises the provisions relating to the governance system with those in other sectors, modifies the rules for qualifying holdings, refines the method for calculating the settlement share in a credit union's assets and introduces the possibility to cover the operating costs of the Deposit Insurance Fund with extraordinary operational contributions or with a subsidy or repayable financial assistance from the state budget. The amendment also simplifies the rules of the notification procedure for cross-border activities of credit institutions and unifies the legislation governing the conditions for winding up a bank after its licence has been revoked and for appointing or dismissing a liquidator with the legislation on credit unions. The new elements of the bill include strengthened protection of bank customers in the event of conversion or disposal of a bank's business or part thereof and the establishment of a platform for exchanging information about cyberattacks between banks with the aim of creating an effective preventive tool in the area of cyber security. The bill went through the interdepartmental comments procedure in 2016.

13 Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as amended.

**Amendment to the Recovery and Resolution Act**

The bill modifies some of the instruments transposed from the Bank Recovery and Resolution Directive (BRRD) so that they better meet their objectives. It is mostly based on a proposal prepared by the CNB, including a relevant justification and part of an impact study. It extends the framework for introducing a moratorium on institutions' capital instruments and other liabilities, defines in more detail the CNB's powers to limit an institution's exposure so as to remove impediments to the resolvability of another institution and refines the rules for the setting of contributions to the Resolution Fund (by, among other things, clarifying the currency and defining the procedure to be followed in the event of the annulment of a decision). The bill also extends the confidentiality requirements to obliged persons and state administration bodies involved in resolution. Based on the CNB's comments submitted in the interdepartmental comments procedure, an exemption from the provision governing approvals of mergers of competitors where a bridge institution is used was inserted and the provision stipulating that the CNB decide on the disposal of the Resolution Fund's assets acquired in resolution was dropped from the draft law. The bill was going through the comments procedure at the end of 2016.

**Amendment to the Act on Bonds**

The aim of the draft amendment to this law is to regulate the issue of covered bonds. The draft also strengthens the material definition of bonds and defines some terms. The CNB submitted a number of comments on the draft in the comments procedure. They included, for example, calls to maintain the current group of entities authorised to carry on primary distribution of government bonds and to establish a legislative basis for contingent convertibles (CoCos) and a rejection of the proposal to include minimum reserve requirements in the cover pool of covered bonds. All the CNB's major comments were incorporated. The provisions governing CoCos were moved to the amendment to the Recovery and Resolution Act.

**Amendment to the Act on the Czech National Bank**

An amendment regulating some issues connected with the position of the CNB and its issuing function was submitted to the government at the end of 2016. The amendment also contains a new power with direct relevance to loan providers, namely the power of the CNB to set (through provisions of a general nature) binding fundamental lending indicators such as LTV (loan-to value) and DTI (debt-to-income) ratios.

**Amendment to the Act on Certain Conditions for Business in the Tourism Industry**

The Amendment to the Act on Certain Conditions for Business and the Performance of Certain Activities in the Tourism Industry transposes the directive on travel arrangements of the European Parliament and of the Council<sup>14</sup> into Czech law. The amendment was prepared by an interdepartmental working group for the transposition of this directive into Czech law. A CNB representative was a member of this group. The CNB's primary aim was to address the payment of compensation exceeding the agreed claim settlement limit from a guarantee fund created from travel agencies' contributions. The amendment was circulated for comments in December 2016. The proposed change is in accordance with these aims.

**Act on Bureau-de-Change Activity**

Based on supervisory findings, the CNB prepared a proposal to amend the Act on Bureau-de-Change Activity. The substance of the draft is (i) the introduction of the right of a consumer to withdraw from (cancel) an exchange transaction without giving reasons and without incurring any fees within two hours of entering into the contract, (ii) a prohibition to offer and advertise an exchange rate different from that given on the exchange rate list, (iii) a requirement that the senior officer actually managing bureau-de-change activities must hold the position of senior officer for one bureau de change only, (iv) a clear differentiation between the buying and selling rate, and (v) the introduction of bureau-de-change registration. Stricter penalties have also been proposed. The draft was submitted to the Ministry of Finance in December 2016.

<sup>14</sup> Directive 2015/2302 of the European Parliament and of the Council on package travel and linked travel arrangements, amending Regulation (EC) No 2006/2004 and Directive 2011/83/EU of the European Parliament and of the Council and repealing Council Directive 90/314/EEC.



## 2.2 CNB DECREES

The CNB is entitled to issue implementing legal rules in the form of decrees on the basis of authorisations defined in individual laws. The following list contains the decrees issued by the CNB which implement new or amended laws in the financial market area and which took effect on the date of entry into force of the given law in 2016:

- Decree No. 158/2016 Coll., amending Decree No. 233/2009 Coll., on applications, approval of persons and the manner of proving the professional qualifications, trustworthiness and experience of persons, as amended.
- Decree No. 159/2016 Coll., amending Decree No. 234/2009 Coll., on protection against market abuse and transparency, as amended by Decree No. 191/2011 Coll., and repealing Decree No. 114/2006 Coll., on the fair presentation of investment recommendations.
- Decree No. 198/2016 Coll., amending Decree No. 347/2006 Coll., implementing some provisions of the Act on Financial Conglomerates, as amended by Decree No. 250/2013 Coll.
- Decree No. 305/2016 Coll., on the submitting of statements by insurance and reinsurance companies to the Czech National Bank.
- Decree No. 306/2016 Coll., implementing certain provisions of the Insurance Act.
- Decree No. 307/2016 Coll., on applications according to the Insurance Act.
- Decree No. 381/2016 Coll., on applications, notifications and the submitting of statements pursuant to the Consumer Credit Act.
- Decree No. 382/2016 Coll., amending Decree No. 141/2011 Coll., on the pursuit of business of payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers, as amended.
- Decree No. 384/2016 Coll., on professional qualifications for the distribution of consumer credit.

## 2.3 OFFICIAL INFORMATION ISSUED

The CNB issues official information documents containing information for financial market participants regarding its approach to the application of legal rules and other important facts. In 2016, the CNB issued the following official information documents:

- Official Information of the Czech National Bank of 19 August 2016 regarding the conduct of business in the financial market – cloud computing.
- Official Information of the Czech National Bank of 26 January 2016 regarding the method for calculating risk weights for the purposes of setting contributions to the Deposit Insurance Fund.
- Official information of the Czech National Bank of 27 July 2016 regarding the verification of sufficient coverage of credit losses.
- Official information of the Czech National Bank of 11 January 2016 regarding some provisions of decrees on reporting by banks and foreign bank branches, credit unions and investment firms to the Czech National Bank.
- Official information of 14 April 2016 regarding the conduct of business activities by banks, credit unions and investment firms – publication of information.

The CNB also provided market participants and the public with information in the form of opinions and replies to queries in the area of financial market regulation. In 2016, the CNB published over 30 explanatory opinions on its website and answered more than 500 queries regarding financial market regulation received in writing or via the electronic mailroom.

A complete and up-to-date list of the CNB's decrees, provisions of a general nature, official information and opinions relating to the financial market can be found on the CNB website (*Supervision, regulation > Legislation*).

### 3. EU REGULATIONS IN 2016

Intensive preparations of new financial market regulations continued at the EU level in 2016. These included not only framework directives and regulations of the European Parliament and of the Council, but also Commission implementing regulations. Given that directly applicable regulations of the Commission are an increasingly used form of legislation in the EU, the CNB paid special attention to these proposals and prepared relevant opinions on an ongoing basis. Within the European Supervisory Authorities (the EBA, the ESMA and the EIOPA) the CNB was involved in the preparation of draft technical standards and guidelines.

#### 3.1 REGULATIONS AND DIRECTIVES OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

The following regulations and directives of the European Parliament and of the Council were issued in 2016:

- Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds. It introduces regulation of all indices used as benchmarks and sets detailed rules for the benchmark-setting process, in particular regarding the quality of input data and the methodology used, the restriction of conflicts of interest and checks of administrators and providers of benchmark-setting data.
- Regulation (EU) 2016/1014 of the European Parliament and of the Council of 8 June 2016, amending the regulation on prudential requirements for credit institutions and investment firms (CRR) as regards exemptions for commodity dealers.
- Regulation (EU) 2016/2340 of the European Parliament and of the Council of 14 December 2016 changing the date of application of the regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) from the initial 31 December 2016 to 1 January 2018.
- Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution, which addresses the need to enhance consumer protection, ensure regulation consistent with the capital market rules and harmonise the approach to supervision and administrative sanctions.
- Directive (EU) 2016/1034 of the European Parliament and of the Council of 23 June 2016 amending Directive 2014/65/EU on markets in financial instruments and postponing the date of effect of Directive 2014/65/EU (MiFID II) to 3 January 2018.
- Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs).

The discussions of the draft regulation on the prospectus to be published when securities are offered to the public or admitted to trading and of the draft regulation on money market funds continued into 2016. The CNB commented on the Ministry of Finance's instructions for meetings within EU structures. Political agreement was reached on both drafts and the regulations will be published in the Official Journal of the EU in 2017.

In November 2016, the Commission published a package of legislative proposals to reduce risk in the EU banking sector. They include proposals to revise the prudential regulatory rules contained in CRD IV and CRR, the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). A rather broad revision has been proposed for CRD IV/CRR, including changes to the rules for calculating capital requirements for market risk and counterparty credit risk, the introduction of a binding leverage ratio and a binding net stable funding ratio as a mandatory liquidity standard, changes to the requirements applying to interest rate risk management systems, changes to the remuneration system and a modification of the Pillar 2 rules (the supervisory review process).

The main aims of the proposed changes to BRRD are to further harmonise the insolvency ranking of bank creditors, to harmonise the introduction of a moratorium on the fulfilment of a bank's obligations and to implement the international standard for own funds and eligible liabilities (TLAC) in European legislation. The Commission presented the proposal in late November 2016. The CNB analysed it in detail with a view to actively participating in a dialogue with the Ministry of Finance (by helping to prepare the Czech Republic's general position, among other things) and in the negotiations on the legislative package in EU institutions in 2017. The most important issues identified from the CNB's point of view included the application of the TLAC rules to global systemically important institutions only, maintenance of resolution authorities' current decision-making flexibility, and ensuring balance between the powers of home and host supervisors in the context of maintaining financial stability.

### 3.2 IMPLEMENTING MEASURES FOR DIRECTIVES AND REGULATIONS

Directives and regulations often require the European Supervisory Authorities (the EBA, the ESMA and the EIOPA) to prepare regulatory and implementing technical standards which the Commission then issues as directly applicable regulations. Directives and regulations likewise empower the Commission to issue implementing measures, for which the European Supervisory Authorities (ESAs) draw up technical advice. Within the ESAs, the CNB was actively involved, among other things, in preparing the following implementing measures:

#### ***Implementing measures for the directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV)***

- Commission regulations (implementing technical standards) published in the Official Journal of the EU in 2016 (two in total) governing templates, definitions and IT-solutions for reporting to the European Banking Authority (EBA) and national supervisory authorities, and the functioning of colleges of supervisors.
- Commission regulations (regulatory technical standards) published in the Official Journal of the EU in 2016 (two in total) concerning the general conditions for the functioning of colleges of supervisors and the methodology for the identification of global systemically important financial institutions and for the definition of subcategories thereof.

#### ***Implementing measures for the regulation on prudential requirements for credit institutions and investment firms (CRR)***

- Commission regulations (regulatory technical standards) published in the Official Journal of the EU in 2016 (three in total) specifying and supplementing regulatory technical standards for non-delta risk of options in the standardised market risk approach. In particular, the regulations set out quantitative and qualitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile, specify the conditions for the application of the derogations concerning currencies with constraints on the availability of liquid assets and lay down rules for prudent valuation.
- Commission regulations (implementing technical standards) published in the Official Journal of the EU in 2016 (11 in total) governing, among other things, the extension of the transitional periods related to own funds requirements for exposures to central counterparties, the mapping of credit assessments of external credit assessment institutions for securitisation and for credit risk, main indices and recognised exchanges, disclosure of the leverage ratio for institutions, the uniform formats and date for the disclosure of the values used to identify global systemically important institutions, the reporting of the leverage ratio and the liquidity coverage requirement for the purposes of supervisory reporting, and the joint decision process with regard to the application for certain prudential permissions.
- Commission implementing decisions published in the Official Journal of the EU in 2016 (two in total) on the lists of third countries and territories whose supervisory and regulatory requirements are considered equivalent for the purposes of the treatment of exposures according to CRR.

**Implementing measures for the directive on the recovery and resolution of credit institutions and investment firms (BRRD)**

- Commission regulations (regulatory technical standards) published in the Official Journal of the EU in 2016 (seven in total) specifying in particular the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges. The implementing measures also specify the minimum elements of a business reorganisation plan, the minimum set of the information on financial contracts that should be contained in detailed records, the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities and the criteria for the determination of the activities, services and operations with regard to critical functions.
- Commission regulations (implementing technical standards) published in the Official Journal of the EU in 2016 (three in total) governing the procedures, standard forms and templates for the provision of information for the purpose of resolution plans for credit institutions and investment firms, the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to the European Banking Authority, and the details of group financial support agreements.

**Implementing measures for the directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II)**

- Commission regulations (implementing technical standards) published in the Official Journal of the EU in 2016 (six in total) specifying technical information for the calculation of technical provisions and basic own funds for reporting, the procedures for the application of the transitional measure for the equity risk sub-module, the allocation of credit assessments of external credit assessment institutions and the templates for the submission of information to supervisory authorities.

**Implementing measures for the regulation on OTC derivatives, central counterparties and trade repositories (EMIR)**

- Commission regulation (regulatory technical standard) published in the Official Journal of the EU in 2016 on risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty. The aim of the regulation is to lay down rules regarding in particular the calculation and collection of initial and variation margins and also, for example, to define eligible collateral and set forth procedures for collateral valuation, management and segregation.
- Commission regulations (regulatory technical standards) published in the Official Journal of the EU in 2016 (two in total) on the clearing obligation for index credit default swaps (CDS), fixed-to-float interest rate swaps and forward rate agreements (FRA) denominated in the Norwegian, Polish and Swedish currencies through central counterparties.

**Implementing measures for the market abuse regulation (MAR)**

- Commission regulations (regulatory technical standards) published in the Official Journal of the EU in 2016 (eight in total) specifying in particular the conditions applicable to buy-back programmes and stabilisation measures, the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings, the criteria, procedure and requirements for establishing an accepted market practice, the appropriate arrangements, systems and procedures to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions, and the technical arrangements for objective presentation of investment recommendations.
- Commission regulations (implementing technical standards) published in the Official Journal of the EU in 2016 (three in total) governing the timing, format and template of the submission of notifications to competent authorities, the technical means for appropriate public disclosure of inside information and for delaying the public disclosure of inside information, the precise format of insider lists and for updating insider lists, and the format and template for notification and public disclosure of managers' transactions.

**Implementing measures for the directive and regulation on markets in financial instruments (MiFID II, MiFIR)**

- Commission regulations (regulatory technical standards) published in the Official Journal of the EU in 2016 (three in total) on the information for registration of third-country firms providing investment services in the EU, criteria for determining whether derivatives should be subject to mandatory trading on trading venues and the conditions of access to benchmarks for central counterparties and trading venues.
- A Commission regulation (implementing technical standard) published in the Official Journal of the EU in 2016 specifying the information submitted by multilateral trading facilities and organised trading facilities to supervisory authorities.

**Implementing measure for the directive on the prospectus**

- A Commission regulation (regulatory technical standard) published in the Official Journal of the EU in 2016 setting out the rules for the approval and publication of prospectuses and dissemination of advertisements.

**Implementing measure for UCITS**

- A Commission regulation (implementing technical standard) published in the Official Journal of the EU in 2016 laying down the standard procedures and forms for submitting information in accordance with the directive.

**3.3 GUIDELINES**

In addition to technical standards, guidelines are drawn up with a view to ensuring uniform application of EU law. The guidelines are issued by the European Supervisory Authorities (the EBA, the ESMA and the EIOPA) as non-binding legal acts. National supervisory authorities and financial market participants should make every effort to comply with these guidelines. However, national supervisory authorities may inform the competent European supervisory authority that they do not comply or do not intend to comply with the guidelines, giving their reasons for not doing so. Within the ESAs, the CNB contributed to the preparation of numerous draft guidelines, concerning, for example, MiFID, CRD IV, BRRD, Solvency II and UCITS. More than 30 guidelines were issued in 2016. In no case did the CNB state that it did not comply or did not intend to comply with the guidelines.

More information about the preparation of guidelines and technical standards is available in section 6. *International cooperation*.

## 4. FINANCIAL MARKET SUPERVISION IN 2016

In addition to regulatory work, the CNB performed its role of integrated supervisory authority by means of supervisory work involving in particular on-site and off-site supervision of financial institutions, of the procedures followed by supervised entities and of capital market infrastructure. Supervisory activities also include licensing, approval and authorisation activities and the imposition of penalties, including remedial measures if serious shortcomings are detected in the activities of supervised entities.<sup>15</sup> Although the core supervisory activities are very alike across sectors, there are some specificities. These ensue from the different natures of the activities of the individual types of financial market institutions. The following section presents the main characteristics of supervision of each financial market sector in 2016.

### 4.1 SUPERVISION OF CREDIT INSTITUTIONS

Supervision of credit institutions involves supervision of banks, foreign bank branches, building societies and credit unions. The main aim of supervision is to contribute to safeguarding and maintaining the stability of credit institutions, and hence also of the sector as a whole. In accordance with this aim, the supervision performed by the CNB involved the development and application of risk-oriented supervision with an emphasis on timely identification of risks. On the basis of continuous assessment of information about individual credit institutions and about the sector as a whole and its segments, the CNB actively responded to changes in the individual risk factors, flexibly adjusting the focus of supervision and taking specific measures as needed.

#### 4.1.1 Licensing, approval and authorisation activities

The CNB supervised 22 domestic banks, including five building societies, and 11 credit unions as of the end of 2016. To a limited extent, it also supervised 23 foreign bank branches from EU/EEA countries.

**Table A.1 – Numbers of entities in the credit institutions sector**

	As of 31 December 2015	Entries in 2016	Exits in 2016	As of 31 December 2016
Banks <sup>i)</sup>	23	0	1	22
Branches of foreign banks from EU/EEA	23	1	1	23
Credit unions	11	0	0	11
Credit institutions, total	57	1	2	56

*i) Of which five building societies.*

<sup>15</sup> In 2016, the CNB's activity in the enforcement area consisted mainly in investigating petitions for the opening of administrative proceedings, making decisions on the opening of administrative proceedings, and conducting administrative proceedings, within which fines and remedial measures were imposed, licences revoked or registrations cancelled. In addition to conducting penalty administrative proceedings against supervised entities, the CNB conducts penalty administrative proceedings against entities that provide financial market services without having the relevant licence in financial market sectors where the law enables penalties to be imposed for the carrying on of unauthorised business. Statements of final decisions, or full final decisions, in most areas of the financial market are published by law in the Supervision, regulation section of the CNB website. Sanctions imposed on insurance intermediaries are entered in the Register of Insurance Intermediaries.

ERB bank, a.s. had its banking licence revoked in the last quarter of 2016. Credit union CREDITAS, spořitelní družstvo was given consent to convert into a joint-stock company and was granted a banking licence (Banka CREDITAS a.s. with effect from 1 January 2017). A branch of Polish bank PKO BP S.A., Czech Branch was newly established. The branch of German bank Volksbank Lößau-Zittau eG closed down in 2016.

**Table A.2 – Numbers of administrative proceedings in the credit institution sector**

Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Completed in 2016	Continuing into 2017
37	9	28	31	6

In the credit institutions sector, 37 administrative proceedings were conducted and 31 decisions were issued in 2016. The first-ever proceeding on the granting of a banking licence to a foreign bank having its registered office in an EU non-Member State and intending to establish a branch in the Czech Republic was opened. Proceedings with two credit unions concerning applications to convert into a joint-stock company and obtain a banking licence were also conducted. The proceedings were discontinued due to withdrawals of the applications.

#### 4.1.2 Off-site surveillance

The off-site supervisory work involved checking compliance with prudential rules and regularly assessing the financial condition of individual regulated entities. High-intensity cooperation with partner supervisory authorities in other countries also remained a priority.

In 2016, the largest part of supervisory resources were focused on systemically important institutions.<sup>16</sup> The CNB paid attention to the performance of entities with a short market history and entities which changed their owner. It also concentrated on smaller entities and domestic groups with specific business models or risk profiles. Despite its relatively small market share, the credit union sector was subject to intensive CNB supervision. A substantial proportion of supervisory capacity was devoted to this sector.

Information for supervisory work was obtained mainly from the statements and reports regularly submitted by individual entities on a solo and consolidated basis. An extraordinary reporting duty was imposed on credit institutions where more intensive monitoring of their financial situation was needed. In addition to the regular reports, information from on-site inspections and other sources was used for continuous monitoring of entities and the market. These sources include financial statements, annual and auditors' reports, public presentations and press releases. Regular meetings with representatives of credit institutions to discuss the latest results, risks in the banking industry, strategic objectives and business plans, usually held quarterly, were also an important source of information.

The main analytical instrument employed in off-site surveillance is regular comprehensive analyses of the financial condition of individual entities and the sector as a whole. An analysis of the credit institution sector is also produced quarterly. The observance of prudential limits is monitored on a monthly basis for credit institutions. Early warning information is also assessed every month. This helps supervisors to identify potential negative tendencies in financial indicators.

<sup>16</sup> The CNB compiles a list of systemically important institutions on the basis of the obligation rising under Article 131 of CRD IV and Article 12(w) of the Act on Banks, Article 8at of the Act on Credit Unions and Article 9at of the Capital Market Undertakings Act. The list is available at [https://www.cnb.cz/en/financial\\_stability/macprudential\\_policy/list\\_other\\_systemically\\_important\\_institutions/index.html](https://www.cnb.cz/en/financial_stability/macprudential_policy/list_other_systemically_important_institutions/index.html)



In 2016, the CNB's supervisory activities continued to focus primarily on credit institutions' credit portfolios (categorisation of claims, sufficient provisioning, collateral value, etc.), the overall performance of credit institutions and their consolidated units, sufficient capitalisation and liquidity. When performing supervision, the CNB also analysed the situation of parent groups and monitored intra-group transactions.

In the supervisory review and evaluation process (SREP), the CNB regularly prepares comprehensive evaluations of the risk profiles of individual credit institutions. Risk profiles are determined on the basis of a quantitative and qualitative assessment of the scope of credit institutions' exposures to individual types of risks and an evaluation of each institution's risk management system and internal control environment.

The SREP was thus based on monitoring of the institution's key indicators, an analysis of its business model, a review of its management and control mechanisms, an assessment of the risks to its capital and an evaluation of liquidity and financing risks.

An essential component of the SREP was an evaluation of the adequacy and effectiveness of the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). Under the SREP, the CNB set additional Pillar 2 capital requirements and other quantitative or qualitative liquidity measures, particularly in the capital and liquidity areas, for credit institutions in accordance with the regulatory rules.

The CNB, in cooperation with selected banks, continued to implement the joint project of stress testing of banks in 2016. The frequency of the joint stress testing was unchanged from the previous year, i.e. yearly testing using year-end data. As in 2015, interest rate risk of banks was tested in addition to credit risk. The nine largest domestic banks, most of which have received approval to use the special IRB approach<sup>17</sup> for calculating the capital requirement for credit risk, took part in the testing using data as of 31 December 2015. These banks account for almost 75% of the assets of the Czech banking sector. The aggregated results of the stress tests confirmed the good resilience of domestic banks. Their capital adequacy ratio stayed above the regulatory minimum by a sufficient margin even in an adverse scenario. In addition to these bottom-up tests, the CNB conducts half-yearly stress tests of the entire banking sector (top-down tests), whose results are regularly published on the CNB website.

The CNB last year also assessed the quality of resolution plans and their compliance with the requirements of BRRD and the Recovery and Resolution Act. Joint decisions on group recovery plans were taken by some supervisory colleges for the first time in 2016. Such decisions should be made for all European banking groups in 2017. However, the first drafts of these plans do not currently fully cover individual locally important entities. This is the most frequent objection made by national supervisory authorities to the group resolution plans that have been submitted. Local resolution plans for individual entities should be adequately incorporated into the group resolution plans in the period ahead.<sup>18</sup>

In 2016, off-site surveillance in the credit union sector was concentrated in particular on assessing the current situation and developments in individual credit unions and on resolving their problems on an individual basis, mainly with respect to specific risks undertaken. The CNB's supervisory activities in this sector were focused mainly on credit portfolio categorisation, sufficient provisioning, financing of groups of connected persons, compliance

<sup>17</sup> Internal Ratings Based Approach.

<sup>18</sup> More information about the functioning of supervisory colleges can be found in section 6.6.

with regulatory limits, the origin of credit unions' capital, the use of outsourcing services and compliance with the conduct of business rules, especially as regards the provision of deposit products. Following an amendment to the Act on Credit Unions, an extraordinary information duty for credit unions, aimed at closely monitoring developments in individual credit unions in the areas of liquidity, credit portfolios, operating costs, outsourcing, transfer of receivables, and so on, remained in place.

As part of its off-site surveillance work, the CNB also assessed the competence and integrity of proposed senior officers in banks and approved external auditors of banks and credit unions. It also approved lists of shareholders for the purposes of banks' general meetings, the eligibility of additional T1 capital for capital adequacy purposes and the early repayment of subordinated debt.

Off-site surveillance of credit institutions in the conduct of business area consists primarily in supervision of maintenance of internal governance systems, supervision of compliance of credit institutions' conduct with their internal governance systems, supervision of rules of conduct towards clients and supervision of compliance with legal regulations imposing duties on credit institutions. Supervision in the conduct of business area is primarily based on sector-specific laws governing the activities of credit institutions (the Act on Banks, the Building Savings Schemes Act, the Act on Credit Unions and the Payment System Act). In the case of credit institutions, however, conduct of business supervision is not limited to sector-specific legislation, but also examines whether credit institutions observe other laws (for example: the Civil Code in relation to contracts with clients and the Civil Procedure Code and the Dstraint Procedure Code in relation to distraints), which impose further duties on credit institutions. In such cases, conduct of business supervision entails evaluating whether credit institutions' internal processes are set in accordance with these laws so that they can provide services to their clients with professional care.

In 2016, special attention was devoted to the issue of changes to master agreements on payment services (typically agreements on opening and maintaining a payment account) and the issue of setting an effective system for dealing with customer complaints. In these areas, findings obtained in the course of investigating submissions made by the public suggested that credit institutions may not have their procedures configured correctly to ensure compliance with their statutory duties as defined particularly in the Payment System Act. The CNB thus issued two supervisory benchmarks relating to changes to master agreements on payment services and the handling of complaints, in which it described in detail the proper procedures for proposing changes to a master agreement and for setting the internal system of rules for dealing with clients' complaints.

The execution of foreign payment transactions (cross-border payment transactions and payment transactions in foreign currencies) by credit institutions was also systematically checked on the basis of submissions made by the public, with an emphasis on observance of the time limit for executing the transaction. The CNB conducted thematic examinations in selected credit institutions that are significant payment service providers to check whether they were executing foreign payment transactions within the agreed or statutory time limits.

During 2016 the CNB also dealt systematically with the issue of reporting by credit institutions of information subject to banking secrecy at the request of authorised entities (courts, law enforcement authorities, etc.). To inform credit institutions that they should report such information in a proper and timely manner, the CNB sent all of them a communication calling on supervised entities to have their governance systems configured properly in this respect.

Supervision of banks' activities as investment fund depositaries is also an integral part of off-site supervision of credit institutions. This is due mainly to depositaries' essential role in checking, monitoring and registering investment funds' assets and financial resources on a daily basis. During 2016, the CNB communicated with depositaries regarding adaptation to the new requirements of UCITS V and the implementing measures issued for it. As regards depositaries' activities, this mainly involves a tightening of the rules for fitness to perform the depositary function, regulation of the protection of UCITS funds' assets in the event of insolvency of the depositary, and a strengthening of the depositary's accountability. Particular emphasis is placed on the transparency and independence of performance of the depositary function, with the new rules having significant impacts on depositaries providing services to entities within a single financial group.

### 4.1.3 On-site examinations

Both comprehensive and partial examinations were conducted in the credit institution sector in 2016. A total of 13 examinations were conducted or commenced in banks in 2016. Four of these were comprehensive and the remainder were partial. Three comprehensive examinations and two partial examinations were conducted in credit unions in 2016. The examinations focused on a number of areas presented in Table A.3.

**Table A.3 – Focus of examinations in credit institutions in 2016**

	ICAAP	Credit risk	Market risks, including IRRBB	Regulatory reporting of financial market risks, including CA	Liquidity risk	Regulatory reporting in liquidity area	Processing of transactions in financial markets	Operational risk	IS/IT risks	AML/CFT	Remuneration
Banks	4	8	6	6	4	4	4	3	3	11	3
Credit unions	4	4	2	2	4	1	3	3	1	2	1

#### **Examinations of credit risk management**

Eight examinations in banks (three of which continued into 2017) and three examinations in credit unions were conducted in the area of credit risk management. In one credit union, a supervisory examination was conducted outside the inspection plan to verify sufficient elimination of shortcomings detected during a previous on-site examination for the purposes of administrative proceedings regarding conversion of the credit union into a bank. The other examinations in banks and credit unions were regular examinations in line with the plan of inspection activities. In all cases, the examinations focused on compliance with prudential rules arising from regulatory rules, especially in relation to risk management functions in institutions. Where relevant, the inspection team also concentrated on assessing compliance with remedial measures imposed in previous examinations and compliance of the institutions' advanced credit risk management methods with regulatory standards.

The extent, nature and degree of seriousness of the shortcomings detected differed significantly across institutions. The shortcomings frequently identified in the entities examined included errors in the valuation process and in records of collateral. This most often involved acceptance of old valuations of pledged property (when refinancing mortgage loans, for example), failure to conduct (or insufficient conduct of) regular revaluation of the portfolio of property held as collateral for loans, failure to take into account high correlation between some collateral values and the borrower's credit quality, and shortcomings in the monitoring of collateral insurance.

In some cases, failure to respect the CNB's loan categorisation rules was identified. This mainly involved repeated cases where the repayment probability was assessed not on the basis of the customer's ability to service the loan from his own resources, but taking into account sources stemming from collateral (such as support from parent companies or other companies from the customer's group). In these cases, the institutions examined had not assessed the loans as default receivables.

Problems relating to an insufficient role of the risk management units within the governance systems of banks and credit unions (and to the requirement for segregation of conflicting duties) were also identified. Shortcomings in evaluating and recording groups of economically connected persons (for example, insufficient evaluation of links arising from business relations between entities) also occurred frequently. In the case of some smaller entities, insufficiently set internal credit exposure limits preventing the identification of all sources of concentration risk were identified. In the area of debt recovery, shortcomings in the setting of mandatory rules for the transfer of claims under the administration of the debt recovery unit and the absence of a debt recovery strategy were often detected.

Based on an assessment of the scale and seriousness of the findings, the entities examined were called on to eliminate the shortcomings and to regularly report the remedial measures adopted, or enforcement proceedings were opened against them. In these proceedings, a duty to adopt a remedial measure, or a requirement to hold higher capital to cover the risks identified until such time as the shortcomings were eliminated, was imposed on them.

#### ***Examinations of internal capital systems (ICAAP)***

Eight on-site examinations (four in banks and four in credit unions) focused on evaluating internal capital systems (ICAAP) were conducted in 2016. The shortcomings detected related to the verification of the assumptions used, the integration of ICAAP in governance processes (use tests) and the method for setting internal capital requirements for individual risks, in particular concentration risk and investment portfolio interest rate risk. Shortcomings were also identified in the concept of stress testing, which is an integral part of ICAAP. The shortcomings identified did not jeopardise the ability of the examined banks and credit unions – with the exception of one credit union – to cover the internal capital requirements with available capital. In the cases of credit unions where the shortcomings in ICAAP jeopardised their ability to cover the internal capital requirements with available capital, administrative proceedings proposing to increase the minimum capital requirements to sufficiently cover risks by capital were opened to eliminate the shortcomings. In the other cases, the CNB called on the institutions examined to remedy the shortcomings identified. The elimination of those shortcomings is being monitored on an ongoing basis.

#### ***Examinations in the area of market risk management***

Market risk management was examined in six banks and two credit unions as part of on-site examinations. The shortcomings identified mainly concerned the measurement of investment portfolio interest rate risk, the analysis of financial market entities, breaches of some regulatory and internal limits, insufficient or absent checks of the market conformity of prices, the calculation of additional valuation adjustment (AVA) and internal auditing. The shortcomings identified did not jeopardise the financial situation and capital of the examined entities or their ability to manage such risk.

Regulatory reporting in the area of risks associated with trading in financial markets was subject to examination in six banks and two credit unions. Shortcomings were detected mainly in the valuation of certain types of financial derivatives, in connection with the interest rate risk statement, and in the calculation of capital requirements for general and specific interest rate risk, commodity risk, counterparty risk and credit valuation adjustment (CVA) risk. The CNB called on the institutions examined to eliminate the shortcomings identified. The elimination of those shortcomings is being monitored on an ongoing basis.

#### ***Examinations in the area of liquidity risk***

Liquidity risk management was examined in four banks and four credit unions as part of on-site examinations. The quality of liquidity risk management in one bank was also examined with regard to an application for the approval of the establishment of a liquidity sub-group under Article 8 of Regulation (EU) No. 575/2016. The shortcomings in the area of liquidity risk most often related to a missing or insufficient definition of risk appetite and failure to link individual elements of the liquidity risk management system or to ensure their consistency. They also concerned limits that did not reflect the institution's risk profile, stress scenarios that failed to take sufficient account of relevant risk factors and emergency plans that were not integrated with stress testing or failed to define indicators of exceptional events. The shortcomings identified did not jeopardise the ability of the examined entities to manage liquidity risk. The CNB called on the institutions examined to eliminate the shortcomings identified. The elimination of those shortcomings is being monitored on an ongoing basis.

A new area that was examined in two banks and one credit union was the regulatory reporting of liquidity risk. In this regard, the liquidity coverage ratio (LCR) and additional monitoring metrics (AMM) for liquidity are verified. Although this is a new examination area, a shortcoming in the records of deposits in the LCR report was identified in only one case.

**Examinations in areas associated with trading in financial markets**

Risks associated with trading in financial markets were examined in five banks and one credit union. Shortcomings of various degrees of seriousness were found in all the entities examined. Risks arising from insufficient separation of the business and settlement functions, the absence of authorisation (validation) actions taken by another worker (the “four eyes” principle) and shortcomings in the system of allocation of rights of access to the system for the settlement of financial market transactions were assessed as serious findings. The CNB called on the institutions examined to eliminate the shortcomings identified. The elimination of those shortcomings is being monitored on an ongoing basis.

**Examinations of the application of advanced methods for determining capital requirements**

In 2016, the CNB's expert teams (for IRB, AMA and VaR) continued their consultations with all regulated institutions that use the special approaches for the calculation of capital requirements for credit, operational and market risks under the Basel II rules. The teams communicated with foreign supervisors on an ongoing basis.

In its on-site examinations in 2016, the inspection team concentrated mainly on continuous verification of the procedures of banks which have already received approval to use the IRB approach. The team is also dealing on an ongoing basis with banks' applications for consent to change their IRB models by means of a joint application from their parent bank (several dozen applications for, and notifications, of the approval of changes in the IRB approach were handled in 2016). The discussions between the CNB and the banks focused on assessing the compliance of the banks' procedures with Decree No. 163/2014 Coll. and Regulation (EU) No. 575/2013. Most applications were approved (some with additional conditions), although in some cases banks were asked for additional information. Cooperation with banks at an expert level involves regular meetings at which CNB representatives discuss planned changes to IRB models and methodological issues with the relevant members of staff. In 2016, meetings were also held at an expert level with the ECB and other supervisory authorities regarding the joint approach to the assessment of IRB models.

An examination of the internal VaR model for market risk was conducted in one bank in 2016. A material change in the VaR model of another institution was validated and subsequently approved in 2016. The CNB also conducted a preliminary validation and a validation of option valuation models in two banks in 2016. With regard to the result of the validation process, one bank was then granted consent to use the option model for the calculation of delta equivalents for currency options. In the second case, an official application for the approval of the model is expected to be filed in early 2017.

**Examinations of operational risk management**

Examinations in the area of operational risk management focused on verifying all key areas of risk management, including the instruments used for identifying, assessing, monitoring and reporting operational risk in credit institutions. Emphasis was placed on the functioning and effectiveness of selected risk management tools. Compliance with the regulatory requirements for determining the capital requirement for operational risk was also assessed.

Six examinations – three in banks and three in credit unions – were conducted in 2016. Operational risk management systems were assessed with respect to the nature, scope and complexity of the institution's activities. The results revealed that operational risk management systems are implemented and maintained in credit institutions. Most shortcomings concerned partial operational risk management processes, most notably processes associated with the collection and assessment of information on operational risk events, an inappropriate structure of indicators capturing potential changes in exposure to operational risk, and methods applied for identifying and assessing operational risk undertaken which prevented reliable measurement of risks with higher impacts and a lower frequency. In addition, some institutions had not chosen suitable indicators for monitoring risk and capturing key factors which might change the institution's risk profile in terms of operational risk. Shortcomings in the allocation of responsibility for operational risk management were also identified.

**Examinations of IS/IT risk management**

In 2016, great emphasis was also placed on verifying IS/IT risk management standards. Examinations were conducted in four credit institutions in this area. In addition to the information security management system, comprising, for example, security of access to information systems, security monitoring and security incidents management, the examinations focused on topical issues and trends in this area. This included in particular the outsourcing of information technology and services, including cloud computing.<sup>19</sup> The CNB's expectations regarding cloud computing were set out in the form of official information in 2016.<sup>20</sup> Due to an increase in cyber crime and the level of sophistication of the attacks, the examinations paid increased attention to electronic distribution and information channels and IS development security.

The most serious shortcomings concerned insufficient analysis of IS/IT risks, unrecognised IT outsourcing and configuration of relationships with suppliers, management of security of access to IT systems, and segregation of conflicting roles in developing, testing and operating IT systems. The CNB continuously monitored and assessed compliance with remedial measures agreed in previous on-site examinations. As part of this process, meetings were held with the entities examined in order to bring their procedures into line with the CNB's expectations.

**Examinations of remuneration principles and procedures**

Examinations of the application of remuneration principles were conducted in three banks and one credit union in 2016. The examination team focused on the correct configuration of key performance measures for the measurement of flexible components of remuneration, which should incentivise proper risk management and take into account capital and liquidity costs. The process of identifying selected employees and contractual relationships with these workers, the manner of applying special remuneration principles and the disclosure of information about remuneration were also examined.

The most frequently identified shortcoming was the absence of an analysis of the institution's risk cycle, or insufficient incorporation of the analysis into the selected manner of applying the principles. Some institutions had not introduced special remuneration principles as part of their principles (or were not applying them to a sufficient extent in practice). These special principles include in particular the postponement of part of the variable component of pay, the provision of part of the variable component of pay in non-monetary instruments and the introduction of the option of taking back pay which has already been dispersed (clawback). Excessive influence of the parent company on remuneration processes and an inappropriate correlation between remuneration of employees and performance of the parent company were identified in one institution. Given the institutions' interest in these issues, numerous consultations were held between the CNB's authorised staff and individual credit institutions. The CNB provided interpretations of some aspects of remuneration, for instance regarding appropriate performance criteria. These should be linked as closely as possible to the worker's decisions, and the worker should have a direct influence on the fulfilment of them.

After the examinations, the institutions examined were in most cases called on to eliminate the shortcomings identified in the form of a supervisory call, and an administrative proceeding was opened in one case.

**Examinations in the area of conduct of business in the provision of investment and payment services**

Three on-site examinations in banks and two on-site examinations in credit unions were conducted in the conduct of business area in 2016. Of these, examinations in two banks and one credit union were completed in 2016.

In both credit unions and in one bank, the examinations focused on compliance with disclosure duties by payment service providers. The shortcomings detected consisted above all in the absence of mandatory information, the provision of information in a different manner than on a durable information medium, and incomprehensible (or ambiguous) information. Shortcomings were also found in the provision of information to clients without access to internet banking and in the provision of information about time limits for executing transactions, along with related shortcomings in the governance system.

<sup>19</sup> The provision of computer services (e.g. servers, storages, databases, networks and software) via the internet.

<sup>20</sup> Official Information of the Czech National Bank of 19 August 2016 regarding the pursuit of business in the financial market – cloud computing.

An examination was conducted in one bank focusing on checking compliance with the rules laid down in legal regulations connected with the duty to provide investment services with professional care and compliance with the rules for conduct of business in the provision of investment services. Shortcomings were identified in the maintenance of accounts and a transactions and orders book of an investment firm, the process for vetting a cooperating investment intermediary, the provision of information to clients and the storage of communications with clients and potential clients.

Further to these examinations, the credit institutions concerned took remedial measures, the implementation of which is being continuously monitored. Administrative proceedings were opened in one case.

***Examinations in the area of anti-money laundering and combating the financing of terrorism (AML/CFT)***

AML/CFT examinations are focused primarily on verifying the efficiency and effectiveness of the measures meant to protect the institution examined from being used for money laundering and terrorist financing and also to create conditions for detecting such conduct.

In 2016, 11 examinations were opened in banks and nine were completed. CNB representatives were also invited to join the inspection team of the Financial Analytical Unit at the Ministry of Finance, which launched an examination in one bank in 2016. One examination was opened and two completed in the credit unions segment. The shortcomings identified in credit institutions related mainly to the application of preventive measures in the implementation of international sanctions, the identification of the status of political exposure, client vetting, the identification of risk factors and the application of procedures against risky clients. The CNB called on the institutions examined to take remedial measures, the implementation of which is being continuously monitored.

The long-running supervisory collaboration between the CNB and the Financial Analytical Unit continued into 2016 and related mainly to an amendment of the AML Act<sup>21</sup> and the preparations for national risk assessment.

**4.1.4 Assessment of information from submissions made by members of the public in the conduct of business area**

In 2016, submissions made by members of the public again constituted a major source of information on compliance with the duties of credit institutions towards their clients for the purposes of off-site surveillance of compliance with the conduct of business duties of credit institutions.

The information obtained by the CNB in the course of dealing with submissions made by members of the public is used in the supervisory area in several ways:

- if any shortcomings are uncovered in the activities of a credit institution, the institution is notified of the shortcomings identified and called upon to provide information on remedial measures adopted or proposed. Based on such notifications, most shortcomings are then eliminated in the course of supervision by the credit institution bringing its internal procedures into conformity with the legal rules or the CNB's opinions contained in the notifications;
- in some cases, information obtained in the course of off-site surveillance is used as a basis for thematic surveys on the breadth of occurrence of a particular type of unlawful conduct in the financial market;
- based on its findings, the CNB identifies potential systemic shortcomings in the financial market or identifies problem areas where it deems it useful to prepare and publish interpretations to clarify or tighten particular legal provisions;

<sup>21</sup> Act No. 368/2016 Coll., substantially amending Act No. 253/2008 Coll., on certain measures against money laundering and terrorist financing (the amendment took effect on 1 January 2017).



- supervisory findings are also used in the preparation of legislative proposals and in the interpretation of existing legal rules;
- information from supervisory practice is also used in the selection of specific supervised entities or specific areas of their activity where the CNB deems it useful to conduct on-site examinations. On-site examinations subsequently check whether credit institutions are complying with remedial measures adopted on the basis of notifications of shortcomings identified or on the basis of an administrative decision;
- supervisory findings are used when assessing the credibility of persons proposed as senior officers and persons with qualifying holdings in credit institutions.

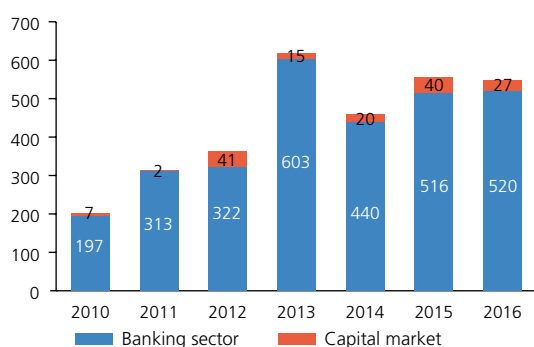
Information on particularly serious or systemic shortcomings is assessed and described in internal petitions for the opening of administrative proceedings.

In 2016, the CNB received broadly the same number of submissions from the public (547) regarding activities of credits institutions as in 2015 (556). Table A.4 shows the numbers of submissions received in 2012–2016 regarding activities of credit institutions.

**Table A.4 – Numbers of submissions received from members of the public in the conduct of business area in the credit institutions sector**

Financial market sector	Type of entity	2012	2013	2014	2015	2016	Change 2016/2015 (in %)
Banking sector	Credit institutions	322	603	440	516	520	+0,8
Capital market	Investment firms – banks	41	15	20	40	27	-32,5
Total		363	618	460	556	547	-1,6

**Chart A.1 – Numbers of submissions received from members of the public in the conduct of business area in the credit institutions sector**



Given the new payment system legislation and the resulting duties for credit institutions (e.g. changes to the basic payment account, the payment account switching procedure and the new payment services directive), an increase in the number of submissions made by members of the public can be expected in the future.



The submissions received by the CNB in 2016 from the public mainly concerned the provision of payment services, changes and terminations of master agreements on payment services, lending, the handling of clients' complaints, the provision of investment services, the provision of information to clients at their request and private law relationships between clients and credit institutions. The submissions in the area of building savings mostly concerned the termination of building savings contracts by building societies and the paying out of building society deposits.

In the credit institutions sector, as in previous years, particular attention was paid to the provision of payment services, the execution of payments and compliance with other duties under the Payment System Act.

Given the submissions made by the public, significant space was devoted in 2016 to credit institutions' procedures for proposing changes to master agreements on payment services (typically agreements on opening and maintaining a payment account). Investigations of some credit institutions' procedures for proposing changes to master agreements resulted in the preparation of Supervisory Benchmark No. 1/2016.<sup>22</sup> Its purpose was to draw the attention of credit institutions in the position of payment service providers to the correct procedure for proposing changes to a master agreement, especially as regards the statutory requirements for the content of a proposed change to a master agreement and the form of provision of the proposal.

When investigating submissions made by members of the public, it was also found that some credit institutions may not have a correctly configured system for dealing with clients' complaints. In order to draw credit institutions' attention to the importance of putting in place a system of rules for dealing with complaints, the CNB issued Supervisory Benchmark No. 2/2016<sup>23</sup> detailing the concept of an effective system of rules for dealing with complaints. This system ensures that complaints are properly recorded, investigated and dealt with and also contains control mechanisms to ensure that the procedures for dealing with complaints are complied with and, where necessary, remedial measures of a systemic nature are taken based on findings obtained during the investigation or analysis of complaints.

Based on findings obtained when examining submissions made by members of the public, a technical examination was conducted in 2016 concerning the setting and observance of time limits for executing foreign payment transactions (international payment transactions and foreign currency payment transactions) by banks, specifically the time limit within which a bank as a payer's provider is obliged to ensure that the amount of a payment transaction is credited to the account of the payee's provider. Banks eliminated the shortcomings identified in the thematic investigation by taking remedial measures based on a CNB notification.

In 2016, based on submissions from the public, the CNB also investigated the provision of information by credit institutions about their clients at the request of authorised entities (courts, law enforcement agencies, etc.). In this context, the CNB circulated a communication to all credit institutions calling on them to have their governance systems correctly configured to deal with applications for the provision of assistance to authorised entities. As a result, applications made by authorised entities for the provision of information should be dealt with in a timely and proper manner.

In addition to the there is described above, the CNB dealt with the following issues based on submissions made by members of the public in the conduct of business area: the configuration of credit institutions' governance systems in some specific areas, payment cards, the procedure for the termination of master agreements on payment services, banking secrecy, the procedure under the AML act, compliance with information duties to clients and transfers of contractual relationships.

In 2016, attention continued to be paid to building societies' procedures, especially those connected with the termination of building savings contracts.

22 Supervisory Benchmark No. 1/2016: Procedure for changing a master agreement on payment services, available at: [https://www.cnb.cz/cs/dohled\\_financni\\_trh/vykon\\_dohledu/dohledove\\_benchmarky/](https://www.cnb.cz/cs/dohled_financni_trh/vykon_dohledu/dohledove_benchmarky/).

23 Supervisory Benchmark No. 2/2016: Effective procedure of credit institutions for dealing with complaints, available at: [https://www.cnb.cz/cs/dohled\\_financni\\_trh/vykon\\_dohledu/dohledove\\_benchmarky/](https://www.cnb.cz/cs/dohled_financni_trh/vykon_dohledu/dohledove_benchmarky/).

#### 4.1.5 Enforcement

Seven new administrative enforcement proceedings were opened in the area of supervision of credit institutions in 2016. Nine decisions became final and conclusive: two decisions imposed remedial measures, one decision imposed a remedial measure and a fine, three decisions imposed fines, one decision revoked a banking licence and two administrative proceedings were discontinued. Fines totalling CZK 7,300,000 were imposed in the area of credit institutions.

#### 4.2 SUPERVISION OF INSURANCE COMPANIES

At the general level, the aim of CNB supervision in the insurance sector is to safeguard and maintain the financial stability of the sector and to protect policy holders, insured persons and beneficiaries. The CNB considers decisions on licence, permit and registration applications and prior consents under special legal rules, and especially the assessment of compliance with the current legislative and regulatory framework applicable in the Czech Republic, to be the key supervisory activities in this sector. To this end, the CNB obtains, verifies and, where necessary, enforces information provided by supervised entities. It is allowed to impose remedial measures, decides to impose sanctions if necessary, and is authorised to conduct administrative proceedings.

##### 4.2.1 Licensing, approval and authorisation activities

A total of 29 domestic insurance companies (excluding the Czech Insurers' Bureau) and one reinsurance company were subject to CNB supervision as of the end of 2016. A total of 24 branches of foreign insurance companies were subject to supervision by the CNB to a limited extent. The domestic insurance companies Wüstenrot pojišťovna, a.s. and Wüstenrot, životní pojišťovna, a.s. closed down in the Czech market in 2016 after merging with the successor company Allianz pojišťovna, a.s. One insurance company from the EU started operating under the single licence regime in the Czech Republic in 2016. It was Compañía Española de Seguros y Reaseguros de Crédito y Caución, S.A., odštěpný závod.

**Table A.5 – Numbers of entities in the insurance sector**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Insurance companies (including branches and reinsurers)	55	1	2	54
of which:				
domestic insurance companies (excluding the CIB)	31	0	2	29
branches of insurance companies from the EU/EEA	23	1	0	24
reinsurance companies	1	0	0	1

The CNB conducted 47 administrative proceedings in the insurance sector in 2016, seven of which were carried over from 2015. The CNB issued 44 administrative decisions, i.e. three administrative decisions have been carried over to 2017.

**Table A.6 – Numbers of administrative proceedings in the insurance sector**

Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Closed in 2016	Continuing into 2017
47	7	40	44	3

The structure of domestic entities operating on the Czech insurance market continued to simplify. In addition to the winding-up of the two Wüstenrot insurance companies, ING pojišťovna, a.s. applied for withdrawal of its licence. In this context, it was ordered to transfer its insurance portfolio to another insurance company. Travel insurance company ADRIA Way, družstvo, was authorised to transfer its insurance portfolio to UNIQA pojišťovna, a.s. before applying for withdrawal of its licence. In the case of these two insurance companies, the administrative proceedings concerning the withdrawal of their licences to carry on insurance activities had not been closed by the end of 2016.

The other proceedings concerned changes in the scope of permitted activities (Pojišťovna VZP, a.s., Slavia pojišťovna, a.s.), changes in the statute of the Czech Insurers' Bureau, changes in the maximum limit for the structure of financial placements (DIRECT pojišťovna, a.s. and UNIQA pojišťovna, a.s.) and consents to changes in members of insurance companies' bodies.

#### 4.2.2 Off-site surveillance

The CNB's supervisory activities in this sector generally focus on compliance with the prudential rules based on a reliable and functioning governance system. The main element of off-site prudential supervision of insurance companies is regular assessment of the financial condition and solvency situation of regulated insurance companies on the basis of regularly submitted statements. In 2016, the CNB drew on statements submitted in compliance with Solvency I and statements compiled in accordance with Solvency II for the purposes of analysing economic and technical insurance indicators. Ongoing communication with insurance companies, comprising information-gathering meetings with representatives of insurance companies, including board members, is an important part of supervisory work.

Timely identification of changes and potential risks to the financial condition of insurance companies is made possible by an early warning system which, on the basis of a regular quarterly assessment of selected indicators, monitors the financial results of insurance companies and allows negative trends and potential weaknesses in their finances to be identified in time. The facts identified are then analysed in detail and insurance companies are called on to take corresponding measures if any shortcomings are detected.

The specific scope of supervision of individual insurance companies is set, among other things, on the basis of their risk profile and the complexity of their activities. Regular assessments of the level of risk associated with insurance companies based on their financial and capital condition, the nature, scope and complexity of their risk exposures and the adequacy of their management and governance processes are conducted to this end. Analytical and other supervisory activities are performed at higher frequency and in greater detail for systemically important insurance companies and for high-risk entities.

The main factor affecting the focus and priorities of supervision of insurance companies in 2016 was the entry into effect of the Solvency II regulatory regime in September 2016. As the amendment to the Act did not enter into effect on 1 January 2016 as had been envisaged, the CNB extended the schedule gradual preparation for Solvency II applied in the previous two years to 2016. The aim of this extension was to ensure that insurance companies were fully prepared to fulfil the new regulatory requirements as of the date of effect of the amended Insurance Act. The combination of Solvency I and Solvency II placed increased demands on both insurance companies and supervisors.

Based on the information submitted and on continuous communication with insurance companies, the CNB assessed the implementation status and the degree of compliance with the new regulatory requirements under all three pillars<sup>24</sup> on which Solvency II is based. The important areas discussed with insurance companies as part of the implementation of the Solvency II requirements and emphasised by the CNB in its supervisory work included the methodology for calculating the best estimate of technical provisions, compliance with requirements for configuring the risk and key

<sup>24</sup> Quantitative requirements, supervision including qualitative requirements, disclosure of information and the submission of information to supervisory authorities.

function management system, and internal risk and solvency assessments. The CNB provided insurance companies with feedback in individual areas in a general form communicated at the sector or individual insurance company level. In specific areas where the preparations were assessed as insufficient or significantly delayed in some insurance companies, the CNB requested measures be taken and monitored progress with preparedness. To this end, an extraordinary information duty was imposed on some insurance companies.

In its supervisory work, the CNB continued to intensively monitor the motor third-party liability (vehicle liability) insurance market in 2016. As in previous years, the CNB paid increased attention to assessing premium sufficiency and the adequacy of technical provisions for covering all claims stemming from vehicle liability policies. In 2016, the CNB contacted all domestic insurance companies providing vehicle liability insurance, emphasising that they needed to enhance vehicle liability product management in order to fully maintain their ability to comply with their statutory duties in the long run. The CNB also specified the main principles, procedures, methods and criteria which the vehicle liability insurance management system should satisfy. The CNB will continue to assess in detail the effectiveness of the management of premium sufficiency. Owing to the persisting environment of low interest rates, the CNB continued to assess insurance companies' ability to generate investment yields in the medium term to cover guarantees arising from life insurance policies in 2016. The CNB is focusing mainly on the quality of risk management and asset and liability management systems in this area.

The CNB assesses the resilience of the insurance sector to adverse scenarios of future economic developments using stress testing once a year. Due to the participation of the Czech insurance sector in the European stress tests organised by the EIOPA, the CNB did not perform its own stress tests in 2016. The CNB supplied an additional stress scenario for the Czech insurance sector taking into account the specificities of the domestic insurance market. The stress tests assessed the impact of significant changes in risk parameters on the value of insurance companies' assets and liabilities according to Solvency II valuation as of 31 December 2015. EIOPA defined two stress scenarios – a double-hit scenario and a low for long scenario assuming a prolonged low interest rate environment. The double-hit scenario reflected general systemic risks to which the European financial system is exposed and combined them with a prolonged low interest rate environment. The low for long scenario assumed a situation of secular stagnation, concentrating on a drop in the risk-free rate curve, in particular for medium-term and long-term maturities. By contrast, the additional adverse scenario as defined by the CNB assumed growth in bond yields and an increase in the risk-free rate curve. Moreover, the CNB's adverse scenario tested the impact of motor vehicle insurance premium risk and the impact of floods. The aggregated results proved that the sector as a whole is sufficiently capitalised and is able to absorb major changes in risk factors even under Solvency II. The results of the stress tests of Czech insurance companies were also very favourable when compared with the EU results.

Owing to the mentioned major change in regulatory regime, i.e. the switch from the Solvency I rules to Solvency II, work on changing and adjusting supervisory processes, methodology and instruments continued in 2016. The key factors affecting the scale of these necessary adjustments include the strengthening of the risk-oriented and forward-looking approach and the overall change in the form and structure of regulatory reporting.

As regards conduct of business, the CNB focused mainly on the configuration of contractual relationships, the offering and promotion of services, the provision of information to, and conduct towards, clients, and the process of entering into, amending and terminating contractual relationships with clients. Conduct of business supervision in the insurance sector includes ongoing monitoring of compliance with rules of conduct, supplemented by a system of thorough investigation and handling of submissions received from the public and by thematic surveys focusing on the identification and elimination of systemic shortcomings in specific areas.

As part of its conduct of business supervision, the CNB continuously monitored the preparedness of insurance companies for the new requirements set out in the directly applicable PRIIPs regulation during 2016. Given developments in the legislative process at the EU level in the second half of 2016, when the European Parliament voted against the draft PRIIPs regulatory technical standards and the expected date of effect of the PRIIPs regulation was postponed by one year, i.e. until 1 January 2018, the CNB's further steps in mapping preparedness were shifted to 2017, when the amended version of the PRIIPs regulatory technical standards is expected to be approved.

In 2016, conduct of business supervision was also focused on the negotiation of supplementary products or services in combination with motor third-party liability insurance in terms of fair conduct towards clients. Cases where clients would not receive adequate pre-contract information or would be misinformed about the nature and characteristics of the services offered or where the products being negotiated would not be in line with clients' requirements and needs were identified as potentially problematic.

In 2016, the CNB continued to pay attention to insurance companies' compliance with the statutory reporting duty to the Czech Insurers' Bureau (CIP). The frequency and content of the information submitted to the CNB changed by comparison with previous years. Thresholds were set for the degree of error tolerated for compliance with the statutory duty as a criterion for the submission of quarterly reports and possible remedial measures. The CNB also continued to communicate with the CIB about further legislative developments relating to a possible amendment of the law governing the CIB's entitlement to the payment of contributions to the guarantee fund by uninsured entities. The CIB presented a proposal to the Czech Ministry of Finance for a possible revision under which entities that are not subject to the liability insurance duty should contribute to the guarantee fund. The CNB also monitored cooperation with the Czech Ministry of Transport and the experience with the new data exchange system.

The CNB also worked to attain effective supervision in the insurance sector by taking appropriate preventive and proactive action vis-à-vis supervised entities. To this end, it made several information-gathering visits to domestic insurance companies in 2016, focusing on conduct of business in selected areas. For the same reason, generalised supervisory findings were published on the CNB's website, specifically findings regarding the management of legal risk and the risk of financial losses connected with the termination of insurance by agreement and regarding health questionnaires submitted by insurance companies when concluding and amending insurance contracts. The CNB also published a public notice in 2016 pointing out the importance of health questionnaires when concluding or amending insurance contracts and some of the risks the public may face in this regard in the financial market. As part of conduct of business supervision, the CNB used the "Peníze na útěku" ("Money on the Run") internet project to educate young people on how the financial market operates and how to manage money.

#### 4.2.3 On-site examinations

Two partial on-site examinations and two standard examinations were carried out in insurance companies in the area of prudential supervision in 2016.

As regards vehicle liability insurance, the creation and application of technical reserves, the verification of premium sufficiency and the manner and process of determining premiums were assessed. The main findings included insufficient premiums and insufficient activity of the board of directors in this area. The examinations also revealed that insurance companies do not have in place sufficient processes, procedures and methods for determining and verifying premium sufficiency in vehicle liability insurance.

In the accounting area, the examinations focused mainly on the preparation of annual accounts, accounting receivables and payables, and the manner of allocating yields and costs and the accrual thereof. Inconsistent and unjustified accounting procedures and insufficient provisioning were identified in these areas.

The Solvency II on-site examinations focused on the setting of technical provisions and the solvency capital requirement, asset and liability valuation, governance systems, own risk and solvency assessment (ORSA) processes, and reporting and disclosure. Shortcomings were identified mainly in the organisation structure, conflicting duties, accumulation and configuration of responsibility, ORSA processes and the remuneration method. Shortcomings were also uncovered in the calculation of technical provisions and the capital requirement.

Further to the results of the examinations, insurance companies took remedial measures, the implementation of which is being continuously monitored. Some shortcomings are addressed in administrative proceedings against the insurance companies.

On-site conduct of business examinations were conducted in five insurance companies in 2016. Four of those examinations were completed in 2016.

Three of the examinations focused on external distribution network quality control. In all cases, shortcomings were identified in the extent of pre-contract vetting of a distributor and in distribution activity quality control during contractual cooperation with a distributor. In particular, insurance companies did not pay sufficient attention to the quality of records of potential clients' requirements and needs. Draft contracts and policies contained non-standard parameters relating to clients' needs (mainly a long insurance period with respect to the insured person's age and failure to respect clients' interest in pure investment or saving for retirement, for which investment life insurance is not a suitable product). Four examinations focused on the duty of insurance companies to act with professional care in loss adjustment, one of which was a follow-up check of the elimination of shortcomings identified in a previous examination in this area. The shortcomings concerned late registration of insurance losses, loss adjustment delays, justification of the amount of claims and traceability of control processes and internal regulations.

Further to the completed examinations, the insurance companies took remedial measures, the implementation of which is being continuously monitored. In one case, an insurance company declared the termination of the sale of a life insurance product through a branch within the territory of the Czech Republic with effect from 1 December 2016. In one case, a proposal to open administrative proceeding was filed with respect to shortcomings in the operational system preventing it from providing sufficient support to the loss adjustment service.

AML/CFT examinations are also conducted in insurance companies carrying on life insurance-related activities. In 2016, one examination was commenced in an insurance company carrying on life insurance, and two examinations were completed. The findings mainly concerned shortcomings in client vetting and the application of preventive measures in the implementation of international sanctions.

Further to these examinations, the entities examined took remedial measures, the implementation of which is being continuously monitored.

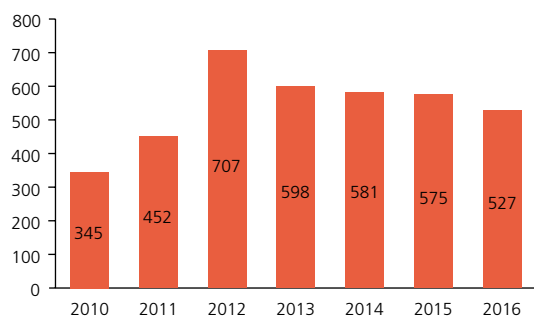
#### 4.2.4 Assessment of information from submissions made by members of the public in the conduct of business area

Comprehensive investigation of submissions from the public drawing attention to possible shortcomings in the conduct of business of supervised entities is an integral part of supervision of conduct of business in insurance companies and an important source of information. The investigation of submissions can lead to the CNB drawing systemic conclusions.

In 2016, the CNB received a total of 527 submissions from the public concerning the activities of insurance companies.

**Table A.7 – Numbers of submissions received from members of the public in the conduct of business area in the insurance sector**

Financial market sector	Type of entity	2012	2013	2014	2015	2016	Change 2016/2015 (in %)
Insurance	Insurance companies	707	598	581	575	527	-8,3

**Chart A.2 – Numbers of submissions received from members of the public in the conduct of business area in the insurance sector**

In 2016, the submissions from the public most often involved notifications of shortcomings in the activities of insurance companies relating to maladministration in dealing with claims and loss adjustment. Specifically, these shortcomings mainly concerned excessive duration of dealing with claims, insufficient information about the results, justification of the amount of claims and infringement of the duty to notify the client that the claim cannot be dealt with within the statutory time limit. The submissions made by the public also related to shortcomings in the management and control of insurance companies' distribution networks (especially in respect of the activities of the distribution network in the negotiation of insurance), shortcomings relating to changes to, and administration and termination of, insurance policies, and to failure to react, or delayed reaction, to clients' suggestions and complaints. In 2016, the submissions from the public mostly concerned vehicle insurance products, i.e. motor third-party liability insurance and vehicle accident insurance. Compared to the previous year, there was a higher number of submissions drawing attention to access by clients of individual sellers of consumer goods and services to the existing insurance contract between the insurance company and the relevant seller of consumer goods and services.

Investigations of the submissions received from the public identified shortcomings in the activities of insurance companies consisting in breaches of legal rules or the duty to act with professional care. Both individual shortcomings and repeated systematic shortcomings were identified. They were resolved on an individual basis with specific insurance companies.

The CNB used the findings obtained through examinations of individual submissions from the public when commenting on insurance legislation, above all the new Act on Insurance Distribution, and also when preparing and mapping insurance companies' preparedness for the new requirements for insurance products with an investment component.

#### 4.2.5 Enforcement

A further three administrative enforcement proceedings were opened in the area of supervision of insurance companies in 2016. Three decisions became final and conclusive, with remedial measures being imposed in two cases and the administrative proceeding being discontinued in one case.

### 4.3 SUPERVISION OF PENSION MANAGEMENT COMPANIES AND RETIREMENT FUNDS

As with other financial market sectors, supervision of pension management companies (PMCs) and retirement funds is based on assessment of compliance with the regulatory rules. This mainly includes PMCs' compliance with the capital adequacy requirements, sufficiency of the assets of transformed funds, compliance with investment limits by funds managed by PMCs and the accuracy of the accounting of PMCs' fees for the accounting period.

#### 4.3.1 Licensing, approval and authorisation activities

The CNB registered eight pension management companies, 27 participation funds and eight transformed funds at the end of 2016. The authorisation to establish retirement funds expired by law on 30 June 2016.<sup>25</sup> Upon expiry, all retirement funds were abolished and went into liquidation.

**Table A.8 – Numbers of entities in the pension management companies and retirement funds sector**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Pension management companies	8	0	0	8
Transformed funds	8	0	0	8
Retirement funds	20	0	20	0
Participation funds	27	0	0	27
Accredited entities <sup>i)</sup>	17	0	0	17

*i) Entities accredited to organise examinations of supplementary pension savings and retirement savings distributors.*

A total of 48 administrative proceedings were conducted by the CNB in the pension management companies and retirement funds sector in 2016. Decisions were made in all cases.

**Table A.9 – Numbers of administrative proceedings in the pension management companies and retirement funds sector**

	Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Closed in 2016	Continuing into 2017
Pension management companies and retirement funds	48	25	23	48	0
Accredited entities	3	0	3	0	3

At the start of 2016, the CNB conducted a large number of proceedings concerning changes in the statutes of participation and transformed funds associated with the amendment to the Supplementary Pension Savings Act (Act No 427/2011 Coll.) that took effect on 1 January 2016. This amendment enabled management fees to be increased. In 2016, consent to a change in the statute of a participation or transformed fund was granted in 39 cases (more than one change was made in several entities) and consent to a change in the pension plan of a transformed fund was given in five cases. The CNB granted prior consent to the discharge of office of director of a pension management company in four cases.

<sup>25</sup> For details, see Article 10(1) of Act No. 376/2015 Coll., on discontinuation of retirement savings.



### 4.3.2 Off-site surveillance

Off-site surveillance of pension management companies and funds managed by them was concentrated on assessing their compliance with the regulatory requirements, above all capital adequacy compliance by PMCs, i.e. whether they keep their capital above the capital requirement. As regards transformed funds, CNB supervision was focused on compliance with the duty to always cover liabilities with assets. Given the requirements for reliable monitoring of the capital requirement and continuous compliance with it by PMCs, appropriate configuration of the governance system in this area was also supervised. Given the persisting environment of low interest rates, the CNB focused mainly on the quality of risk management.

The CNB also focused on compliance with the legal and statutory investment limits for funds managed by PMCs and the accuracy of accounting of PMCs' fees for the accounting period. The CNB was involved assessing changes to the statutes of participation and pension funds after an amendment was made to the Act on Supplementary Pension Savings which changed the limit for the amount of remuneration for PMCs and the parameters of investment policy.

CNB supervisors also paid attention to the retirement fund liquidation process. Retirement funds went into liquidation on 30 June 2016. On 15 October, PMCs started to pay out planholders' savings in retirement funds. This process was completed by the end of 2016.

As regards off-site surveillance of conduct of business in PMCs, the CNB focused mainly on compliance with information duties to planholders and on PMCs' procedures and internal rules for dealing with planholders and procedures for concluding, amending and terminating contractual relationships between PMCs and planholders.

### 4.3.3 On-site examinations

Two on-site examinations were conducted in PMCs in 2016. The examinations concentrated on the governance system in respect of management of conflicts of interest, distribution quality management, and compliance and internal audit activities. Examinations were also conducted focusing on compliance with the rules and principles for the conduct of business in the management of assets of transformed and participation funds, the issuance and redemption of pension units, the setting of the current value of pension units, cooperation with a depository and the manner of concluding contracts on supplementary pension savings. One of the examinations also addressed prudential mechanisms in the management of assets of a transformed fund, investment risk management and the calculation of, and compliance with, capital requirements.

The examinations identified shortcomings in the control of outsourced activities, internal audit activities, risk management quality and risk management activities, where the scope of the activities failed to comply with the requirement for a proactive and forward-looking approach, the limit control system (ex ante and ex post), the product construction process and the identification of clients' requirements and needs. The examinations also revealed the use of a non-compliant investment questionnaire form, formal shortcomings in contractual documentation, shortcomings in the fund management process and shortcomings in the setting of remuneration for PMCs. The examinations also identified shortcomings in the content of marketing materials, which contained misleading or insufficient information.

Further to the completed examinations, the companies took remedial measures, the implementation of which is being continuously monitored. A proposal to open administrative proceedings was filed in one case. Further to the results of a 2015 examination, a proposal to open administrative proceedings against a pension management company was also filed in the period under review.

An AML/CFT examination was also opened in a pension management company in 2016. A large part of this examination was completed during the year. Shortcomings were identified in the application of preventive measures in the implementation of international sanctions, client vetting, the identification of risk factors and the application of procedures against risky clients.

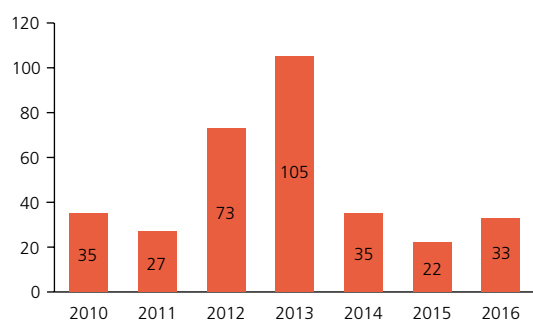
#### 4.3.4 Assessment of information from submissions made by members of the public in the conduct of business area

The CNB received a total of 33 submissions in the area of private pension schemes and supplementary pension savings in 2016. Retirement savings, the second pillar of the pension system, were abolished during 2016. Unlike in previous years, there were no massive migrations of planholders between PMCs and related negotiation and termination of private pension policies or supplementary pension savings.

**Table A.10 – Numbers of submissions received from members of the public in the conduct of business area in the pension management companies and retirement funds sector**

Financial market sector	Type of entity	2012	2013	2014	2015	2016	Change 2016/2015 (in %)
Pension management companies and retirement funds	Pension management companies	73	105	35	22	33	+50,0

**Chart A.3 – Numbers of submissions received from members of the public in the conduct of business area in the pension management companies and retirement funds sector**



Although submissions about private pension schemes executed by means of assets in transformed pension funds had outnumbered submissions about supplementary pension savings in most years, the latter predominated in 2016.

The most frequent submissions from the public concerned the provision of information to clients by PMCs and payments of benefits from private pension schemes or supplementary pension savings.

Based on the submissions received from the public, partial shortcomings were identified in activities pertaining to PMCs. These mainly concerned the provision of information to clients, the duty not to disclose information from private pension policies and the payment of funds from abolished retirement savings. Upon investigating the submissions made by the public, the CNB identified flaws in the internal information systems and limited functionality of the internal control systems of the relevant PMCs as the primary causes of these shortcomings. After the CNB notified them of the shortcomings identified, the PMCs in question took remedial measures to prevent such shortcomings from occurring in the future.

### 4.3.5 Enforcement

Four administrative enforcement proceedings were opened in the area of supervision of PMCs in 2016. No enforcement decisions became final and conclusive in 2016.

## 4.4 SUPERVISION OF INVESTMENT FIRMS

Supervision of investment firms is focused on conduct of business. The main sources of information for supervision in this segment of the financial market are transaction monitoring and examinations prompted by the public or other external entities. Off-site surveillance is supplemented where necessary by on-site examinations, both planned and unplanned. These are focused mainly on risky investment firms.

### 4.4.1 Licensing, approval and authorisation activities

At the end of 2016, the CNB registered 32 entities holding an investment firm licence. No investment firm licences were granted or expired in 2016. One licence expired due to a merger. The CNB received five notifications from foreign investment firms of the provision of investment services through a branch in the Czech Republic (all cases were non-bank investment firms).

**Table A.11 – Numbers of investment firms**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Investment firms	33	0	1	32
of which: banks	13	0	0	13
non-banks	20	0	1	19
Branches of investment firms	29	6	2	33
of which: banks	15	0	1	14
non-banks	14	5	0	19

In 2016, a total of 14 administrative proceedings conducted with investment firms were closed, of which three concerned a change in the investment firm licence (one application approved, two proceedings discontinued), three concerned prior consent to the discharge of office of director of an investment firm (two approvals, one proceeding discontinued) and eight were connected with consent to the acquisition of qualifying holdings in investment firms (consent granted in six cases, two proceedings discontinued).

**Table A.12 – Numbers of administrative proceedings conducted with investment firms**

Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Closed in 2016	Continuing into 2017
24	4	20	14	10

#### 4.4.2 Off-site surveillance

Numerous foreign investment firms authorised to provide cross-border investment services based on authorisations granted by their home supervisory authority carry on business in the investment service providers sector in the Czech Republic (1,812 entities held such authorisation as of 31 December 2016). These are mainly entities having their registered office in the UK (78%). The second largest group is made up of entities registered in Cyprus (9%). As part of its supervisory tools, the CNB shares its findings with home supervisory authorities concerning supervision of foreign entities carrying on business in the Czech Republic.

As regards the activities of foreign investment firms in the Czech Republic, concurrent notification of the provision of investment services through a branch and of cross-border provision of services is often a problem. In practice, this can lead to a situation where a foreign investment firm declares that no investment services are provided by its branch and that all investment services in the Czech Republic are provided by its headquarters abroad. Compliance with the prudential duties of foreign investment firms is supervised solely by the supervisory authority of the home Member State, while compliance with conduct of business duties is supervised by the supervisory authority of the host Member State as regards investment services provided through a branch in the territory of the state. However, as regards investment services provided by the investment firm's foreign headquarters or provided by a branch located in the territory of a state other than the host Member State, the host supervisory authority has only very limited powers. Such double notification thus gives rise to an unclear situation where the division of competences between the CNB and the supervisory authority of the home Member State is vague. The CNB has therefore long worked to enhance cooperation with supervisory authorities of home Member States based on sharing information about the true activity declared to the CNB by branches during the negotiations on the manner of compliance with regular information duties and the ensuing division of competences for supervision of compliance with conduct of business duties by foreign investment firms.

Another major problem in the capital market is a significant expansion in investment services relating to contracts for difference (CFDs) and binary options. Such services are offered mainly by foreign investment firms, most of them based in Cyprus. This means that speculation in investment instruments which are totally inappropriate for most non-professional customers is widely available in the Czech Republic. The services are offered on a cross-border basis, which means that supervisory competences in such cases fall to the home supervisory authority and the CNB's powers are very limited. Clients are often contacted by "introducing brokers". They collaborate with foreign investment firms but officially provide their clients with language or IT support or marketing services rather than investment services and it is very difficult to prove otherwise. The fact that such derivatives transactions are usually executed exclusively against the investment firm's own account is also giving rise to doubts. This, coupled with the fact that customers cannot verify the correctness of realisation prices from an independent source, is providing scope for unfair practices.

The CNB addressed this (then newly identified) problem back in 2014 by publishing a warning about the risks of investing in CFDs on its website. In 2015 the CNB published on its website an opinion on the provision of investment services for binary options, stating clearly that, given the nature of this instrument, investing in binary options will be inconsistent with the knowledge and experience of most non-professional clients. As the issue of non-compliance with the conduct of business rules in the provision of investment services relating to CFDs and binary options has reached EU-wide proportions, two ESMA working groups have been established to find a solution to this problem. The CNB was actively involved in these working groups in 2016.

#### 4.4.3 On-site examinations

Three comprehensive on-site examinations were completed in the conduct of business area in non-bank investment firms in 2016. These inspections were focused on verifying compliance with the rules laid down in legal regulations connected with the duty to provide investment services with professional care. They also assessed whether the rules for the conduct of business in the provision of investment services were being complied with. Last but not least, the examinations focused on capital adequacy and internal capital systems.

The examinations found shortcomings in the provision of information to clients, the obtaining and assessment of information about clients, client asset protection processes, capital adequacy, the internal capital system, traceability of control processes, the governance system and internal audit, compliance, information systems and the proper manner of checking investment intermediaries, and the transactions and orders book. Formal shortcomings, especially in the internal regulations of the companies, were also identified.

Further to the results of the completed examinations, the institutions examined took remedial measures, the implementation of which is being continuously monitored. An administrative proceeding was opened in one case.

In addition, a comprehensive on-site examination was conducted in a non-bank investment firm to verify compliance with the rules laid down in legal regulations connected with the duty to provide investment services with professional care and compliance with the related prudential rules. Failures were identified concerning the obtaining and assessment of information about clients, internal regulations and the internal governance system.

AML/CFT examinations were launched in four investment firms and completed in seven investment firms in 2016.

The main shortcomings concerned client identification and vetting, the application of preventive measures in the implementation of international sanctions and traceability of procedures. Although these shortcomings were not systemically important, the said companies were called upon to remove them and to take remedial measures, compliance with which is regularly monitored by the CNB.

#### **4.4.4 Assessment of information from submissions made by members of the public in the conduct of business area**

A total of 125 submissions from the public (complaints and enquiries) concerning conduct of business in the provision of investment services were received in 2016. Of these, 28 concerned the provision of investment services by bank investment firms and 97 concerned the activities of non-bank investment firms. These submissions can be divided into the following thematic categories:

- activities concerning administrative services provided to clients;
- the arrangement or settlement of transactions;
- compliance with contractual terms by investment service providers;
- provision of information before the use of an investment service or the execution of a transaction;
- provision of investment advice;
- unauthorised provision of investment services.

Submissions relating to administrative services include those concerning general services provided to clients and administration, such as dealing with clients' complaints, general communication with clients, the dividend payment process and withdrawals or deposits on trading accounts. Administrative services were the most significant category in terms of numbers of submissions from the public in 2016. The majority of the submissions pertained to foreign investment firms.

Other areas which recorded larger numbers of submissions in 2016 included compliance with the terms and conditions of contracts between investment firms and clients and the arrangement or settlement of transactions in accordance with clients' instructions. These complaints were mainly about delayed execution of, or failure to execute, clients' instructions, the operation of internet trading applications or platforms (the setting of prices at which clients' instructions were executed, whether the prices of investment instruments shown in the application are up-to-date,

temporary unavailability of the application, etc.). A large proportion of the submissions in this area concerned the activities of foreign investment firms.

A number of submissions drew attention to unauthorised business. This type of submission also usually concerned the activities of foreign companies or entities collaborating with foreign investment firms.

The provision of investment services by foreign investment firms was assessed as a major problem in the capital market area. The suggestions related to cases where foreign investment firms had provided notification of their intention to provide investment services in the Czech Republic through a branch as well as cases where investment services are provided on a cross-border basis based on notification. Of the total of 97 submissions regarding non-bank investment firms, 55 concerned foreign investment services. Compliance with the duties of foreign investment firms in the cross-border provision of investment services in the Czech Republic is supervised not by the CNB but by the supervisory authority of the home Member State, to which the CNB refers the complainant in its replies to complaints. The CNB may notify the supervisory authority of the home Member State that an entity supervised by it is not complying with the duties imposed by the Capital Market Undertakings Act.<sup>26</sup> Such notification can only be sent if the complaint contains relevant documentation of the foreign investment firm's conduct, which is not always the case.

### 4.4.5 Enforcement

Five administrative enforcement proceedings were opened in the area of supervision of investment firms in 2016. Five decisions became final and conclusive, with fines being imposed in two cases, remedial measures in two cases and conservatorship in one case. Fines totalling CZK 1,100,000 were imposed in the administrative proceedings.

## 4.5 SUPERVISION OF MANAGEMENT COMPANIES AND INVESTMENT FUNDS

In line with the CNB's *Long-term Supervisory Strategy*, supervision takes the form of off-site surveillance and on-site examinations. Supervision is concentrated mainly on funds managing funds from the public and on funds with a potentially significant systemic impact. Inspection work is focused on the configuration of governance systems, compliance with the rules of conduct of business for fund management and the fund investment fee structure.

### 4.5.1 Licensing, approval and authorisation activities

The CNB registered 27 management companies, 108 investment funds with legal personality (of which 27 autonomous investment funds) and 201 mutual funds at the end of 2016.

One new management company (Patria investiční společnost, a.s.) obtained a licence in 2016. Licences were granted to five autonomous investment funds,<sup>27</sup> three of which were new entities entering the sector. In the other two cases, licences were granted to non-autonomous investment funds in connection with their intention to switch to the autonomous regime. Two management companies (I.C.P. Czech, investiční společnost, a.s. and CLOVIS, investiční společnost, a.s.) and six autonomous investment funds terminated their activities at their own request.

<sup>26</sup> Act No. 256/2004 Coll.

<sup>27</sup> In 2016, a licence was granted to an autonomous investment fund and later revoked at its request.

**Table A.13 – Numbers of entities in the management companies and investment funds sector (active or newly licensed)**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Management companies	28	1	2	27
Branches of foreign management companies	1	0	0	1
Management funds with legal personality	92	33	17	108
of which: autonomous funds	29	4	6	27
Mutual funds	195	16	10	201
of which: standard funds	53	1	0	54
Depositories	5	0	1	4

In all, 113 administrative proceedings were conducted (and 98 decisions made) in the management companies and investment funds sector in 2016.

**Table A.14 – Numbers of administrative proceedings in the management companies and investment funds sector**

Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Closed in 2016	Continuing into 2017
113	27	86	98	15

In 2016, the CNB closed one proceeding to grant a management company licence, one proceeding on a change in the scope of a management company licence (a narrowing of the management company licence to exclude authorisation to provide investment services) and five proceedings to grant autonomous investment fund licences. Licences were revoked from two management companies and six autonomous investment funds at their own request due to a change in the line of business.

The largest number of closed administrative proceedings (34) concerned prior consent to the discharge of office of director of a management company or an autonomous investment fund (including a nominee) or a person discharging another office in a management company subject to the CNB's prior consent (28 consents and six proceedings discontinued). Decisions on granting consent to the acquisition of a qualifying holding in a management company or an autonomous investment fund were issued in 15 proceedings (11 consents granted and four proceedings discontinued). The other proceedings closed by issuing an affirmative decision were conducted in connection with the entry of a standard fund in the list of mutual funds (one proceeding), consent to a change in the statute of a standard fund (17 proceedings), authorisation to merge mutual funds (two proceedings), deletion of a depository from the list maintained by the CNB (one proceeding) and determination of comparability of a foreign investment fund with a special fund (five proceedings).

#### 4.5.2 Off-site surveillance

In its off-site surveillance work, the CNB monitors the activities of investment fund managers and their administrators, especially in terms of their capital quality, governance systems and other prerequisites for doing business. The CNB monitors the situation in the investment funds managed or administered by them mainly in terms of compliance with the portfolio management rules, especially compliance with investment funds' statutes, statutory limits, proper valuation of assets and the determination of the current value of capital. Another important area monitored is investor relations, especially as regards the provision of information to investors. CNB supervision is also concentrated on relations with depositories and distributors, which are a significant component of the fund infrastructure. Depositories

are a security element substituting for financial guarantee schemes with regard to funds. Since distributors have a major effect on sales of investment firms, inducements provided to clients by distributors are another significant area monitored, especially as regards conduct of business compliance in the sale of regular investment programmes.

The fund investment sector was affected by only partial regulatory changes in 2016. Supervisory attention was directed primarily at a new duty to maintain separate accounts for the investment portfolio in investment funds which are joint-stock companies with variable capital (SICAV) and which create no sub-funds. This regulatory change, along with the resolution of other major issues relating to accounting and its verification by statutory auditors (such as the introduction of accounting according to international accounting standards when investment fund securities are admitted to the regulated market), led to the establishment of cooperation with the Chamber of Auditors. This was focused specifically on the area of funds and should foster more effective communication and provide guidance for investment fund auditors who are not members of professional organisations themselves or through their managers.

### 4.5.3 On-site examinations

On-site examinations were conducted in two management companies in 2016. One examination focused mainly on the rules of conduct and principles of conduct of business in the management of investment fund assets, the issuance and redemption of units, the setting of the value of units, cooperation with the depository and the governance system in respect of management of conflicts of interest and distribution quality management and control, and compliance and internal audit activities. The examination found shortcomings in the control environment as regards the control of outsourced activities, shortcomings in internal audit activities, shortcomings in the limit control system (ex ante and ex post), insufficient regulation of fund management procedures and rules, and conflicts of interest and procedures in the management of alternative investment (real estate) in internal regulations.

The other examination concentrated on the governance system, with an emphasis on selected features, most notably management of conflicts of interest, compliance and internal audit activities, the systemic configuration of the investment fund management process, including compliance with investment limits, and the operation of the management company nominees model. The shortcomings identified again concerned the investment fund management process, shortcomings in internal audit activities and shortcomings in the governance system in the areas of promotion, control of delegated activities (outsourcing) and management of conflicts of interest.

Further to these completed examinations, the companies took remedial measures, the implementation of which is being continuously monitored.

AML/CFT examinations were started in four management companies and completed in five management companies in 2016.

The main shortcomings identified concerned client identification and vetting, the application of preventive measures in the implementation of international sanctions and traceability of processes. Although these shortcomings were not systemically important, the said companies were called upon to remove the shortcomings identified and to take remedial measures, compliance with which is regularly monitored by the CNB.

### 4.5.4 Assessment of information from submissions made by members of the public in the conduct of business area

In 2016, the CNB received 25 submissions from the public drawing attention to the activities of management companies and investment funds. The complaints and suggestions can be divided into the following categories:

- complaints about managers of funds for qualified investors; these were mainly cases where a counterparty to a transaction for the account of a fund for qualified investors had tried to use the CNB's supervisory activity as a means of achieving out-of-court settlement of a dispute. However, the CNB has no competence in this area and does not interfere in such disputes;



- enquiries resulting from a lack of information about certain elements of fund investment, for example guarantee schemes, or about exposure to market risk, where investors had not fully grasped the difference between saving and investing;
- a smaller proportion of the queries expressed reservations about the conduct of business. For example, complaints were made about excessive currency conversion during the redemption of units and about administrative requirements during the settlement of an estate.

#### 4.5.5 Enforcement

Two administrative enforcement proceedings were opened in the area of supervision of management companies in 2016. Four decisions became final and conclusive. Fines were imposed in three cases and a fine coupled with a remedial measure was imposed in one case. The fines imposed in the area of management companies and investment funds totalled CZK 3,050,000.

#### 4.6 SUPERVISION OF BUREAUX DE CHANGE

In 2016, the CNB also supervised bureau-de-change licence holders (i.e. the sector of entities authorised to carry on bureau-de-change activity other than credit institutions). Supervision of these entities mainly took the form of on-site examinations and local investigations. The identification of shortcomings was supported by submissions made by the public.

##### 4.6.1 Licensing, approval and authorisation activities

The CNB registered 984 bureaux de change as of 31 December 2015. In 2016, 41 bureaux de change were granted licences, while 38 terminated their activity. The CNB registered 987 bureaux de change as of 31 December 2016.

**Table A.15 – Numbers of bureaux de change**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Bureaux de change	984	41	38	987

A total of 44 administrative proceedings to grant bureau-de-change licences were opened in the bureau-de-change sector in 2016. An additional 36 administrative proceedings to revoke bureau-de-change licences were conducted in the sector at the request of the bureaux de change concerned.

##### 4.6.2 On-site examinations

Despite its low importance relative to other financial market sectors, the bureau-de-change sector is subject to a greater intensity of on-site examinations, due mainly to shortcomings identified in other supervisory activities (submissions from the public in particular) and the low quality of services provided by some bureaux de change. This is reflected in surges in media coverage of this sector. During its supervisory examinations, the CNB concentrated mainly on the proper provision of information to clients before transactions.

A total of 54 examinations were carried out and completed in 2016 (including the examinations started in 2015). As part of these examinations, 408 local investigations were conducted in individual bureaux de change. A further three examinations were opened in 2016.

The examinations identified persisting shortcomings in exchange rate lists, especially their mistakability with information about more favourable exchange rates. However, the CNB's ability to penalise such conduct is limited to a large extent by the possibility of subjective interpretation of the ambiguous legislation on this issue. The other significant set of shortcomings identified relates to pre-contract information and the proper communication of that information. Pre-contract information is either not communicated to potential clients at all or not provided in text form. It should be said in this regard that some bureaux-de-change have repeatedly drawn attention to the alleged ambiguity of the said legislation, under which they have no duty to provide their clients with a copy of the pre-contract information.

Further to examination findings, bureaux de change were called on to take remedial measures. Administrative proceedings to impose a fine were opened where major shortcomings were identified.

The examinations in bureaux de change also focused on AML/CFT measures. The most common findings included shortcomings in the system of internal policies and shortcomings relating to client identification and vetting.

In response to the above shortcomings identified during off-site surveillance and on-site examinations, the CNB prepared a draft amendment to the Act on Bureau-de-Change Activity.<sup>28</sup>

### **4.6.3 Assessment of information from submissions made by members of the public in the conduct of business area**

In 2016, the CNB dealt with 172 submissions from the public regarding bureau-de-change activities. The complaints concerned mostly disadvantageous exchange rates or commissions. Clients expect a bureau de change to offer the same exchange rate as that declared by the CNB, together with a zero or low commission. After having agreed to the conditions for the exchange transaction, they demand that it be cancelled and ask for their money back, but the bureau de change does not usually oblige.

The level of exchange rates and commissions is not regulated by law and the CNB has no power to interfere in these matters. An analysis of the submissions received from the public also reveals that the publication of more favourable exchange rates on the premises of the bureau de change seems to be a problematic issue, especially since such rates can be mistaken for the exchange rate list.

The most frequent shortcomings found in this sector in the investigation of submissions made by members of the public lie in the area of informing customers about exchange rates and commissions for services rendered. In the case of newly registered bureaux de change, supervisory calls were most frequently chosen to remedy shortcomings identified.

### **4.6.4 Enforcement**

A total of 43 administrative proceedings were opened in 2016 for violation of the Act on Bureau-de-change Activity. The CNB issued 42 final and conclusive decisions. Fines were imposed in 40 cases, a fine was imposed and a bureau-de-change licence withdrawn in one case, and a licence was revoked in one case. Fines totalling CZK 3,935,000 were imposed in this area. Nine on-site orders and fines totalling CZK 79,000 were also imposed in 2016.

<sup>28</sup> Act No. 277/2013 Coll. See section 2. *Regulation in the Czech Republic in 2016*.

#### 4.7 SUPERVISION OF OTHER SMALL FINANCIAL MARKET ENTITIES

Supervision of other small financial market entities comprises supervision of payment institutions, electronic money institutions, small-scale electronic money issuers and small-scale payment service providers (unless they are also investment firms). In addition, the CNB supervises investment and insurance intermediaries. It also supervises the activities of consumer credit providers and intermediaries who also provide or intermediate credit on the basis of a CNB authorisation, licence or registration.

##### 4.7.1 Payment service providers and electronic money issuers

In 2016, the CNB conducted supervision of payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers. An increase in the number of entities is still visible in the case of payment institutions and small-scale payment service providers, in line with the long-term trend in this sector.

At the start of 2016, the CNB registered 16 payment institutions. In 2016, three new entities (ComGate Payments, a.s., VIKIPID, a.s. and Investiční aukce, s.r.o.) were granted licences for the pursuit of business of a payment institution. Three branches of a foreign payment institution were established in the Czech Republic in 2016.

**Table A.16 – Numbers of payment institutions and electronic money institutions**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Payment institutions	18	3	1	20
Branches of payment institutions	9	3	0	12
Electronic money institutions	2	0	0	2
Branches of electronic money institutions	1	0	0	1

Nine administrative proceedings were completed in the payment system area in 2016. Seven concerned licences for the pursuit of business of a payment institution or a change thereto (five applications were approved and two proceedings were discontinued). The other two proceedings concerned withdrawal of registration of a small-scale payment service provider.

**Table A.17 – Numbers of administrative proceedings in the sector of payment institutions and electronic money institutions**

	Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Closed in 2016	Continuing into 2017
Payment institutions	13	2	11	9	4
Electronic money institutions	1	0	1	0	1

The CNB's supervisory activities in the sector of payment institutions and electronic money institutions focused mainly on monitoring compliance with the prudential rules, with the rules for protecting clients' funds and with private law as laid down by the Payment System Act. In 2016, the CNB focused mainly on small-scale payment service providers, whose importance in terms of the amount of payment transactions executed increases every year. Supervision of these entities took the form of both off-site surveillance and on-site examinations. In the case of other entities active in the payment system area, off-site surveillance was dominant.

**Off-site surveillance**

Compliance with disclosure duties by the supervised entities is the main source of information for prudential off-site surveillance. Entities in which shortcomings were detected in the conduct of surveillance were called on to remedy the shortcomings and adopt measures to prevent them from recurring. Where more serious or repeated shortcomings were identified, administrative proceedings were opened against these entities. The main shortcomings were miscalculated amounts of payment transactions, miscalculations due to incorrectly selected exchange rates and failure to submit data on the amounts of payment transactions within the set deadlines. Most of the shortcomings occurred in new entities and their number was not significant.

The business plans and requisites of the governance systems of entities applying for authorisation to operate as payment institutions were also evaluated as part of the surveillance work.

**On-site examinations**

A total of eight on-site examinations were performed and completed in small-scale payment service providers in 2016 (including those commenced in 2016). In addition, six examinations – including checks of compliance with the AML Act – were commenced in 2016.

In the payment system area, the most frequent shortcomings concerned pre-contract information duties and information duties vis-à-vis the CNB. As regards the application of the AML Act, the most frequent shortcomings pertained to the system of internal policies, failure to prepare evaluation reports within the set deadlines and shortcomings in the process of client identification and vetting.

Further to these examinations, the entities examined took appropriate remedial measures. In more serious cases, proceedings to impose a fine were opened against these entities.

**Submissions made by the public**

A total of 20 submissions from the public were dealt with in this sector in 2016. They pertained to various unfair practices in payment service provision and the charging of fees for payment services. In this segment, therefore, submissions from the public were a marginal source of information on the activities of the supervised entities.

**Enforcement**

Four administrative proceedings were opened in the payment system area in 2016. Five final decisions were taken. Fines were imposed in all five cases. The fines totalled CZK 2,210,000.

**4.7.2 Handlers of domestic banknotes and coins**

No proceedings to authorise the activities of a handler of domestic banknotes and coins were conducted in 2016 and the sector saw no changes compared to 2015.

**Table A.18 – Numbers of handlers of domestic banknotes and coins**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Handlers of domestic banknotes and coins	4	0	0	4

**Enforcement**

Two new administrative proceedings were opened pursuant to the Act on the Circulation of Banknotes and Coins in 2016. Seven decisions became final and conclusive. Fines were imposed in five cases, a remedial measure was imposed in one case and the administrative proceeding was discontinued in one case. The fines totalled CZK 1,050,000.

### 4.7.3 Consumer credit providers

In 2016, the CNB prepared intensively for the entry into effect of the new Act No. 257/2016 Coll., on Consumer Credit. As from its date of effect, i.e. 1 December 2016, the CNB started to accept applications for authorisation to provide and intermediate consumer credit and applications for accreditation to organise professional examinations. No authorisations under this Act had been granted by the end of 2016.

**Table A.19 – Numbers of administrative proceedings in the consumer credit sector**

	Opened in 2016	Closed in 2016	Continuing into 2017
Non-bank consumer credit providers	8	0	8
Independent intermediaries	27	0	27
Accredited entities	11	0	11

### 4.7.4 Insurance and investment intermediaries

In 2016, the CNB supervised insurance intermediaries, independent loss adjusters and investment intermediaries and their tied agents, the number of which continued to rise moderately in 2016. The CNB supervised this sector in the form of both off-site surveillance and on-site examinations. Numerous submissions made by the public served as an important source of information on the activities of the supervised entities.

#### **Off-site surveillance**

Off-site surveillance of this sector consists in continuous monitoring of the activities of supervised entities and evaluation of their compliance with the relevant legal rules and conduct of business rules. As in previous years, the CNB focused on proper compliance of supervised entities with information duties to clients in 2016. As regards insurance intermediaries, attention was focused on proper compliance with duties connected with the identification and recording of the requirements and needs of clients. Attention was also paid to the reasons given for recommending a product, including recommendations to “renegotiate”<sup>29</sup> existing insurance contracts. Furthermore, CNB supervision in this segment was focused on verifying the conformity of the data on supervised entities with the data given in the register maintained by the CNB and compliance with the reporting duty.

Entities in which shortcomings were detected in the conduct of surveillance were called on to remedy the shortcomings and adopt measures to prevent them from recurring. Where more serious or repeated shortcomings were identified, administrative proceedings were opened against these entities. Where insurance intermediaries were found to have been inactive for more than 24 consecutive calendar months, deletion of their entry in the register was initiated.

#### **On-site examinations**

A total of 44 examinations were performed and completed in insurance and investment intermediaries in 2016 (including those commenced in 2015). In addition, eight examinations had been commenced but not completed by the last calendar day of 2016. The examinations of insurance intermediaries acting as life insurance intermediaries also included checks of compliance with the duties set forth in the AML Act.

As regards insurance intermediation, the most serious shortcomings were detected in the areas of insufficient recording of the requirements and needs of clients and the reasons for the intermediary recommending a specific insurance product. In addition, changes in the data entered in the CNB register had not been announced, the reporting duty to

<sup>29</sup> Renegotiation means replacement of one insurance policy with another.

the CNB had been performed incorrectly and shortcomings were detected in the governance of a distribution network. In the context of compliance with duties pursuant to the AML Act, the most frequent shortcomings were errors in the system of internal policies, insufficient training content and maintenance of training registers, and failure to prepare evaluation reports within the set deadlines. As regards investment intermediation, the shortcomings registered most often pertained to compliance with the information duty to clients, the obtaining of information from clients and errors in the registration of contracts and orders maintained by investment intermediaries.

Further to these examinations, these entities were called upon to take appropriate remedial measures. In more serious cases, proceedings to impose a fine and remedial measures were opened against these entities (especially against insurance intermediaries).

#### ***Submissions made by the public***

In 2016, a total of 343 submissions from the public were dealt with in this sector. These drew attention to conduct by supervised entities which, according to the public, was in contravention of the legal rules. Over 80% of the submissions from the public concerned insurance intermediation. In this area, the submissions mostly pointed to shortcomings in investment life insurance, specifically disadvantageous (to clients) renegotiation of existing insurance products, the provision of incomplete or untrue information on the nature of insurance and its costs, conclusion of insurance in conflict with the requirements and needs of clients and the forging of signatures on insurance contracts.

The submissions in the area of investment intermediation pertained to various types of conduct, mostly late transmission of client orders, renegotiation of existing products, failure to provide information on the nature of a product or fees, conclusion of disadvantageous products in relation to clients' needs and the forging of clients' signatures on documents. Some submissions also pointed to unauthorised provision of investment services.

#### ***Enforcement***

A total of 30 new administrative enforcement proceedings were opened in the insurance intermediation area in 2016. A total of 40 decisions became final and conclusive. Fines were imposed in 13 cases, fines and remedial measures were imposed in eight cases, a fine was imposed and an entry in the register of insurance intermediaries was deleted in one case, fines were imposed and the administrative proceedings were partially terminated in two cases, remedial measures were imposed in five cases, entries in the register of insurance intermediaries were deleted in five cases, the administrative proceedings were terminated in five cases and a procedural fine was imposed in one case. The fines imposed in 2016 totalled CZK 6,585,000.

A total of 23 new administrative enforcement proceedings were opened in the investment intermediation area in 2016. In all, 17 decisions became final and conclusive. Fines and remedial measures were imposed in five cases, fines were imposed in five cases, fines were imposed and the administrative proceedings were partially terminated in two cases, an entry in the register of insurance intermediaries was deleted in one case and the administrative proceeding was terminated in one case. Fines totalling CZK 12,655,000 were imposed in the investment intermediation area in 2016.

### **4.8 SECURITIES ISSUES AND REGULATED MARKETS**

A total of 83 companies whose securities had been admitted to trading on the European regulated market (issuers of listed securities) were registered at the start of 2016.<sup>30</sup> Securities of 19 collective investment entities (funds for qualified investors, of which 17 were funds with variable registered capital and two were closed-end investment funds) and ten other issuers (bonds in eight cases – CZECHOSLOVAK GROUP, a.s., ČD Cargo, a.s., ČEPS, a.s., Česká zbrojovka, a.s., FINEP BARRANOV ZÁPAD, k.s., HB Reavis Finance CZ, s.r.o., J&T Global Finance VII, s.r.o., and MCI Venture Projects Sp. z o.o. VI S.K.A. – certificates in one case – GRAMEXO plc – and shares in one case – MONETA Money Bank, a.s.) were newly admitted to trading on a regulated market in 2016.

<sup>30</sup> Of these, securities of two issuers had only been admitted to a regulated market outside the Czech Republic.

Securities of eight issuers were excluded from trading. Five cases involved bonds excluded owing to redemption (ABS Jets, a.s., Československá obchodní banka, a.s., DAIREWA plc, Home Credit B.V. and ISTROKAPITAL CZ, a.s.) and three involved shares (Kofola S.A. and Imperial nemovitostní, UIF, a.s. at the decision of the issuer and Pivovary Lobkowicz Group, a.s., following a squeeze-out). A total of 104 issuers of listed securities were registered at the end of 2016.

**Table A.20 – Numbers of securities issuers, regulated market operators and settlement system operators**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Issuers of listed securities	83	29	8	104
of which: registered office abroad	20	2	3	19
listed solely abroad	2	0	0	2
Regulated market operators	3	0	0	3
Multilateral trading facility operators	2	1	0	3
Operators of settlement systems with settlement finality	3	0	1	2
Central depository	1	0	0	1

The number of licensed regulated market operators (RM-SYSTÉM, česká burza cenných papírů, a.s. (RM-S), Burza cenných papírů Praha, a.s. (BCPP) and Power Exchange Central Europe, a.s. (PXE)) remained unchanged from the previous year. The number of multilateral trading facility operators rose from two to three, as BCPP – START and RM-S – Volný trh were joined by 42 Financial Services, a.s., whose authorisation was expanded in May 2016. The number of operators of settlement systems with settlement finality (the RM-S transaction settlement system (SVYT), the CNB's short-term bond market system (SKD) and the Central Securities Depository Prague – CSDP (Centrální depozitář cenných papírů, a. s.)) remained unchanged from the previous year. The activity of central depository was performed by the CSDP.

The CNB conducted 60 administrative proceedings in the area of securities issues, securities registers and regulated markets in 2016. Most of the 52 decisions (46) concerned the approval of documents relating to new securities issues. The CNB issued three decisions in the area of takeover bids in 2016 (one consent to the publication of an obligatory takeover bid addressed to the shareholders of ENERGOCHEMICA SE, as well as one consent to the publication of an additional takeover bid and one prior consent to the adoption of a general meeting decision to transfer all remaining participating securities to the main shareholder, in both cases in relation to Pivovary Lobkowicz Group, a.s.). In addition, three decisions were issued in the area of market infrastructure (one approval of changes in the CSDP settlement system rules and two prior consents to the acquisition of a qualifying holding in a regulated market operator – PXE).

**Table A.21 – Numbers of administrative proceedings in the area of securities issues and regulated markets**

Number of administrative proceedings conducted in 2016	Continuing from 2015	Opened in 2016	Closed in 2016	Continuing into 2017
60	2	58	52	8

In the area of securities issues, 35 sets of final conditions for offers of securities were reviewed outside administrative proceedings in 2016. Regularly published reports were subject to standard inspections (inspections of annual and semi-annual reports of all issuers and detailed checks of the application of IFRS in annual accounts in five selected

issuers). Compliance with the duties of issuers of listed securities and related persons was supervised at the same time (notifications of shares in voting rights and directors' transactions). Shortcomings were communicated and remedy ensured.

In the area of regulated markets, the PSE rules (the rules for admission of securities of collective investment entities, the free market rules and the rules of the START market) and the CSDP rules (the settlement rules) were reviewed as part of off-site surveillance. As regards the PXE, consent to the acquisition of a qualifying holding was granted to European Energy Exchange AG and the entities from the Deutsche Börse group which control it. Involvement in supervising the central counterparty European Commodity Clearing AG, which operates on the PXE, continued in the form of an ESMA college (in accordance with EMIR<sup>31</sup>). Several exemptions from the clearing duty for intra-group transactions were granted in accordance with EMIR. Several examinations concerning RM-S and the CSDP were conducted on the basis of submissions. The transformation of the manner of settlement in RM-S aiming to ensure compliance with CSDR<sup>32</sup> was completed, and some minor issues regarding the maintenance of the central securities register and the legal entity identifier were addressed.

### **Enforcement**

A further seven administrative enforcement proceedings were opened in the securities issuance area in 2016. A total of seven decisions became final and conclusive. Fines were imposed in all seven cases. Fines imposed in the securities issuance area totalled CZK 2,420,000 in 2016.

## **4.9 SUPERVISION-RELATED NOTIFICATION, REGISTRATION AND INFORMATION ACTIVITIES**

### **4.9.1 Notifications (under the single licence)**

#### **Outbound notifications**

Four domestic banks had branches in Slovakia as of 31 December 2016. Three domestic insurance companies had branches in Slovakia and one had a branch in Poland. Eleven domestic banks and 20 domestic insurance companies were providing services without establishing a branch within the territory of host EU Member States at the end of 2016.

The investment firm 42 Financial Services, a.s., provided notification of its intention to operate in Poland via a branch. By contrast, the investment firm HighSky Brokers, a.s., provided notification of the closure of its branch abroad (also in Poland). Under the freedom to provide services in the EU, the investment firm NN Investment Partners C.R., a.s., expanded its provision of investment services to Hungary and Romania, 42 Financial Services, a.s., expanded its provision of investment services to Croatia and HighSky Brokers, a.s., provided notification of its intention to operate in France and Poland.

The payment institution AKCENTA CZ, a.s., provided notification of its intention to operate in Germany, and the payment institution Global Payments, s.r.o., provided notification of its intention to operate in a further 23 host EU Member States under the freedom to provide services. The payment institution PayU Czech Republic, s.r.o., terminated its cross-border activities in host EU Member States owing to the termination of its activities as a payment institution.

Outbound notifications (or changes thereto or termination thereof) were dealt with for 4,597 insurance intermediaries residing or having their registered office in the Czech Republic.

31 Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

32 Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the EU and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012.



**Inbound notifications****Table A.22 – Numbers of cross-border service provision notifications**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Credit institutions <sup>i)</sup>	388	30	8	410
Electronic money institutions	61	37	3	95
Insurance companies <sup>i)</sup>	805	88	16	877
UCITS funds	1,199	100	49	1,250
AIFs (excluding EuVECAs and EuSEFs <sup>ii)</sup> )	93	67	42	118
EuVECAs <sup>iii)</sup>	14	7	6	15
Management companies	48	2	2	48
Investment service providers	1,718	154	60	1,812
Payment institutions	300	57	11	346
Institutions for occupational retirement provision	1	0	0	1
Insurance intermediaries	5,802	403	208	5,997

i) In the insurance and banking sectors, insurance companies and banks and their branches operating in other EU/EEA countries provide notification.

ii) AIFs: alternative investment funds (special funds and funds for qualified investors); EuSEFs: European social entrepreneurship funds.

iii) EuVECAs: European venture capital funds.

The CNB received 179 notifications of the approval of securities prospectuses (or amendments thereto) for the purposes of public offers in the Czech Republic or admission to trading on a regulated market from foreign supervisory authorities.

**4.9.2 Registrations, representations of banks and financial institutions****Table A.23 – Numbers of registered and listed entities**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Registered representations of foreign banks <sup>i)</sup>	14	2	1	15
Investment intermediaries	7,464	22	146	7,340
Tied agents	26,660	6,583	6,631	26,612
Small-scale payment service providers	118	26	6	138
Small-scale electronic money issuers	7	5	0	12
Entities authorised to distribute pension products:				
investment intermediaries	112	13	3	122
non-bank investment firms	1	0	0	1
bank investment firms	5	1	0	6
tied agents	8,152	2,513	1,007	9,658
tied agents of pension management companies	8	0	0	8
Insurance intermediaries and ILAs <sup>ii)</sup>	163,224	6,011	1,140	168,095
Tied agents (consumer credit)	0	3,505	0	3,505
Intermediaries of specific-purpose consumer credit	0	0	0	0

i) Registration of a representation of a foreign bank pursuant to Article 39 of Act No. 61/1993 Coll., on the CNB, does not entitle it to carry on business in the Czech banking sector, but only entitles it to promote the services of its head office in the Czech Republic.

ii) The figure does not include foreign intermediaries listed in the register due to notifications of insurance intermediation from another EU/EEA Member State.

In 2016, the CNB made entries in the register of persons conducting asset administration comparable to asset management pursuant to the Act on Management Companies and Investment Funds (Act No. 240/2013 Coll.) at the request of those persons. In all, 28 persons were entered in the register as of the end of 2016.

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 and higher level of competence. In all, 436 candidates took these examinations in 2016 and 402 passed.

#### 4.9.3 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 information requested. In 2016, the CNB conducted oral proceedings with liquidators, provided consultations and opinions on liquidation processes and provided information and documentation on the requests of courts and law enforcement agencies.

**Table A.24 – Numbers of financial market entities in liquidation**

	As of 31 December 2015	Entries 2016	Exits 2016	As of 31 December 2016
Banks	3	2	0	5
Credit unions	8	0	3	5
Insurance and reinsurance companies	0	0	0	0
Management companies	5	0	2	3
Investment funds	11	0	0	11
Mutual funds	7	8	6	9
Pension management companies	0	0	0	0
Investment firms	0	0	0	0
Total	34	10	11	33

The number of financial market entities in liquidation monitored by the CNB was down by one year on year at the end of 2016. Eleven entities – three credit unions, two management companies and six mutual funds in liquidation – ceased to be subject to CNB supervision as a result of the completion of liquidation and the subsequent deletion of the entities from the Companies Register. In 2016, one entity returned into liquidation after its bankruptcy had been cancelled, namely Česká banka, akciová společnost Praha – v likvidaci. One bank (ERB Bank, a.s.) also went into liquidation. Furthermore, eight mutual funds went into liquidation (Florida Opportunity Fund uzavřený podílový fond, AMISTA investiční společnost, a.s.; 11. Zajištěný fond kvalifikovaných investorů České pojišťovny a.s., otevřený podílový fond Generali Investments CEE, investiční společnost, a.s.; 12. Zajištěný fond kvalifikovaných investorů, otevřený podílový fond Generali Investments CEE, investiční společnost, a.s.; 13. Zajištěný fond kvalifikovaných investorů, otevřený podílový fond Generali Investments CEE, investiční společnost, a.s.; První lesnický otevřený podílový fond DELTA Investiční společnost, a.s.; 16. Zajištěný fond kvalifikovaných investorů, otevřený podílový fond Generali Investments CEE, investiční společnost, a.s.; 10. Zajištěný fond kvalifikovaných investorů, otevřený podílový fond Generali Investments CEE, investiční společnost, a.s.; 14. Zajištěný fond kvalifikovaných investorů, otevřený podílový fond Generali Investments CEE, investiční společnost, a.s.).

In accordance with Article 10(1) of Act No. 376/2015 Coll., on Termination of Retirement Savings, licences to establish retirement funds expired on 30 June 2016. As a result, all 20 retirement funds went into liquidation. Each of the five pension management companies (ČSOB Penzijní společnost a.s.; Allianz penzijní společnost, a.s.; Česká spořitelna – penzijní společnost, a.s.; KB Penzijní společnost, a.s.; Penzijní společnost České pojišťovny, a.s.) liquidated four mandatory retirement funds (government bond retirement fund, conservative retirement fund, balanced retirement fund and dynamic retirement fund). At the start of the liquidation process, the CNB registered total assets of

CZK 3,408.8 million and a total number of participants of 84,529 in all the 20 retirement funds in liquidation. Pension management companies paid out the retirement savings participants' funds between 15 October and 31 December 2016 under the CNB's oversight. All the participants' funds had been paid out as of the last calendar day of 2016.

#### 4.9.4 Provision of information under Act No. 106/1999 Coll., on Freedom of Information

The CNB is an obliged entity under Act No. 106/1999 Coll., on Freedom of Information, as amended. It provides information pursuant to this Act by way of disclosure of obligatorily provided information on its website and also to applicants on the basis of individual applications lodged under this Act.

##### **Statistics**

In 2016, the CNB received a total of 51 applications under Act No. 106/1999 Coll. and issued 13 decisions refusing applications. Two appeals were filed against decisions to refuse to provide information. In one case, the CNB Bank Board overturned the first-instance decision, terminated the administrative proceedings and decided to provide the information requested.

The numbers of applications received in 2011–2016 show the public's continued high interest in information about the CNB's areas of responsibility.

##### **Focus and content of applications**

**Table A.25 – Numbers of applications under Act No. 106/1999 Coll.**

	2011	2012	2013	2014	2015	2016
Number of applications received	19	26	60	59	53	51

As in previous years, the applications pertained to a broad and diverse range of information which cannot be narrowed down to typical categories with regard to the numbers of applications given above. The applications and queries received from the public often concern statistics, the balance of payments, international reserves, the Czech currency and circulation of banknotes and coins. Applicants are also interested in licensing and enforcement proceedings conducted by the CNB and specific supervisory investigations.

As regards conduct of business supervision, the nature of the matter is such that an application filed under Act No. 106/199 Coll. may also be perceived as a suggestion from the public for supervision. Although some applications are not directly a suggestion, they may relate to supervision, for example when an applicant uses an application under Act No. 106/1999 Coll. to ascertain how their own suggestion or complaint has been dealt with, or enquires about additional circumstances of specific supervisory actions.

Information provided on the basis of individual applications under Act No. 106/1999 Coll. is available in the relevant section of the CNB website.<sup>33</sup>

#### 4.9.5 Cross-border activities – applications for fit and proper assessments<sup>34</sup>

When performing its duties, the CNB works in cooperation with the central banks of other countries, with foreign financial market supervisory authorities and with international organisations engaged in financial market supervision.

<sup>33</sup> [http://www.cnb.cz/cs/o\\_cnb/106/106\\_poskytnute/index.html](http://www.cnb.cz/cs/o_cnb/106/106_poskytnute/index.html) (in Czech only).

<sup>34</sup> Assessments of the trustworthiness, competence and experience of persons working for financial services providers.

In 2016, the CNB dealt with 35 applications for assessments of the trustworthiness, competence and experience of persons working for financial services providers, submitted by 16 foreign authorities.

**Table A.26 – Numbers of applications from foreign regulators**

	2014	2015	2016
Number of applications received	23	29	35

#### 4.9.6 Central Credit Register

The Central Credit Register (CCR) is an information system administered by the Czech National Bank since 2002 which enables banks and foreign bank branches operating in the Czech Republic (banks) to share information on the credit commitments and payment discipline of businesses. It also provides additional information about the foreign credit commitments of legal entities borrowing in selected EU countries. While the individual data are used mainly by users from banks to assess potential and existing clients, aggregated outputs for the banking sector and the main groups of banks are used to analyse the banking sector. Besides users from banks, they are available to selected users from the CNB for the purposes of banking supervision and financial stability.

In addition to its core functions, the CCR is a source of information and inspiration for the development of new granular data collection systems. As in the previous year, transmissions of anonymised data to the ECB took place in the preparatory phase of AnaCredit (Analytical Credit Datasets). Experience with client registration in the CCR was taken into account in the preparation of a new version of the RIAD database, which will ensure, among other things, unambiguous identification of counterparties (such as entities borrowing in the Czech Republic) in AnaCredit.

The development of new output modules and reports scheduled to go live during 2017 continued in 2016.

**Table A.27 – Main operational characteristics of the Central Credit Register**

	31 December 2013	31 December 2014	31 December 2015	31 December 2016
Number of registered borrowers	611,885	621,716	628,436	630,549
of which: natural persons (entrepreneurs)	339,730	338,394	336,897	331,540
legal entities	272,155	283,322	291,539	299,009
Total volume of loans outstanding (CZK billions)	1,508	1,568	1,617	1,607
Number of CCR users	2,836	2,151	2,146	2,259
Ad hoc enquiries about credit commitments (thousands per year)	234	285	285	299
Number of enquiries about client credit commitments in monthly reports (thousands per year)	3,759	4,300	4,292	4,215
Number of extracts made for clients per year	520	499	423	536

Clients are entitled to ask for extracts of information kept on them in the CRC. In 2016, most of the applications (87.5%) were dealt with using data boxes. In addition, the rules for applying for an extract were simplified in 2016.

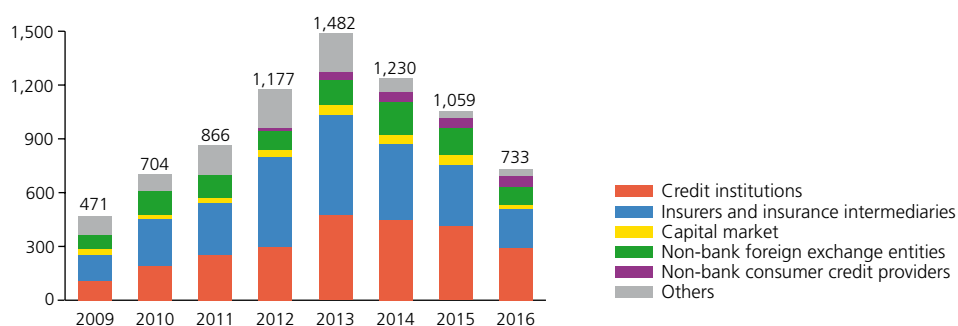
### 5. SUPERVISION OF COMPLIANCE WITH CONSUMER PROTECTION REGULATIONS

Supervision of compliance with the obligations laid down in the Consumer Protection Act<sup>35</sup> primarily involves supervision of compliance with the prohibition of unfair business practices, compliance with the duties and rules for the provision of information about the prices of services and compliance with the prohibition of discrimination against consumers. Attention is also paid to compliance with the obligations set out in the Civil Code,<sup>36</sup> which pertain mainly to distance contracts for financial services and the provision of consumer credit. CNB supervision in these areas is performed in the form of off-site surveillance and on-site examinations. The main sources of information are submissions made by the public and monitoring of the activities of supervised entities via their websites and other publicly available information, especially with regard to changes in legal rules.

#### 5.1 ASSESSMENT OF INFORMATION FROM SUBMISSIONS MADE BY THE PUBLIC IN THE CONSUMER PROTECTION AREA

The CNB received 733 submissions in the consumer protection area in 2016.<sup>37</sup> As in previous years, submissions concerning banking and insurance dominated. A relatively large number of submissions about non-bank foreign exchange entities were also received, although a falling trend can be observed compared to previous years. The number of submissions about non-bank consumer credit providers increased.

**Chart A.4 – Numbers of submissions received in the consumer protection area (by sector)**



#### 5.1.1 Credit institutions

A total of 292 consumer submissions relating to credit institutions were received. As in 2015, a large proportion of the submissions pertained to the payment system area. Most cases concerned consumers' failure to understand or become sufficiently acquainted with the bank's terms and conditions and contractual documents. In some cases, however, improved and simplified information and documents were recommended by the CNB and accepted by banks. As regards fees, the CNB received complaints about the unjustified charging of fees for gambling on a website. Investigations revealed that fees had been introduced in the area of gambling, betting and lotteries for transactions on unsecured terminals.

<sup>35</sup> Act No. 634/1992 Coll.

<sup>36</sup> Act No. 89/2012 Coll.

<sup>37</sup> If a submission pertains to an area where consumers can seek compensation in a private law dispute, they are referred to the Office of the Financial Arbitrator, where they can pursue their claims further.

After receiving submissions from consumers about shortcomings in the information provided by banks on savings accounts in the event of a change in interest rate bands or limits, the CNB conducted a comparison of the basic savings accounts of selected banks. The investigation focused on the extent, completeness and clarity of the information provided on the banks' websites. It found that the supervised entities provided all the necessary product information via their websites, and only in isolated cases was the manner of presentation less clear or more effort was needed to find the product terms and conditions. The parameters of this product were set in a very similar, if not identical, manner across all the banks investigated. No shortcomings in the form of providing insufficient/misleading information on savings accounts were identified in any of them.

In some cases, a problem was addressed concerning a credit institution's requirement that a client without permanent residence in the Czech Republic should establish a correspondence address in the Czech Republic when applying to open an account. This requirement is a problem for persons whose permanent address is outside the Czech Republic. The CNB dealt with this problem mainly from the perspective of possible discrimination and non-compliance with the EU accession treaties. The supervised entities responded by amending their procedures.

### 5.1.2 Insurance

A total of 217 submissions concerned the insurance sector. In 2016, the most frequent submissions concerned the provision of information about life insurance products by insurance companies and insurance intermediaries. When examining these submissions, the CNB focused on compliance with information duties by insurance companies during both the negotiation and the existence of a life insurance policy. Issues with the renegotiation of life insurance policies persisted. When evaluating possible unfair practices of insurance companies in the area of life and non-life insurance claims, the CNB examined whether insurance companies had investigated insured losses without undue delay and whether they had asked the client to provide additional documents in order to delay payment of the claim, thereby (de facto) preventing the consumer from exercising his rights. Several submissions stated that an insurance intermediary had provided insufficient information before contracts were concluded. In these cases, however, the CNB faced the fact that consumers often pointed to this type of shortcoming with a long delay without having made a complaint to the insurance company about having received insufficient information from the intermediary, so it was usually too late to file a proposal to open administrative proceedings. Consumers also received explanations in cases of complaints about the amounts of claim payments or enforcement of premiums owed.

The period under review saw an increased number of consumer complaints about an insurance company refusing to pay claims. These were situations in which consumers had purchased electronic devices with cover against accidental damage to the device. When they made claims, however, the company rejected them, stating that the damage was not caused as a "functional defect (mechanical, electronic or electrical) caused by the sudden and unexpected action of external forces". As part of the remedial measures, the insurance company trained the persons who offer and sell insurance protection in the form of accession to master insurance contracts or as intermediaries. The training was focused on providing a detailed explanation of the difference between insurance against accidental damage and insurance of an extended warranty on purchased goods, with an emphasis on ensuring that the information provided to clients was in line with the actual content of the insurance cover and on amending the contract documents in this context.

### 5.1.3 The capital market

A total of 24 consumer submissions relating to the capital market were investigated. As in the previous period, most of them were notifications of shortcomings in the provision of information about the risk unit and nature of products offered. They also pointed to possible unauthorised provision of investment services or collection of funds from the public for the purposes of joint investment by a natural person.

### 5.1.4 Non-bank foreign exchange entities

A total of 101 submissions concerning the actions of employees of non-bank foreign exchange entities were received in 2016. This represented a slight decrease compared to 2015. Consumers – especially foreigners visiting the Czech Republic – complained about exchange rates and fees for currency purchases. Although exchange rates are given on exchange rate lists and contained in pre-contract information, the amounts provided in exchange do not meet consumers' expectations and are the most frequent source of complaints. The CNB tightened up its examinations in this area.

### 5.1.5 Submissions concerning non-bank consumer credit providers

The CNB received 60 submissions about the activities of non-bank consumer credit providers. These submissions were mainly general enquiries about applications to obtain authorisation to provide and intermediate consumer credit, enquiries regarding the application of duties pursuant to the Consumer Credit Act and requests for information on how a consumer should proceed to get his entry in a register of debtors deleted. Notification of fraud in the form of enforcing a payment before the provision of credit was also registered. As these cases often concerned cash consumer credit, where the CNB did not have supervisory competences under public law, the submissions were forwarded to the Czech Trade Inspection Authority for further investigation.

## 5.2 ON-SITE EXAMINATIONS CONNECTED WITH CONSUMER PROTECTION

Twelve on-site examinations were conducted or commenced in 2016, eight of which pertained to insurance intermediaries, one to a bank, one to a bureau-de-change operator, one to a branch of a foreign insurance company and one to a credit union. As regards insurance, the most frequent shortcomings detected were in the area of informing customers about the nature of life insurance (the presentation of investment-linked life insurance as a form of saving) and the costs of life insurance products, policy renegotiation and, for the first time, the provision of insufficient information about the options for out-of-court resolution of consumer disputes by supervised entities.

Depending on the seriousness of the findings, the entities concerned took remedial measures. Proposals to open administrative proceedings were prepared and filed in some cases.

## 6. INTERNATIONAL COOPERATION

In 2016, the CNB continued to be actively involved in the activities of European and international institutions engaged in financial market regulation and supervision. It drafted opinions on proposals of new rules and its representatives promoted its position in negotiations of the strategic bodies, expert committees and working groups of these institutions. Of particular importance was cooperation within the European Supervisory Authorities, in which the CNB was involved in the preparation of numerous other technical standards and guidelines for directives and regulations, including CRD IV, CRR, BRRD, Solvency II and MiFID II. Ongoing cooperation with other national supervisory authorities of EU Member States within supervisory colleges for banking and insurance groups is also becoming increasingly important.

### 6.1 COOPERATION WITHIN THE EUROPEAN SUPERVISORY AUTHORITIES

#### *European Banking Authority (EBA)*

In 2016, the CNB was actively involved through its representatives in the activities of the EBA at the level of the Board of Supervisors, the Management Board, standing committees and most expert working groups.

In 2016, the EBA continued to carry out its main task to create the European Single Rulebook. The regulatory area saw ongoing preparation of level-three regulations in accordance with CRD IV/CRR, BRRD and other EU legal acts, including the directives on deposit guarantee schemes (DGSD), payment services in the internal market (PSD<sup>38</sup>) and credit agreements for consumers relating to residential immovable property (MCD).

In 2016, the EBA completed and submitted to the Commission a total of twelve draft regulatory and implementing technical standards on methodologies for identifying global systemically important banks, validating internal credit risk models and calculating market risk in internal models. The standards contained, among other things, rules for mapping credit quality steps to the credit assessments of rating agencies, rules for assigning risk weights to specialised lending exposures, remuneration rules for the offering or providing of services to clients, the consultation process between supervisory authorities for acquisitions of qualifying holdings in credit institutions and rules for evaluating preferential treatment of cross-border intra-group flows for the purposes of the liquidity coverage requirement (LCR). In the payment system area, the standards concerned for example, cooperation and exchange of information between the competent authorities of home and host Member States in the area of passporting under PSD2.<sup>39</sup>

The CNB also actively participated in the preparation and subsequent translation of twelve EBA guidelines. These regulations mainly concerned remuneration policies, supervisory authorities' internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP) under the supervisory review and evaluation process (SREP) and the provision of summary information for resolution purposes. The guidelines also focused on stress testing of deposit guarantee schemes and cross-border cooperation agreements between deposit guarantee schemes in the EU. The guidelines also contained a detailed specification of indicators for the identification of global systemically important banks and disclosure rules for systemically important institutions in the areas of risk management and capital requirements.

The CNB was also involved in the preparation of EBA reports, opinions and replies in consultations of the Commission, the Council, the European Parliament and other EU bodies, especially as regards MREL,<sup>40</sup> the assessment of the

38 Payment Services Directive.

39 Directive 2015/2366 (EU) of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC. Compared to PSD, market and technological developments and security requirements have been newly taken into account, the scope of the Directive has been extended in both territorial and currency terms, and consumers' rights as regards transfers of funds outside the EU have been strengthened. The Directive reacts to the development of innovative digital payment services and contains new areas relating to the provision of cardless internet electronic payments. It also places higher requirements on payment service providers as regards internet payment security and client authentication.

40 Minimum requirement for own funds and eligible liabilities.



implementation of IFRS 9, the possible introduction of prudential requirements for investment firms under CRR, the functioning of supervisory colleges, the comparison of remuneration policies in EU countries and the setting of the leverage ratio.

In 2016, the EBA conducted a peer review focusing on evaluating the implementation of EBA implementing technical standards on supervisory reporting. The CNB received a very good assessment.

Further EU-wide stress tests of banks were conducted in 2016. In cooperation with national supervisory authorities including the CNB, the EBA tested 51 banks from 15 countries, covering about 70% of the total assets of the EU banking sector.

In July 2016, the CNB hosted an away day of the EBA Board of Supervisors, where the main topics under discussion were the use of modern technology in financial services and the EBA's future strategic orientation.

#### ***European Securities and Markets Authority (ESMA)***

The CNB was involved in ESMA's activities at the level of the Board of Supervisors, standing committees and working groups. Last year, ESMA focused more on supervisory convergence and, in the regulatory area, mainly on the implementation of MiFID II/MiFIR.

In the area of investment service provision, the CNB contributed above all to documents on the implementation of MiFID II/MiFIR. These included draft ESMA guidelines on the rules of product governance under MiFID II and joint ESMA and EBA guidelines on the assessment of the suitability of selected persons under MiFID II and CRD IV. The CNB also contributed to an ESMA statement addressed to credit institutions and investment firms on the application of the MiFID rules for conduct towards clients in the distribution of instruments subject to write-down under BRRD. The CNB also contributed to ESMA questions and answers, for example regarding the implementation of MiFID I in the area of offering contracts for difference and new duties under MiFID II/MiFIR.

In the area of creation and harmonisation of trading rules on the secondary securities market, the CNB also helped prepare documents on the implementation of MiFID II/MiFIR. These mainly included ESMA opinions on the Commission's requests to change three draft regulatory technical standards. Specifically, these concerned non-equity transparency, the calculation of position limits for commodity derivatives trading and the definition of ancillary activity. Other activities were connected with an ESMA report (prepared jointly with the EBA and the ESRB) on securities financing transactions (SFTs) and leverage in the EU. The CNB also helped to create a consultation paper on draft ESMA guidelines on temporary trading halts due to a significant change in the price of an investment instrument under MiFID and an ESMA paper on the implementation of the regime for systematic internalisers under MiFID II/MiFIR.

Turning to the area of financial innovation, the CNB contributed to a draft ESMA discussion paper on the possible use of distributed ledger technology (DLT) on the capital market. ESMA also focused on research in the area of high-frequency trading (HFT), more specifically its definition and identification on EU equity markets, order duplication and the impact of HFT on market liquidity.

The CNB also contributed to documents on market infrastructure. As regards the European market infrastructure regulation (EMIR), draft regulatory technical standards were drawn up, for example, on risk mitigation techniques for OTC derivative contracts not cleared by a central counterparty and on indirect clearing of OTC derivatives. As regards the regulation on central depositories (CSDR), draft regulatory technical standards were prepared on securities settlement discipline, among other topics. ESMA also drew up a joint report with the EBA on the application of CRR as regards duties under EMIR, which aimed to notify the Commission of potential duplications and inconsistencies in the application of these regulations.

The CNB also contributed to documents in the fund investment area. In connection with the UCITS<sup>41</sup> and AIFMD<sup>42</sup> directives, ESMA prepared, for example, a draft public consultation paper on asset segregation in fund investment and a draft ESMA opinion on the exclusion of investment fund managers licensed under UCITS IV and AIFMD from the scope of the MiFIR product intervention powers. As regards the regulation governing the functioning of European long-term investment funds (ELTIFs), draft regulatory technical standards were prepared concerning the use of financial derivatives solely for the purpose of hedging, the specification of sufficient length of the life of an ELTIF, market assessment and valuation of ELTIF assets, the methodology for the calculation of investors' costs and the essential elements of an ELTIF prospectus. The CNB also contributed to an ESMA public statement on closet index tracking.<sup>43</sup>

The CNB helped to prepare an ESMA letter to the EU institutions in connection with a proposal for a revised regulation on the prospectus to replace the currently valid prospectus directive.

In the area of creating and harmonising rules to protect against market abuse, the CNB commented on a number of draft guidelines containing, for example, an indicative list of important inside information required to be published by trading venues and other private or public institutions which has a significant effect on prices of commodities and commodity derivatives.

The CNB also contributed to an ESMA statement in a public consultation of the International Auditing and Assurance Standards Board (IAASB) regarding a proposed update of the international auditing standards.

In addition, the CNB contributed to documents implementing the regulation on credit rating agencies. These included ESMA guidelines on the validation and review of rating methodologies and draft implementing technical standards on CRR containing a list of main indices taking into account the liquidity of the financial instruments included in each index and a list of recognised exchanges which provide adequate collateral requirements according to the relevant authorities.

The CNB also contributed to ESMA responses to the Commission's public consultations, especially those on the preparation of a revised framework for macroprudential policy in the EU, a potential European personal pension framework and the Commission Green Paper on retail financial services.

In the area of regulation of benchmarks in financial instruments and financial contracts, the CNB contributed, for example, to draft ESMA technical advice to the Commission regarding the Benchmarks Regulation.

In addition, the CNB helped to prepare a peer review of supervisory procedures for enforcing the MiFID rules for performing suitability tests in the provision of investment advice to retail clients. It also participated in a peer review of the application of legal rules in the prospectus approval process and helped to prepare a peer review on the implementation of guidelines on the disclosure duties of issuers of listed securities.

### ***European Insurance and Occupational Pensions Authority (EIOPA)***

In 2016, the CNB was actively involved in EIOPA's activities both at the level of the Board of Supervisors and at the expert level in committees and working groups. It prepared opinions and analyses for individual meetings and for decisions in written procedures. 2016 was the first year of effect of the Solvency II regulatory framework in the EU.

EIOPA completed level-three regulations for the new regulatory framework. For example, it prepared amendments to implementing technical standards containing the templates for the submission of information to national supervisors under Solvency II. The amendments were made in connection with changes relating to support for insurers' investments in infrastructure, in European long-term investment funds and in other assets.

41 Undertakings for the Collective Investment of Transferable Securities.

42 Alternative Investment Fund Managers Directive.

43 Closet index trackers are funds which claim to be actively managed but are in fact more or less passive.

Furthermore, EIOPA drew up guidelines on facilitating an effective dialogue between national supervisors and auditors, on the supervision of branches of third-country insurance undertakings and on product oversight and governance arrangements by insurance undertakings and insurance distributors.

The CNB was actively involved in the debate on changes to the methodology for deriving the ultimate forward rate (UFR).<sup>44</sup> It emphasised the importance of the methodology for correctly valuing technical provisions and called for a deeper analysis of the chosen approach. EIOPA conducted the analysis in cooperation with national supervisors in late 2016 and the results will be applied in 2017.

In addition, the CNB commented on the EIOPA methodology for the calculation of the credit risk adjustment (CRA).<sup>45</sup> It stated that the procedures used by EIOPA were unsuitable for a low interest rate environment and disagreed with the announced increase in the CRA for the Czech koruna, as it was not empirically supported by insurance market developments. It eventually persuaded EIOPA to set the CRA for the Czech koruna at an acceptable level.

Within EIOPA, the CNB was also actively involved in further EU-wide stress tests of insurance and reinsurance companies. The results were published in aggregated form in December 2016.

The CNB also helped to prepare additional sections of the supervisory manual concerning internal models, technical provisions for life insurance, prudential principles and internal risk and solvency assessments. In addition, it contributed to the completion of the half-yearly EIOPA reports on financial stability, the economic situation and developments in the insurance, reinsurance and occupational pensions sectors in EU Member States.

The CNB also commented on an EIOPA document discussing the process of announcing exceptional adverse situations under Article 138 of the Solvency II Directive. In particular, the CNB disagreed with the proposal that any communication with the public in this process should receive prior approval from the EIOPA Board of Supervisors. It therefore advocated that the Board of Supervisors should only approve information published at EIOPA level, not information published by national supervisors.

The CNB also contributed to the annual consumer trends report and to an EIOPA project in which analytical reports and indicators were created to support national supervisors.

The CNB contributed to the peer reviews through which the national supervisory authorities and EIOPA exchange experience with supervisory approaches to various areas of insurance and occupational pension funds. It was involved in the completion of the final reports of peer reviews on freedom to provide insurance services and on supervisory approaches under Article 12 of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision.

### ***Joint Committee of the European Supervisory Authorities***

The Joint Committee is a forum for cooperation between the EBA, ESMA and EIOPA to ensure consistency of activities across financial market sectors. The CNB contributed to the activities of its sub-committees.

In 2016 the Joint Committee prepared joint ESA guidelines on measures against money laundering and terrorist financing and on the prudential assessment of acquisitions and increases of qualifying holdings.

The Joint Committee also prepared draft ESA regulatory technical standards on the content of key information disclosed to consumers by financial institutions for packaged retail and insurance-based investment products (PRIIPs). It also prepared and published a report assessing the risks and weaknesses of the EU financial sector and a response to a Commission consultation on the assessment of financial conglomerates.

<sup>44</sup> The UFR is the forward interest rate to which the risk-free yield curve converges over a specified period of time. It is derived from long-term interest rates and the expected inflation rate.

<sup>45</sup> The adjustment for credit risk that is subtracted from the swap or bond curve when constructing risk-free yield curves for the calculation of technical provisions of insurance companies. The higher the CRA, the higher the technical provisions insurance companies must maintain.

## 6.2 COOPERATION WITHIN EUROPEAN SYSTEMIC RISK BOARD (ESRB) STRUCTURES

The CNB was involved in the activities of the European Systemic Risk Board at the level of both the General Board and the Advisory Technical Committee (ATC) and its standing substructures – the Analysis Working Group (AWG) and the Instruments Working Group (IWG). In particular, the CNB participated in expert teams focusing on risks on residential property markets.

A report on residential and commercial real estate and financial stability in the EU was published in early 2016. As a follow-up, the ESRB issued warnings on medium-term residential real estate vulnerabilities in eight EU Member States.<sup>46</sup>

The ESRB published a report on the use of macroprudential instruments. In this report, Member States listed 60 macroprudential measures directed at reducing lending activity.<sup>47</sup> In addition, the ESRB published documents on macroprudential policy in an environment of low interest rates and macroprudential policy beyond banking.

The ESRB also revised its recommendation on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures, and examined the issue of safe assets, formerly also called European safe bonds.

The ESRB was again involved in designing the adverse scenarios for the EU-wide stress tests of banks, insurance companies (used also as one of the scenarios in the CNB's stress tests) and central counterparties.

The ESRB published reports on indirect channels of contagion of financial market turmoil, on transition to a low-carbon economy and related systemic risks, on market liquidity and on implementation of the countercyclical capital buffer. It also participated in the Commission's consultation on the review of the macroprudential policy framework.

During 2016, the CNB notified the ESRB of the setting of the countercyclical capital buffer rate<sup>48</sup> and of changes in the systemic risk buffer rate. It also confirmed the list of seven other systemically important institutions located in the Czech Republic and replied to requests for reciprocation of macroprudential measures in respect of Belgium and Estonia. It additionally informed the ESRB about its recommendations on prudent mortgage lending.

In 2016, the CNB also reported on compliance with the ESRB recommendations on funding of credit institutions and on setting countercyclical capital buffer rates, including those for exposures to third countries.

## 6.3 COOPERATION WITHIN EUROPEAN CENTRAL BANK (ECB) STRUCTURES

### *Financial Stability Committee (FSC)*

The FSC, whose primary aim is to help ECB bodies fulfil their mandate in the field of supervision of financial institutions and the stability of the EU financial sector, usually meets only in its narrow euro area composition without the participation of CNB representatives. Meetings in the full composition are usually organised as joint meetings with the ESRB Advisory Technical Committee (ESRB ATC). The results of a working group analysing the risks of sustained low interest rates were presented at the autumn meeting. They were also subsequently discussed by the ESRB. Within the FSC, the CNB mainly participated in the completion of a database of macroprudential measures in EU Member States.

46 Austria, Belgium, Denmark, Finland, Luxembourg, the Netherlands, Sweden and the United Kingdom. A CNB representative was involved in a team assessing risks on the Austrian residential real estate market.

47 Systemic risk buffers, buffers applied to global or other systemically important institutions, the countercyclical capital buffer, upper limits on credit indicators for mortgage loans, etc.

48 At 0.5% of the total risk exposure with effect from 1 January 2017.

**Market Infrastructure and Payments Committee (MIPC)**

In 2016, a structural change took place in the organisation of work in this area. A new Market Infrastructure Board (MIB) was established to deal with T2 (TARGET2), TARGET2 Simulator, T2S (TARGET2-Securities), project management, operational processes and risk management. Only some of the euro area countries and countries participating in T2 and T2S are represented in the MIB on a rotating basis.

The former Payment and Settlement Systems Committee was replaced by a new Market Infrastructure and Payments Committee (MIPC), which is responsible for strategy in the area of payments, market infrastructure and oversight of market infrastructure.

Last year these fora increasingly discussed topics which concerned only the euro area or the non-euro area countries participating in T2 and T2S.

Preparatory work on the Secured Financing Transaction Data Store (SF-TDS) continued during the year. This is a relatively large project to establish central collection of data from trade repositories for the purposes of supervision and financial stability.

Last year the MIPC also prepared suggestions for the meetings of the Euro Retail Payments Board (ERPB) and reacted to their conclusions. It repeatedly discussed cyber security, with an emphasis on Eurosystem market infrastructure. It also monitored developments in the area of distributed ledger technology.

Fast euro interbank payments (instant payments) in the euro area were another important topic. This issue is of interest to the CNB due to the preparation of a project for koruna instant payments in the Czech Republic. The European Payment Council completed the preparation of a rulebook for the execution of euro instant payments by clearing systems. In 2016, the ECB worked to coordinate the euro clearing systems in order to achieve a greater degree of harmonisation, but with no clear results so far. In parallel, it launched its own initiative to create a clearing system for euro instant payments called TIPS (Target Instant Payment System). In 2017, after evaluating the public consultation, it will decide whether to start the project.

The MIPC has standing working groups on Payment Systems Policy and Oversight, in which the CNB has representatives.

**6.4 COOPERATION WITH THE EU COUNCIL AND ITS STRUCTURES****ECOFIN, Economic and Financial Committee (EFC), Financial Services Committee (FSC)**

The CNB was involved in the preparation of ECOFIN decisions by proposing modifications to the mandates of the Ministry of Finance for the relevant meetings. The CNB drafted opinions and comments on the Ministry of Finance's instructions for EFC and FSC meetings.

In 2016, the CNB continued to closely monitor the evolution of the banking union, especially as regards the potential impacts of institutional and legislative changes on the CNB's activities and financial stability mandate. Work within the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), i.e. the first and second pillars of the banking union, was focused on making ECB supervision more efficient and preparing European and national authorities for possible resolution in the banking sector. Technical activities related to the creation of a backstop as part of the Single Resolution Fund (SRF) were also launched in 2016.

An ad hoc Council working group on the strengthening of the banking union was established in 2016. It is involved in a technical discussion on the Commission's proposal to establish a European Deposit Insurance Scheme (EDIS) and the related measures to reduce risks in euro area banking sectors. In this context, the CNB commented on the choice of a suitable sequence of steps, on fulfilment of the systemic conditions for potential further risk sharing between banking sectors and on other aspects of the proposal.

At the ECOFIN meeting in June, ministers of finance adopted the Council's conclusions on the plan to complete the banking union. Towards the end of the year, the Commission presented a legislative package to reduce risk in the banking sector. The CNB identified several problematic areas, including the proposal to exempt cooperative credit institutions meeting specified conditions from the application of CRD IV/CRR, reduced use of additional capital requirements for macroprudential purposes under Pillar 2, simplification of reporting duties for small credit institutions and potential disruption of the balance between home and host supervisors.

With regard to the completion of the banking union, the CNB has long promoted the principles of not increasing the risk of moral hazard, giving countries outside the banking union equal treatment on the internal market and preserving the integrity of the internal market.

Work aimed at the establishment of a capital markets union (CMU), intended to lay the groundwork for the development of a common European capital market in the EU, continued during 2016. In the discussions about the individual measures, the CNB emphasised a need for a comprehensive impact assessment of the regulatory measures adopted in the EU. In addition, it criticised any further transfer of direct supervisory powers to the European Supervisory Authorities (ESAs) or other international organisations at the expense of national supervisory authorities, which are responsible for the stability of their financial sectors. It also raised objections to the introduction of the European pension product and continued to voice reservations about the possible relaxation of prudential regulation of some types of assets.

The CNB also welcomed the results of a Commission public consultation on improving the regulatory framework for financial services, as they generally match the CNB's priorities in this area. In particular, it welcomed the recommendation to continuously monitor the impacts of the implementation of the new rules and their potential unintended consequences and interactions.

#### ***MONEYVAL Committee***

Three plenary meetings of the Council of Europe's MONEYVAL Committee were held in 2016. The Czech Republic reported to the committee on the rectification of the shortcomings listed in the FATF<sup>49</sup> recommendations, which fall within the area of competence of the Ministry of Finance. An amendment that took effect on 1 February 2017 brought the Czech Republic into compliance with the requirement to add a separate crime of terrorist financing to the Criminal Code.

### **6.5 COOPERATION WITHIN OTHER INTERNATIONAL ORGANISATIONS AND ASSOCIATIONS**

#### ***OECD – Committee on Financial Markets (CFM)***

In 2016, the CNB participated in meetings of the OECD Committee on Financial Markets (CFM). In particular, issues related to technological innovation in the financial service provision were discussed at the CFM's regular meetings with industry representatives. A level playing field for business and cooperation between banks and financial technology firms, helping them to cut costs and expand innovative services for their clients, are considered crucial. The CFM also discussed current trends on world financial markets, such as the current economic situation in the USA and the euro area and the monetary policy of the Japanese central bank. In continuing negotiations about Lithuania's accession to the OECD, representatives of this Baltic country reported on the state and evolution of regulation and supervision in their country.

#### ***Basel Committee on Banking Supervision (BCBS) – BCG***

The CNB was represented at the Basel Committee on Banking Supervision in the Basel Consultative Group (BCG), which maintains contacts with BCBS member and non-member countries. The BCG was regularly informed about the topical banking regulation issues being addressed by the Basel Committee. In 2016, the CNB coordinated the activities of a working team on a review of the regulatory treatment of sovereign exposures. The role of sovereign exposures and the regulatory approaches to them in small and emerging economies were analysed and possible alternative changes

49 Financial Action Task Force.

in prudential regulation of sovereign exposures in all three pillars were evaluated. Other topics discussed by the BCG included a revision of the standardised approach to the calculation of the capital requirement for credit risk and the implementation of Basel III.

#### ***International Organization of Securities Commissions (IOSCO)***

In 2016, the CNB was actively involved in IOSCO's activities in the European Regional Committee and the Growth and Emerging Markets Committee and attended the IOSCO annual conference. Last year, IOSCO mainly discussed the implementation of the Enhanced Multilateral Memorandum of Understanding, which is a key document governing cross-border cooperation between IOSCO members for preventing unlawful conduct. Compared to the current MMoU, it introduces new forms of cooperation (e.g. exchange of information from providers of telephone and web services) which should enable more integrated and broader cooperation between IOSCO members. Discussions also took place regarding the preparation of further recommendations on asset management and market conduct of financial institutions, as well as in the area of leveraged products traded over the counter. In addition, IOSCO launched a discussion on the evolution of financial technology on capital markets (FinTech). The CNB hosted an extraordinary meeting of the IOSCO European Regional Committee, at which it presented, among other things, its practical experience with some negative aspects of investment product distribution in the Czech Republic.

#### **6.6 COOPERATION WITHIN SUPERVISORY COLLEGES AND OTHER ACTIVITIES**

Supervisory colleges are established to ensure effective supervision of international groups. They aim to deepen and intensify cooperation between national supervisory authorities at the level of supervision of groups and individual entities. By actively participating in meetings of supervisory colleges, the CNB strives for open communication on the significant risks of the group and on the risks of the supervised institutions.

In 2016, the CNB was involved in supervisory colleges for the following European banking groups: Erste, GE Capital, ING, J&T Finance Group, KBC, Raiffeisenbank, Sberbank Europe, Société Générale, UniCredit and Wüstenrot. In the case of J&T Finance Group, the CNB was the consolidating supervisory authority. The main task of the colleges was to safeguard and coordinate the process leading to the approval of joint decisions on capital, liquidity and group recovery plans. The colleges also served as a platform for harmonising the approaches of supervisory authorities in individual areas and for clarifying a number of methodological issues. Last year, intensive discussions took place, among other topics, on the approach to the remuneration of bank staff in connection with the performance of their financial groups.

The CNB provided the supervisory colleges with risk profile assessments and draft requirements for the minimum capital adequacy and liquidity of domestic subsidiaries based on analyses drawn up in the review and evaluation process (SREP).

The competences of supervisory colleges also include assessing recovery plans at the level of individual banking groups. The CNB pushes for a group recovery plan structure that takes sufficient account of recovery planning at the level of individual domestic institutions and sees to it that group recovery measures do not adversely affect the stability of domestic banks.

The CNB was also actively involved in 13 supervisory colleges for the following insurance groups: Aegon, Allianz, AXA, BNP Paribas Cardif, Credimundi, Generali, KBC Insurance, MetLife Inc., Munich Re, NN, UNIQA, Sogecap and VIG. The meetings focused, for example, on group internal models, the quality of the implementation of the Solvency II requirements by individual entities, risk assessments of insurance companies and insurance groups and the evaluation of risk and solvency self-assessment reports.

In the capital market, the CNB continued to work in partnership with other supervisory authorities on the basis of IOSCO and ESMA multilateral memoranda of understanding.

As regards Member States outside the banking union, agreements governing cooperation between supervisory and resolution authorities were prepared. In these cooperation agreements, the CNB requested changes aimed at fostering balanced mutual relations and maintaining the CNB's independence.

PART B  
THE FINANCIAL MARKET IN 2016

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## 1. THE ECONOMIC ENVIRONMENT IN 2016<sup>50</sup>

The growth rate of the Czech economy slowed considerably in 2016. The annual real GDP growth estimate for this year is 2.3%, representing a slowdown of 2.3 percentage points compared with the previous year, when annual growth of 4.6% had been recorded.

The GDP growth in 2016 was driven by increasing household consumption, which rose by 2.9% year on year. The contribution of household consumption to economic growth accelerated slightly during the year, amounting to 1.3 percentage points in annual terms (net of imports). The growth in household consumption was driven mainly by growth in wages and salaries and positive expectations of households. A record-high goods and services surplus also made a significant 1.0 percentage point contribution to the growth in economic performance. By contrast, investment activity recorded a drop, with gross fixed capital formation falling by 3.9% year on year in real terms. The overall negative contribution of gross capital formation was 1.0 percentage point. The drop in investment activity primarily reflected large-scale financing of projects under the ending programme period for absorption of EU funds in 2015 (which, among other things, meant a high year-on-year comparison base) and by slow drawdown of funds for projects under the new programme period. The contribution of general government consumption to GDP growth was insignificant.

The average annual inflation rate stood at 0.7% in 2016. However, inflation accelerated sharply in the last quarter of the calendar year. In the first three quarters of the year, it was below the lower boundary of the tolerance band around the inflation target, with falling fuel and food prices in particular having an anti-inflationary effect. However, the downward effect of fuel prices on inflation gradually weakened and fuel prices turned inflationary in December. In combination with food prices, which also did not raise inflation significantly until the year-end, annual inflation reached the CNB's 2% inflation target in December 2016.

The CNB continued to implement its monetary policy in an environment of "technical zero" interest rates and under a temporary exchange rate commitment at CZK 27 to the euro. Automatic and unlimited foreign exchange interventions were used to fulfil the exchange rate commitment. These helped stabilise the koruna-euro exchange rate close to the commitment level. The Czech koruna appreciated marginally (by 0.7%) against the US dollar compared with the previous year. The average exchange rate for 2016 was CZK 24.4 to the dollar.

<sup>50</sup> The data in this section are based on CZSO data available as of 21 April 2017.

The Czech economy posted a current account surplus of CZK 52.6 billion in 2016. This represented a substantial increase compared with the surplus recorded in 2015 (by CZK 41.4 billion). The current account surplus was primarily due to a high goods and services surplus.

The average annual general unemployment rate for 2016 was 4.0%, the lowest level registered among all the EU Member States. Compared with the previous year, the unemployment rate dropped by 1.1 percentage points, falling almost continuously throughout the year. The downward unemployment trend combined with low inflation was reflected in growth in real wages, which increased by 3.5% year on year.

## 2. CREDIT INSTITUTION SECTORS<sup>51</sup>

### 2.1 STRUCTURE OF THE BANKING SECTOR

At the end of 2016, the Czech banking sector consisted of 45 banks,<sup>52</sup> i.e. one less than a year earlier. ERB bank, a.s. had its licence revoked in the final quarter of 2016. The branch of German bank Volksbank Löbau-Zittau eG closed down in June of the same year. By contrast, Polish bank PKO BP S.A., Czech Branch, established a branch on the domestic market in October. (See Table B.II.1)

At the end of 2016, the banking sector consisted of four large, five medium-sized and eight small banks, along with five building societies and 23 foreign bank branches.<sup>53</sup> The group of four large banks<sup>54</sup> was still the largest component of the banking sector. Its share in total banking sector assets was 59.3% and has increased moderately over the last three years. The shares of medium-sized banks, building societies and foreign bank branches in the sector's assets declined year on year in 2016. By contrast, small banks' share in total assets increased (by almost 80% year on year). (See Table B.II.2)

A total of 397 foreign banks (including their branches) had provided notification under the single licence regime in the Czech Republic as of 31 December 2016. Eleven domestic banks were offering their services and products in EU Member States without establishing a branch. Four domestic banks were operating branches in Slovakia.

The degree of concentration of the Czech banking market, as expressed by the shares of the three largest banks in the sector's total assets, has been flat over the last three years. The level of concentration according to the shares of the sums of the five/ten largest banks' assets in total assets has increased in the same period. Despite the evidence of a possible start of an upward trend in the more broadly

51 Data from reports submitted under the reporting duty by economic agents subject to CNB supervision were used as the primary source of data for the second part of the Financial Market Supervision Report, i.e. Part B. In some cases, data from reports use for the purposes of the CNB's monetary statistics are used to a limited extent. In these cases, an explicit reference to the source of the data is always provided.

52 For the purposes of this sub-section, the term "banks" covers banks, foreign bank branches and building societies. Unlike credit institutions, banks thus do not include credit unions. The credit union sector is the subject of a separate sub-section.

53 The methodology for classifying banks into groups by size changed in 2016. As from 2016, the group of large banks includes banks whose total assets exceed 10% of the total aggregate assets of the banking sector. The group of medium-sized banks comprises banks with total assets between 2% and 10% of total banking sector assets. This fact is reflected in changes in the shares of the individual banking sector groups in the sector's total assets, as Česká exportní banka, Českomoravská záruční a rozvojová banka and Sberbank now rank among small banks. These banks were classified as medium-sized banks in 2015.

54 The group of four large banks consists of Česká spořitelna, ČSOB, Komerční banka and UniCredit Bank. The composition of this size category of banks was unchanged in 2016.

TABLE B.II.1

#### NUMBER OF BANKS

(as of end of period)

	2014	2015	2016
BANKING SECTOR, TOTAL	45	46	45
of which:			
banks	18	18	17
foreign bank branches	22	23	23
building societies	5	5	5

TABLE B.II.2

#### SHARES OF BANK GROUPS IN TOTAL ASSETS

(as of end of period; in %)

	2014	2015	2016
BANKS, TOTAL	100.0	100.0	100.0
of which:			
large banks	57.1	58.8	59.3
medium-sized banks	21.1	19.6	16.6
small banks	3.4	4.2	7.5
foreign bank branches	9.8	9.6	9.5
building societies	8.6	7.9	7.1

CHART B.II.1

#### BANKING SECTOR CONCENTRATION

(in %; as of 31 December 2016)

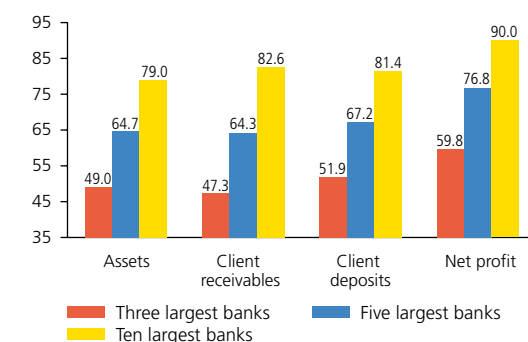


CHART B.II.2

#### BANKING SECTOR CONCENTRATION – ASSETS

(shares of the three, five and ten largest banks in %)

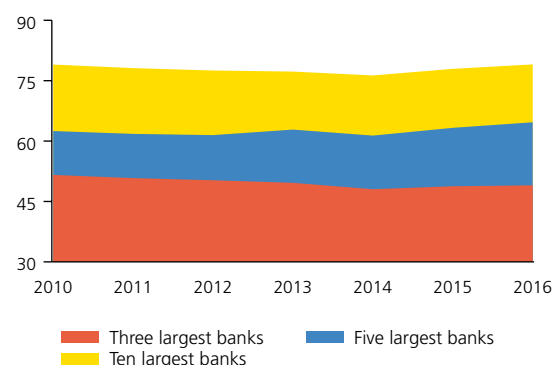
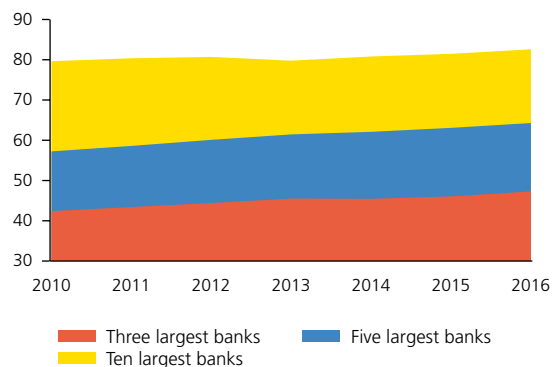


CHART B.II.3

**BANKING SECTOR CONCENTRATION – CLIENT RECEIVABLES**

(shares of the three, five and ten largest banks in %)



defined concentration of the banking market (i.e. based on five/ten banks), the level of concentration of the banking market since 2010 can be considered relatively stable. (See Charts B.II.1 and B.II.2)

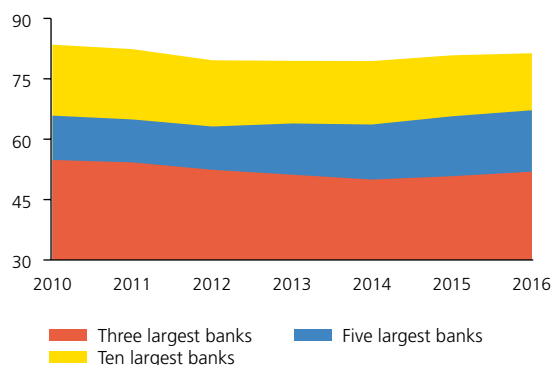
Concentration in the loans to clients market, as expressed by the share of the three and five largest banks, has been increasing steadily since 2010, when an end to the downward trend in both shares was recorded. Over the last seven years, the share of the three largest client loan providers in total client loans has risen by 4.9 percentage points to 47.3% and that of the five largest bank lenders by 7.0 percentage points to 64.3%. The share of client loans provided by the ten largest bank creditors has increased more moderately since 2010 (by 3.0 percentage points to 82.6%). (See Chart B.II.3)

The shares of the bank groups with the largest amounts of client deposits (as a percentage of total client deposits) have increased over the last two years. However, in the case of the three and ten largest banks, the level of concentration in 2016 was below the 2010 level. The share of the client deposits of the three largest banks in total client deposits was 51.9% (as against 54.8% in 2010) and the share of the ten largest banks was 81.4% (as against 83.5% in 2010). The share of the five largest banks with the largest client deposits rose slightly to 67.2% (from 65.9% in 2010), due mainly to higher growth in this share over the last two years. (See Chart B.II.4)

CHART B.II.4

**BANKING SECTOR CONCENTRATION – CLIENT DEPOSITS**

(shares of the three, five and ten largest banks in %)

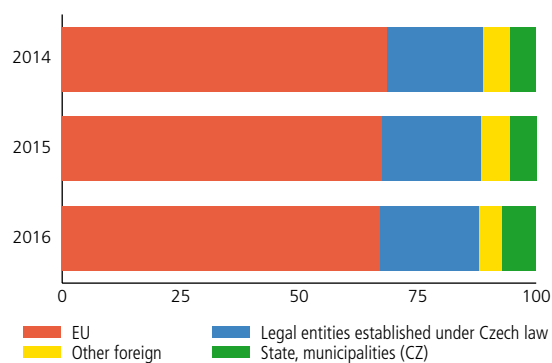
**2.1.1 Ownership structure**

Foreign capital from EU Member States accounts for more than two-thirds of the aggregate registered capital of the banking sector as a whole (67.1%). A total of 72.1% of the registered capital was foreign owned in 2016, representing a modest year-on-year drop of 1.48 percentage points. Foreign owners having their registered office outside the EU had 4.9% of the registered capital of the sector as a whole. (See Chart B.II.5)

CHART B.II.5

**OWNERSHIP STRUCTURE**

(in %; banks as of end of given year)



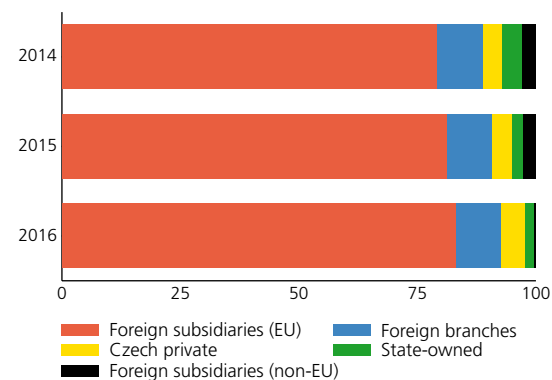
Note: Share in registered capital.

At the end of 2016, foreign owners controlled 93.1% of the assets of the Czech banking sector,<sup>55</sup> with 92.7% of the assets owned by foreign entities from EU Member States. The share of foreign bank subsidiaries in total assets rose by 1.9 percentage points year on year to 83.2%, while the share of the assets of foreign branches solely controlled by owners from EU Member States was unchanged (the share of foreign branches in the sector's total assets was 9.5%). Czech-controlled banks managed 5.1% of the assets of the sector as a whole as of 31 December 2016. State-owned banks had a 1.8% share of assets. (See Chart B.II.6)

CHART B.II.6

## OWNERSHIP OF BANKING SECTOR ASSETS

(in %; banks as of end of given year)



<sup>55</sup> This refers to the share of the banking sector's total assets controlled by foreign entities (i.e. foreign bank subsidiaries or foreign bank branches). A foreign bank entity is one in which foreign owners hold directly or indirectly at least 50% of shares.

CHART B.II.7

**NUMBER OF EMPLOYEES AND BUSINESS UNITS**

(inside and outside CZ; as of end of period)

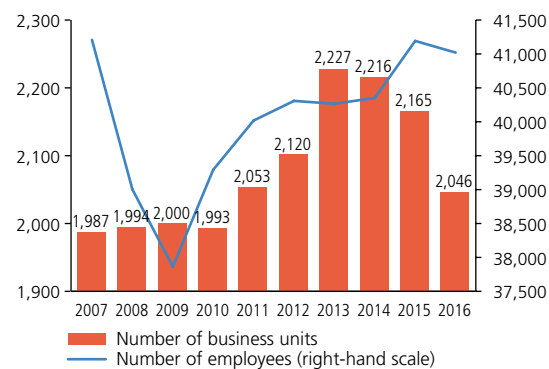


TABLE B.II.3

**BANKING SECTOR EMPLOYEES AND BUSINESS UNITS**

(as of end of period)

	2014	2015	2016
NUMBER OF EMPLOYEES	40,352	41,192	41,020
Number of business units	2,216	2,165	2,046
Number of employees			
per bank	896.7	895.5	911.6
per business unit	18.2	19.0	20.0
Number of citizens			
per bank (thous.)	234.2	229.4	235.1
per business unit (thous.)	4.8	4.9	5.2
per employee	261.2	256.2	257.9

**2.2 EMPLOYEES AND BANKING UNITS**

A total of 41,020 persons were employed in the banking sector at the end of 2016.<sup>56</sup> The post-crisis employment trend in the banking sector was characterised by degressive growth in the number of employees. In 2015, there was a significant year-on-year increase in registered staff of 852 employees (growth of 2.1%). This upward trend halted in 2016, when 85 fewer employees were registered than in the same period of the previous year (a modest year-on-year drop of 0.2%). (See Chart B.II.7)

The largest proportion of the total number of banking sector employees registered at the end of 2016 was concentrated in the four largest banks (66.5%). The group of medium-sized banks accounted for 18.1% and the group of small banks for 6.6% of total employment in the sector. Foreign bank branches employed 5.0% of the total number of registered employees, while 3.8% of banking sector employees worked at building societies. The total number of banks' business units decreased to 2,046 at the end of 2016, a drop of 119 units compared with the figure recorded at the end of 2015. (See Table B.II.3)

The efficiency of the banking sector, as expressed by the ratio of the banking sector's total assets to the number of registered employees, rose by CZK 12.6 million, or 10.8%, year on year. Assets of CZK 129.6 million were thus administered per banking sector employee.

<sup>56</sup> The total number of banking sector employees comprises employees in the Czech Republic and employees in all countries where the banks operate (registered number of employees, full-time and part-time).

### 2.3 DISTRIBUTION CHANNELS AND PAYMENT CARDS

Banks use various channels to provide their products and services. Given the conservative behaviour of clients, business units at bank branches remain the primary distribution channel. Despite this, a downward trend can be identified in the number of business units, due mainly to streamlining and optimisation of branch networks. The intensity of use of electronic banking, which allows remote access to bank products and services, is increasing in parallel with the development of information and communication technologies.

One of the main instruments giving clients connectivity to e-banking is the ATM network, the density of which has been steadily increasing in the Czech Republic in recent years. There were 4,704 ATMs in the Czech Republic at the end of 2016, a rise of 165 ATMs (or 3.4%) compared with the previous year. Most of the ATMs were equipped with a cash withdrawal function (95.5%) and a money transfer function (86.6%). (See Table B.II.4)

Clients commonly use cards with a payment function to remotely access their money on bank accounts. The most frequently used type of such cards is debit cards, which accounted for 83.5% of the total of more than 12 million registered payment cards. There were more than 10 million debit cards registered at the end of 2016. They rose in number by 255,100 year on year. This equates to growth of 2.6%. By contrast, the number of credit cards, of which there were almost 2 million in circulation, declined by 3.5%. The number of payment terminals decreased by more than 33,000 in 2016. This represented a reversal of the previous year's trend, when the number of terminals had risen by more than 41,000. Electronic terminals accounted for 86.7% of all terminals at sales outlets. (See Table B.II.5)

TABLE B.II.4

#### ACCEPTANCE DEVICES

(absolute numbers; as of end of period)

	2014	2015	2016
ATMs, total	4,442	4,539	4,704
of which:			
ATMs with cash withdrawal function	4,436	4,343	4,492
ATMs with money transfer function	3,078	4,024	4,075
Terminals – acceptance devices at sales outlets	101,081	142,164	108,793
of which:			
Electronic terminals at sales outlets	79,957	96,364	94,308

TABLE B.II.5

#### PAYMENT CARDS

(number of cards issued in thousands)

	2014	2015	2016
Debit cards	9,399.2	9,399.2	10,036.8
Credit cards	1,584.9	1,584.9	1,982.6
Charge cards	5.0	4.5	3.8

## 2.4 ACTIVITIES OF THE BANKING SECTOR

## 2.4.1 Banking sector assets

The aggregate balance sheet total of the banking sector was CZK 5,960.8 billion at the end of 2016, a year-on-year increase of CZK 492.3 billion (or 9.0%). (See Table B.II.6)

TABLE B.II.6

## BANKING SECTOR ASSETS

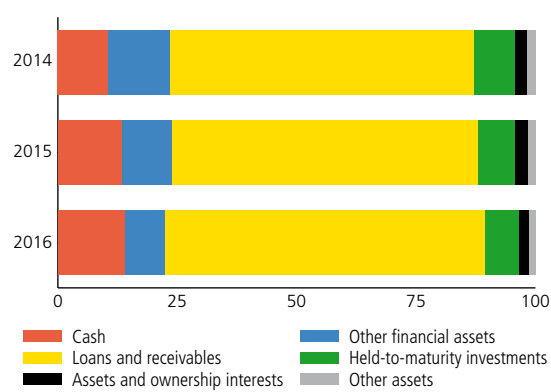
(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
NET ASSETS, TOTAL	5,309.4	5,468.5	5,960.8	+9.0
Cash	49.4	57.5	55.5	-3.4
Cash balances with central banks	465.4	631.4	743.0	+17.7
Demand deposits of credit institutions	44.9	47.4	34.5	-27.3
Financial assets held for trading	191.7	119.9	107.1	-10.7
Financial assets designated at fair value through profit or loss	15.0	11.1	9.8	-11.6
Available-for-sale financial assets	486.6	443.6	388.5	-12.4
Loans and receivables	3,379.5	3,494.1	3,990.9	+14.2
Held-to-maturity investments	445.8	433.6	415.6	-4.2
Derivatives – hedge accounting	53.1	44.6	43.1	-3.4
Fair value changes of the hedged items in portfolio hedge of interest rate risk	2.1	1.3	1.4	+10.1
Investments in subsidiaries, joint ventures and associates	98.7	95.5	92.5	-3.1
Tangible assets	27.9	25.9	23.2	-10.6
Intangible assets	15.3	18.8	21.6	+14.4
Other assets	34.0	43.7	34.2	-21.7

CHART B.II.8

## STRUCTURE OF BANKING SECTOR ASSETS

(in %; as of end of period)



Banks operating in the Czech Republic mostly follow a traditional business model where client deposits are used as the primary source to cover loans provided. This prevailing orientation is reflected in the structure of their balance sheets, where the biggest asset category is loans and receivables. Their share in total assets stood at 67.0% as of the last calendar day of 2016, a year-on-year rise of 3.1 percentage points. The share of cash, cash balances at central banks and other demand deposits in total assets was 14.0% (a moderate year-on-year increase of 0.5 percentage point). The portfolios of other financial assets whose value is sensitive to current pricing by financial markets<sup>57</sup> accounted for 8.5% of the banking sector's total assets, a drop of 2.0 percentage points compared with the end of 2015.

<sup>57</sup> Such assets include available-for-sale financial assets, financial assets held for trading and financial assets designated at fair value through profit or loss.



Held-to-maturity investments accounted for 7.0% of total assets (down by 1 percentage point year on year) and tangible and intangible assets and ownership interests for 2.3% (a year-on-year drop of 0.3 percentage point). The residual value of other assets not mentioned above represented a 1.3% share. More than half of these assets consisted of the fair value of hedging derivatives with a 0.7% share of total assets. (See Chart B.II.8)

In absolute terms, the biggest contribution to the aggregate growth in banking sector assets came from large banks, whose assets rose by CZK 321.4 billion (10%) year on year. The assets of the fast-growing small banks also recorded significant growth, increasing by CZK 218.0 billion (almost 96%) compared with a year earlier. Foreign bank branches raised their assets by CZK 44.9 billion (8.6%) year on year. By contrast, the assets of medium-sized banks and building societies declined by CZK 78.1 billion and CZK 13.8 billion respectively compared with the end of 2015. (See Table B.II.7)

#### 2.4.2 Loans and receivables of the banking sector<sup>58</sup>

The total loans and receivables of the banking sector (net of provisions) reached CZK 3,753.9 billion at the end of 2016, a year-on-year rise of CZK 475.9 billion (14.5%). (See Chart B.II.9)

From the sector perspective, the biggest relative year-on-year change was recorded by loans and receivables from central banks, which increased by 120.6%.<sup>59</sup> By contrast, loans and receivables from general government and financial institutions fell by 17.7% and 6.5% year on year respectively. (See Table B.II.8)

Client loans and receivables ("client loans"<sup>60</sup>), which form a fundamental component of total loans and receivables provided, accounted for 80.6% of this banking sector aggregate, down by 5.7 percentage points year on year. This ratio fell in 2016 Q1 and was then flat for the rest of the year. (See Chart B.II.9 and Table B.II.8)

TABLE B.II.7

#### BALANCE SHEET TOTALS OF BANK GROUPS

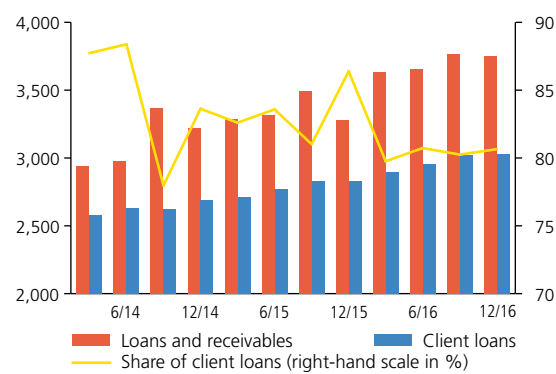
(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
BANKS, TOTAL	5,309.4	5,468.5	5,960.8	+9.0
of which:				
Large banks	3,031.4	3,214.8	3,536.3	+10.0
Medium-sized banks	1,120.2	1,069.4	991.2	-7.3
Small banks	182.3	227.3	445.2	+95.9
Foreign bank branches	519.8	522.5	567.4	+8.6
Building societies	455.8	434.5	420.7	-3.2

CHART B.II.9

#### LOANS AND RECEIVABLES OF BANKING SECTOR

(in CZK billions; as of end of period)



<sup>58</sup> In addition to standard loans and receivables, the figures for the category of loans and receivables presented in this sub-section include financial assets held for trading and held-to-maturity investments (note: these two items account for just 0.15% of loans and receivables). This category does not include non-marketable debt securities in banks' portfolios.

<sup>59</sup> The high growth in loans and receivables from central banks was due mainly to more intensive involvement by the banking sector in trading with the Czech National Bank in the form of reverse repo operations (from the perspective of commercial banks). The aggregate receivables of the banking sector as a whole arising from this type of trade grew by CZK 341.4 billion, i.e. almost doubled, between 2015 and 2016. The large amounts of repos traded in 2016 were due mainly to limited alternative ways of making returns on the liquidity held by commercial banks.

<sup>60</sup> Client loans represent the aggregate of loans and receivables provided to general government, other financial institutions, non-financial corporations and households. Loans and receivables provided to central banks and other credit institutions are not included.

TABLE B.II.8

## LOANS AND RECEIVABLES BY SECTOR

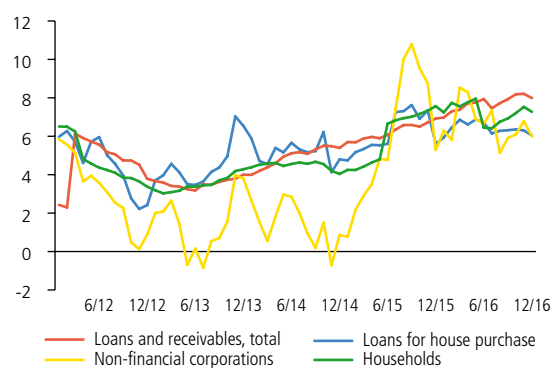
(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
LOANS AND RECEIVABLES, TOTAL	3,218.2	3,278.0	3,753.9	+14.5
Central banks	226.6	243.5	537.0	+120.6
General government	87.1	82.8	68.2	-17.7
Credit institutions	300.4	202.7	189.5	-6.5
Other	2,604.1	2,749.0	2,959.2	+7.6
Other financial institutions	211.2	227.1	262.0	+15.4
Non-financial corporations	1,141.6	1,175.3	1,233.1	+4.9
of which:				
Project financing	173.9	160.6	208.1	+29.6
Households	1,251.4	1,346.7	1,464.0	+8.7
of which:				
Consumer credit	167.2	174.7	196.8	+12.6
Loans secured by property	893.7	968.3	1,069.3	+10.4
CLIENT LOANS	2,691.3	2,831.8	3,027.3	+6.9

CHART B.II.10

## ANNUAL RATES OF GROWTH OF CLIENT LOANS

(year-on-year change in %)



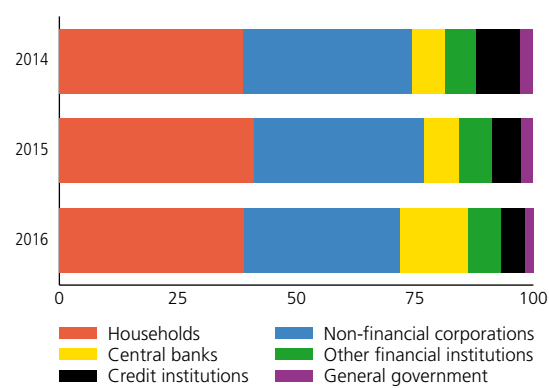
Client loans exceeded CZK 3 trillion (CZK 3,027.3 billion) at the end of 2016, recording a year-on-year increase of 6.9%. Compared with the figure recorded at the end of 2015, the growth accelerated by 1.7 percentage points. The drop in the share of client loans in total loans and receivables provided was thus due to a substantial increase in credit activities with the central bank.

Loans to households, which totalled CZK 1,464.0 billion, as usual formed the largest component of client loans, accounting for more than one-third of the aggregate loans and receivables of the banking sector as a whole (39.0%). Loans to households increased by CZK 117.4 billion (8.7%) year on year. Loans secured by property were the largest item in household loans and receivables in 2016, accounting for 73.0%. Consumer credit represented 13.3% of total loans in the household sector. (See Chart B.II.11 and Table B.II.8)

CHART B.II.11

## LOANS BY ECONOMIC SECTOR

(in %; as of end of period)



The second-largest segment of the domestic banking sector in terms of the allocation of loans and receivables provided were non-financial corporations with a 32.3% share. The loans and receivables provided by the banking sector to non-financial corporations amounted to CZK 1,233.1 billion at the end of 2016, of which CZK 208.1 billion (16.9%) was allocated for project financing.

Loans to general government – the smallest component of client loans – decreased by CZK 14.6 billion year on year to CZK 68.2 billion. Their share in total loans and receivables was 1.8%. Loans to financial institutions amounted to CZK 262.0 billion at the end of 2016, up by 15.4% year on year. Loans to other financial institutions accounted for 7.0% of total loans and receivables.

Loans and receivables to financial institutions accounted for 5.0% of total loans and receivables at the end of 2016 (a year-on-year drop of 1.1 percentage points). By contrast, the share of loans provided to central banks in the loans and receivables of the banking sector as a whole recorded a significant year-on-year increase of 6.9 percentage points to 14.3%.

The downward trend in interest rates on newly granted loans for all the main types of loans broken down by purpose of use continued throughout 2016.<sup>61</sup> The average interest rate on newly granted loans for house purchase secured with a lien on property was 2.16% at the end of 2016 (a year on year drop of 0.35 percentage point). The average rate which banks charged clients for newly granted consumer credit was 10.08% (a 1.61 percentage point drop). (See Chart B.II.12)

### 2.4.3 Structure and growth of securities and equity portfolios

At the end of 2016, banking sector entities held securities and equity ("total investment" or "investment") amounting to CZK 1,182.2 billion, i.e. 5.6% less than at the end of 2015. (See Table B.II.9)

As regards the structure of total investment, debt securities – in particular government debt securities totalling CZK 680.1 billion – formed the majority of the portfolios. Their share in total investment was 57.5%. The year-on-year change in government security holdings was -11.8%, which represented a drop of CZK 91.1 billion.

Securities issued by credit institutions, which amounted to CZK 345.9 billion, made up another significant share of security and equity holdings (29.3%). This category saw an increase of 5% compared with the end of 2015.

Significant year-on-year growth (of 26.3%) was recorded for debt securities issued by other clients, which totalled CZK 60.3 billion at the end of 2016.

In aggregate terms, debt securities – with a 91.9% share – as usual represented far and away the largest part of the banking sector's total investments. This share remained virtually unchanged compared with the end of 2015 (91.7% at the end of 2015). (See Chart B.II.13)

It has long been typical of domestic banks to use a traditional business model, employing deposits as the source of money to fund the loans they provide. This is reflected in limited participation in investment activity involving collective investment and stock market trading. Capital instruments of CZK 10.4 billion, consisting of held-for-trading

<sup>61</sup> Data from the monetary statistics reporting statements submitted by banks were used as a source for processing data on interest rates on new loans.

CHART B.II.12

#### INTEREST RATES ON NEW LOANS

(individuals; in %)

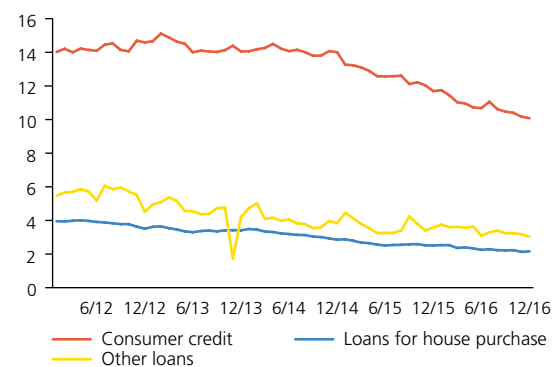


TABLE B.II.9

#### SECURITIES BY ISSUER'S SECTOR, PORTFOLIO AND TYPE

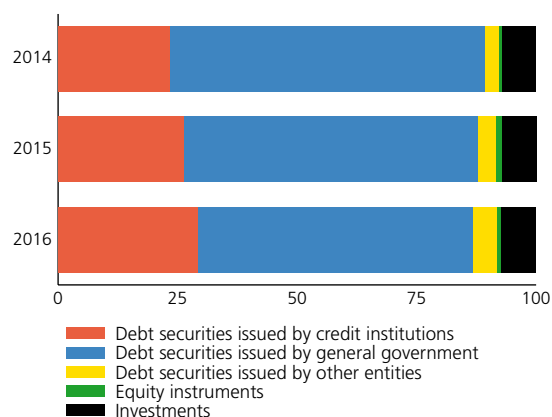
(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
SECURITIES AND INVESTMENTS, TOTAL	1,306.6	1,252.5	1,182.2	-5.6
Debt securities, total	1,207.0	1,148.5	1,086.3	-5.4
Debt securities issued by credit institutions	305.7	329.6	345.9	+5.0
Debt securities issued by general government	862.2	771.2	680.1	-11.8
Debt securities issued by other clients	39.1	47.7	60.3	+26.3
Equity instruments	8.4	14.7	10.4	-29.1
Shares	4.0	9.1	4.9	-46.4
Units	4.1	5.3	5.1	-2.5
Other equity instruments	0.3	0.3	0.4	+26.5
Investments in subsidiaries, associates and joint ventures	91.2	89.3	85.6	-4.2
Investments with substantial influence	8.6	2.5	1.8	-26.5
Investments with substantial influence in credit institutions	6.3	0.0	0.0	0.0
Other investments with substantial influence	2.3	2.5	1.8	-26.5
Investments with controlling influence	82.6	86.8	83.7	-3.6
Investments with controlling influence in credit institutions	36.6	42.0	43.0	+2.5
Other investments with controlling influence	46.0	44.9	40.7	-9.2

CHART B.II.13

## SECURITIES AND INVESTMENTS OF BANKING SECTOR

(in %; as of end of period)



shares, shares designated at fair value through profit or loss and available-for-sale shares, had a marginal share in their investments (0.9%). Capital instruments decreased by 29.1% in year-on-year comparison, due mainly to a drop in holdings of shares of 46.4%.

Investments in subsidiaries, associates and joint ventures made up the remaining 7.2% share of total investments. Investments in this category amounted to CZK 85.6 billion at the end of 2016, representing a year-on-year decline of 4.2%. As regards the structure of ownership interests, the vast majority of them (almost 98% of the total value of registered ownership interests) were controlling shares.

Holdings of ownership interests accounting for 85% of the aggregate amount of the sector as a whole were concentrated in the portfolios of large banks. This is a long-term feature of the domestic banking sector. These assets consist mainly of ownership interests in bank subsidiaries, building societies, mortgage banks and the like.

## 2.4.4 Structure and growth of banking sector liabilities

TABLE B.II.10

## BANKING SECTOR LIABILITIES

(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
<b>LIABILITIES AND EQUITY, TOTAL</b>	5,309.4	5,468.5	5,960.8	+9.0
Liabilities, total	4,797.0	4,941.4	5,420.0	+9.7
Financial liabilities held for trading	153.8	93.1	107.0	+14.9
Derivatives	85.7	63.7	60.5	-4.9
Short positions	16.1	17.2	27.7	+61.2
Deposits	45.0	1.6	7.3	+359.4
Debt securities issued	7.1	10.1	11.4	+13.4
Other financial liabilities	0.0	0.6	0.0	N/A
Financial liabilities designated at fair value through profit or loss	9.7	4.0	3.6	-10.0
Deposits	8.9	4.0	2.0	-50.3
Debt securities issued	0.8	0.0	1.6	N/A
Financial liabilities measured at amortised cost	4,532.9	4,728.2	5,200.6	+10.0
Deposits measured at amortised cost	4,060.7	4,057.9	4,501.9	+10.9
Debt securities issued and other liabilities	472.2	670.3	698.8	+4.2
Derivatives – hedge accounting	33.3	27.4	26.8	-2.1
Provisions	8.1	6.3	7.2	+13.3
Tax liabilities	8.9	8.9	7.0	-21.3
Other liabilities	38.8	44.5	55.6	+24.8
Liabilities included in disposal groups classified as held for sale	0.0	17.2	0.0	N/A
Equity, total	512.3	527.1	540.8	+2.6
Capital	96.3	97.7	98.2	+0.6
Share premium	54.0	62.6	62.6	0.0
Retained earnings	204.5	199.2	213.1	+7.0
Other reserves	0.1	0.1	0.1	-8.3
Profit or loss attributable to owners of the parent	55.3	53.1	50.7	-4.5
Other equity	102.1	114.4	116.1	+1.5

Banking sector liabilities consist of banks' liabilities to other entities<sup>62</sup> and equity. The banking sector's liabilities of CZK 5,420 billion accounted for 91.9% of the balance sheet total. The remaining 9.1% (or CZK 540.8 billion) fell to equity. Year-on-year growth in the sector's liabilities as of the last calendar day stood at 9.7% (a rise of CZK 486.7 billion). Equity increased by 2.6% (CZK 13.9 billion) year on year. (See Table B.II.10)

The share of deposits measured at amortised cost in liabilities was 75.5%, up by 1.3 percentage points on the end of 2015. In absolute terms, these deposits amounted to CZK 4,511.1 billion at the end of 2016, an increase of CZK 444 billion. Other financial liabilities measured at amortised cost (of CZK 698.8 billion), consisting mainly of debt securities issued by banks, accounted for 11.7% of the sector's balance sheet total. In year-on-year terms, they decreased by CZK 28.4 billion, or 0.5 percentage point. The residual component of liabilities<sup>63</sup> of CZK 219.4 billion accounted for the remaining 3.7% of the sector's balance sheet total. (See Chart B.II.14)

Most of the banking sector's total deposits are generated by client deposits, i.e. deposits excluding the deposits of central banks and other credit institutions. These deposits totalled CZK 3,892.8 billion at the end of 2016 and accounted for 86.3% of total deposits, i.e. 3.1 percentage points less than a year earlier. Credit institutions' deposits stood at CZK 606.0 billion at the end of 2016, accounting for 13.4% of total deposits. Deposits of central banks amounted to CZK 12.3 billion (0.3% of total deposits). (See Charts B.II.15 and B.II.16)

Equity is the primary source of funding for banks' business activities. As of 31 December 2016, accumulated equity amounted to CZK 540.8 billion. Its largest component was retained earnings of CZK 213.1 billion, accounting for 39.4% of the equity of the sector as a whole. Bank capital amounted to CZK 98.2 billion, up by 0.6% year on year. Share premium had risen by 16.0% year on year to CZK 62.6 billion at the end of 2015, but a year later, i.e. in 2016, it remained at the same level. Share premium accounted for 11.6% of the total equity of the sector as a whole. The banking sector generated a net profit of CZK 50.7 billion in 2016, a drop of 4.5% compared with the previous year. The net profit for the current accounting year 2016 made up 9.4% of total equity. (See Table B.II.10)

CHART B.II.14

## STRUCTURE OF BANKING SECTOR LIABILITIES

(in %; as of end of period)

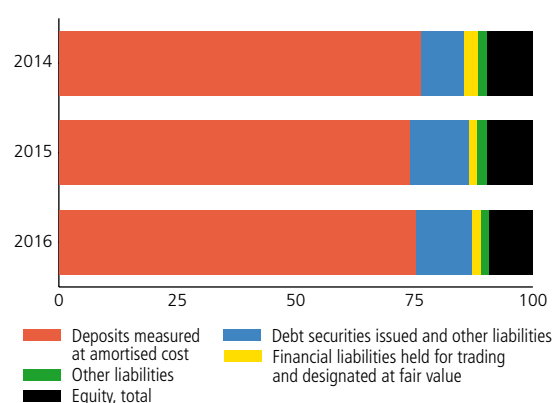
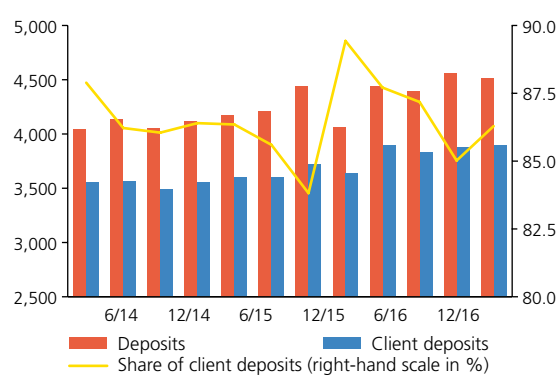


CHART B.II.15

## DEPOSITS OF BANKING SECTOR

(in CZK billions; as of end of period)



62 In this context, other entities consist of central banks, banks' clients, non-bank financial institutions and other credit institutions.

63 Residual liabilities consist of financial liabilities held for trading, financial liabilities designated at fair value through profit or loss, provisions, tax liabilities, liabilities arising from derivatives transactions and short selling, and other liabilities not mentioned above.

TABLE B.II.11

## CLIENT DEPOSITS OF BANKING SECTOR

(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
CLIENT DEPOSITS, TOTAL	3,554.9	3,634.0	3,892.8	+7.1
General government	343.1	218.9	246.5	+12.6
Deposits of other entities and not broken down by sector	3,211.8	3,415.1	3,646.4	+6.8
Deposits of other financial institutions	216.9	199.7	224.1	+12.2
Deposits of non- financial corporations	938.9	1,047.3	1,055.4	+0.8
Deposits of households	2,056.0	2,168.1	2,367.0	+9.2
Current accounts	1,122.7	1,293.1	1,588.6	+22.9
Time deposits	313.9	296.3	285.9	-3.5
Deposits redeemable at notice	619.4	578.8	492.5	-14.9

CHART B.II.16

## DEPOSITS BY ECONOMIC SECTOR

(in %; as of end of period)

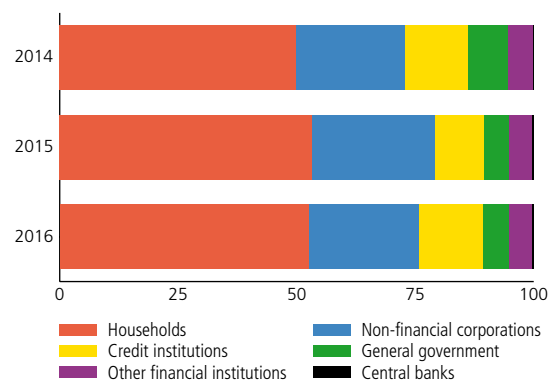
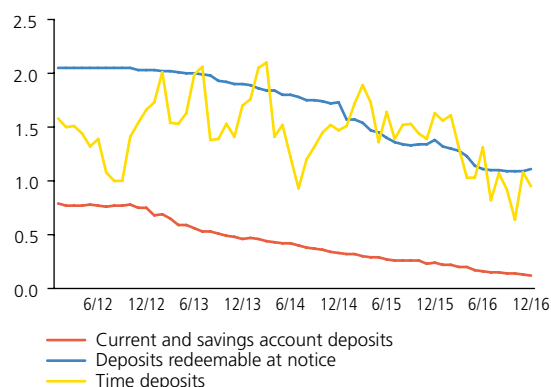


CHART B.II.17

## INTEREST RATES ON NEW DEPOSITS

(individuals; in %)



## 2.4.5 Deposits of bank clients and their structure

Compared with 2015, the rate of growth in client deposits rose quite sharply to 7.1% (for comparison, a year-on-year increase in client deposits of 2.2% had been recorded at the end of 2015). In absolute terms, client deposits increased by CZK 258.8 billion to CZK 3,892.8 billion. (See Table B.II.11)

As usual, the largest item of client deposits was household deposits (CZK 2,367.0 billion) with a 60.8% share in total client deposits. These figures indicated a year-on-year rise of 9.2%. This growth was primarily driven by a sharp increase in current account deposits, which rose from CZK 1,293.1 billion to CZK 1,588.6 billion, i.e. by 22.9% year on year. By contrast, time deposits and deposits redeemable at notice recorded decreases of 3.5% and 14.9% respectively. (See Chart B.II.16)

Deposits of non-financial corporations were also an important part of the client deposits of the banking sector as a whole. Compared with the end-2015 figure, they increased modestly by CZK 8.1 billion (0.8%) to CZK 1,055.4 billion in 2016. The share of deposits of non-financial corporations in client deposits was 27.1%. Deposits of other financial institutions recorded relatively sharp year-on-year growth of 12.2%. They totalled CZK 224.1 billion and accounted for 5.8% of client deposits. The final item of client deposits was deposits of general government with a 6.3% share. They amounted to CZK 246.5 billion as of 31 December 2016 (a year-on-year increase of 12.6%). (See Table B.II.11)

The significant growth in deposits of the economic sector of households was accompanied by a continued downward trend in interest rates on new deposit products.<sup>64</sup> At the end of 2016, the average interest rate on deposits on current and savings accounts stood at 0.12%, that on deposits redeemable at notice at 1.11% and that on time deposits at 0.95%. In year-on-year comparison, the average interest rates in all the three categories decreased. The largest drop was recorded for interest rates on time deposits, which declined by 0.68 percentage point. Interest rates on deposits redeemable at notice fell by 0.28 percentage point and those on deposits on current and savings accounts by 0.12 percentage point during one year. (See Chart B.II.17)

The concentration of client deposits can be expressed in terms of the shares of the client deposits of specific groups of banks in the aggregate client deposits of the banking sector as a whole. The majority of client deposits (57.5% of the total) were concentrated in large banks. Medium-sized banks accounted for 16.6% of total client deposits and small banks for just 3.8% (despite recording considerably

<sup>64</sup> Data from the monetary statistics reporting statements submitted by banks were used as the source for processing data on interest rates on new deposits.

high growth in the amount of deposits), while 11.8% of client deposits were allocated to foreign bank branches. The remaining 10.2% of deposits were concentrated in the building societies segment.

Turning to the concentration of client deposits in the individual groups of banks, the fastest growth of 58.5% was recorded by small banks (a year-on-year increase from CZK 199.9 billion to CZK 316.6 billion). Lower relative growth was recorded for the other groups: year-on-year growth of 11.5% for large banks, 1.3% for medium-sized banks and 12.5% for foreign bank branches. Only in the building societies segment did deposits decline (by 3.3%).

#### 2.4.6 Liquidity situation of the banking sector

The banking sector's positive liquidity situation, arising from a long-term excess of aggregate client deposits over accumulated client loans in the Czech Republic, persisted in 2016. Abstracting from a short-term swing in Q1, the ratio of client deposits to loans was stable in 2016. The ratio of 128.6% at the end of 2016 was almost the same as that at the end of 2015 (up by 0.3 percentage point). Compared with the end of 2014, the coverage ratio was down by 7.1 percentage points due to faster growth in loans than in deposits in 2014. (See Chart B.II.18)

The volume of quick assets went up by 17% year on year. This represented a sharp acceleration compared with the previous year, when growth of 6.2% had been recorded. The sector as a whole had quick assets of CZK 2,050.1 billion as of 31 December 2016, a rise of almost CZK 300 billion compared with 31 December 2015. The largest quick asset item at the end of 2016 was cash including cash balances at central banks and other short-term deposits, accounting for 40.6% (CZK 833.0 billion) of quick assets. Government securities in banks' portfolios of CZK 680.0 billion accounted for 33.2%. The remaining 26.2% (or CZK 537.0 billion in absolute terms) were loans and receivables provided to central banks. (See Chart B.II.19)

In an environment of a stagnating excess of deposits over loans in 2016, a modest year-on-year increase was recorded in the share of quick assets in total banking sector assets (from 32.0% at the end of 2015 to 34.4% a year later). The share of quick assets in client deposits also increased, by 4.5 percentage points to 52.7%.

The high levels of these indicators in the Czech Republic allow for potential growth of the credit market. However, different liquidity characteristics were identified across the different groups of banks. At the end of 2016, the highest shares of quick assets in assets were recorded by foreign bank branches (51.3%, i.e. 17.0 percentage points above the banking sector average) and small banks (40.8%, i.e. 6.4 percentage points above the average). By contrast, medium-sized banks and building societies had the smallest liquidity buffers –

CHART B.II.18

#### LIQUIDITY RATIOS OF BANKING SECTOR

(in %)

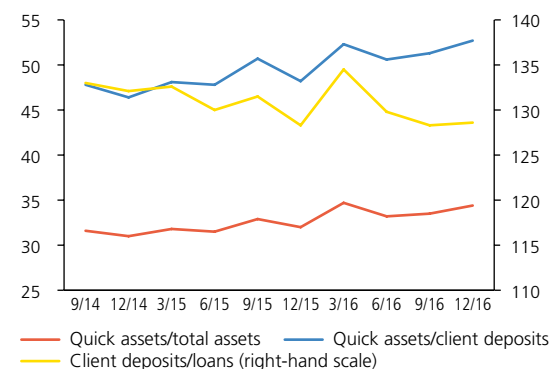


CHART B.II.19

#### QUICK ASSETS IN 2016

(in CZK billions; in %)

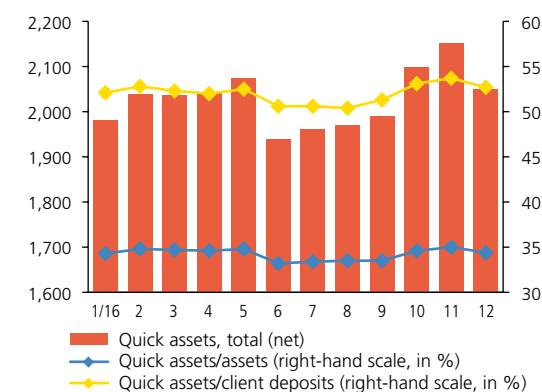


CHART B.II.20

#### LIQUIDITY RATIOS OF BANK GROUPS

(in %; as of 31 December 2016)

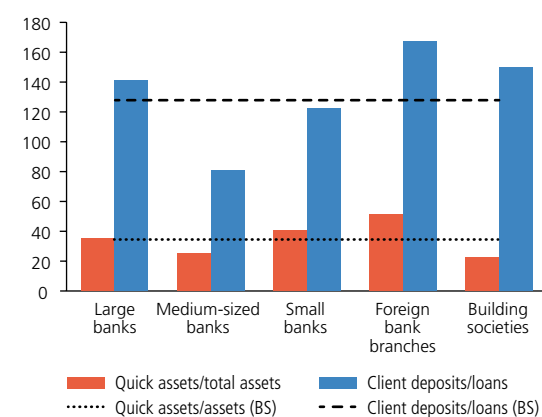




TABLE B.II.12

**LIQUIDITY OF BANKING SECTOR**

(in %/CZK billions; as of end of period)

	2014	2015	2016
QUICK ASSETS, TOTAL (CZK billions)	1,648.5	1,750.9	2,050.1
POSITION			
Position on interbank market (CZK billions)	-255.2	-214.9	-416.5
Ratio of position on interbank market to balance sheet total of BS (%)	-4.8	-3.9	-7.0
OTHER LIQUIDITY RATIOS			
Loan coverage by primary funds (%)	132.1	128.3	128.6
Quick assets/assets (%)	31.0	32.0	34.4

25.3% (9.1 percentage points below the average) and 22.2% (12.2 percentage points below the average) respectively. (See Chart B.II.20)

The position on the interbank market<sup>65</sup> in absolute terms was minus CZK 416.5 billion. This represented an increase in the negative difference of CZK 201.6 billion, or 93.8%. Despite this relative growth in exposure to the banking sector, however, banks operating on the Czech market are characterised by sufficient stable funding sources and a good liquidity position. (See Table B.II.12)

**2.4.7 The share of foreign currencies in the banking sector's activities<sup>66</sup>**

Assets denominated in foreign currencies ("foreign currency assets") in the domestic banking sector exceeded CZK 1,000 billion (CZK 1,031.4 billion) at the end of 2016. They were up by 6.4% year on year at the end of 2016. This equated to an absolute increase of CZK 62.0 billion. (See Table B.II.13)

TABLE B.II.13

**ASSETS AND LIABILITIES – FOREIGN CURRENCIES**

(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
ASSETS, TOTAL	941.5	969.2	1,031.4	+6.4
Cash	7.3	8.9	8.9	+0.1
Deposits and loans with other credit institutions	224.6	207.3	205.8	-0.7
Loans and other client receivables, total	490.7	519.7	578.5	+11.3
Debt securities held by bank	156.0	168.9	173.3	+2.6
Equity instruments held by bank	22.7	25.4	21.0	-17.5
Other assets	40.1	39.0	43.5	+11.3
LIABILITIES, TOTAL	869.6	948.2	1,039.4	+9.6
Deposits and loans from other credit institutions	279.1	238.5	342.6	+43.6
Deposits and loans from clients	421.0	426.4	427.6	+0.3
Debt securities issued	93.4	197.1	176.9	-10.3
Equity and provisions	28.7	38.9	39.1	+0.3
Other liabilities	47.3	47.2	53.2	+12.8

This growth was due mainly to loans and other receivables, which went up by CZK 58.7 billion, and other assets with a rise of CZK 4.5 billion (both increased by 11.3% in relative terms). With a 56.1% share, foreign currency loans and other receivables are the largest item of the foreign currency assets of the sector as a whole. Other large

<sup>65</sup> The position on the interbank market is defined as the difference between the receivables of the banking sector from credit institutions and the deposits of credit institutions recorded under banking sector liabilities.

<sup>66</sup> Data from the monetary statistics reporting statements submitted by banks were used to prepare this section.



items of foreign currency assets included deposits with other credit institutions with a 20% share and debt securities in banks' portfolios with a share of almost 17%.

Capital instruments held by the banking sector recorded a year-on-year drop of CZK 4.4 billion, or 17.5%. However, they are of negligible significance, as their share in total foreign currency assets was just 2%. The structure of foreign currency assets was unchanged compared with the data for the previous year. The year-on-year changes in the significance of the above asset categories can be regarded as marginal.

The share of foreign currency assets in total assets remained stable in 2016, the average share for the year being 17.3%. Just a marginal drop of 0.33 percentage point was recorded at the end of 2016 compared with the end of 2015. Developments in recent years have also been characterised by an increasing share of foreign currency deposits and loans to other credit institutions in the total, i.e. in the aggregate value for the sector as a whole with no differentiation between the currency denominations of these assets. (See Chart B.II.21)

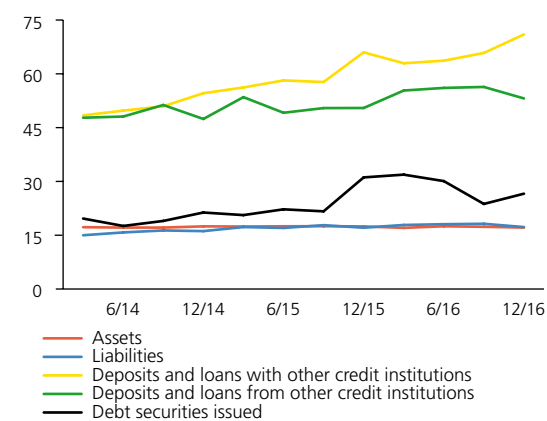
Foreign currency liabilities accounted for roughly the same share of the balance sheet total of the sector as a whole (17.9%). They amounted to CZK 1,039.4 billion, an increase of 9.6% compared with the end-2015 figure. In 2016, the difference between foreign currency assets and liabilities was negative, thereby de facto ending the convergence observed in previous years, when the falling amounts of foreign currency assets and the rising amounts of foreign currency liabilities had been converging. As of 31 December 2016, foreign currency liabilities exceeded foreign currency assets by CZK 8.0 billion.

Deposits and loans received from clients totalled CZK 427.6 billion, forming the largest share of total foreign currency liabilities. Another important category of liabilities was deposits and loans received from other credit institutions (CZK 342.6 billion), which increased by a substantial 43.6% year on year. By contrast, debt securities issued recorded a drop of more than 10%, amounting to CZK 176.9 billion at the end of 2016. (See Table B.II.13 and Chart B.II.21)

CHART B.II.21

**SHARES OF FOREIGN CURRENCIES**

(in %; banking sector balance sheet)



### 2.4.8 Assets and liabilities vis-à-vis non-residents<sup>67</sup>

Aggregate non-resident assets amounted to CZK 766.6 billion, down by 3.5% from a year earlier. Their share in the banking sector's total assets was 12.7%, a year-on-year drop of 1.6 percentage points. A steady downward trend has been apparent since mid-2015. (See Table B.II.14 and Chart B.II.22)

TABLE B.II.14

#### ASSETS AND LIABILITIES – NON-RESIDENTS

(in CZK billions)

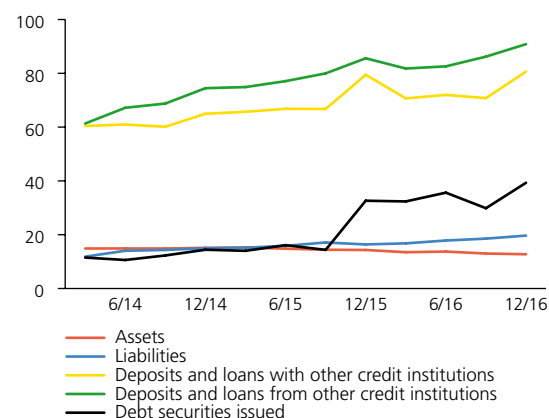
	2014	2015	2016	Change 2016/2015 (in %)
ASSETS, TOTAL	814.7	794.6	766.6	-3.5
Cash	7.3	8.9	8.9	+0.1
Loans and deposits provided (credit institutions)	267.3	249.6	233.8	-6.3
Other loans and deposits provided	322.0	320.9	318.6	-0.7
Debt securities held by bank	107.1	118.6	115.6	-2.5
Equity instruments held by bank	20.7	22.5	17.8	-21.0
Other assets	90.2	74.2	71.4	-3.8
LIABILITIES, TOTAL	806.8	909.2	1,184.3	+30.3
Loans and deposits accepted (credit institutions)	438.5	404.5	585.7	+44.8
Other loans and deposits accepted	156.9	167.9	209.5	+24.7
Debt securities issued	63.1	206.6	261.5	+26.6
Equity and provisions	42.6	46.3	46.5	+0.5
Other liabilities	105.8	83.9	81.3	-3.0

The largest item of non-resident bank assets was client loans and receivables of CZK 318.6 billion, with a 41.6% share. They fell by 0.7% year on year at the end of 2016. Behind them were loans provided to and deposits made at credit institutions of CZK 233.8 billion with a 30.5% share (down by 6.3% year on year). While the share of client loans and receivables grew by 1.2 compared with the previous year, the share of this category allocated to credit institutions dropped by 0.9 percentage point.

CHART B.II.22

#### NON-RESIDENT TRANSACTIONS

(in %; banking sector balance sheet)



The share of non-resident loans and receivables provided to other credit institutions in loans and receivables of the same type for the sector as a whole was 80.1% as of 31 December 2016. This share fluctuated moderately around 71% throughout the year. An increase of more than 9 percentage points occurred in the last quarter of 2016. (See Chart B.II.22)

Non-resident debt securities in banks' portfolios fell by 2.5% year on year to CZK 115.6 billion, representing 15.1% of the total. Capital instruments held by banks recorded the largest drop, falling by 21% from CZK 22.5 billion at the end of 2015 to CZK 17.8 billion a year later. The share of this type of assets in the sector's total non-resident assets dropped by 0.5 percentage point to 2.3%. The residual group of assets (including cash) accounted for 10.5% of total non-resident assets.

<sup>67</sup> Data from the monetary statistics reporting statements submitted by banks were used to prepare this section.

While the banking sector's non-resident assets dropped in 2016, its non-resident liabilities increased steadily. They amounted to CZK 1,184.3 billion at the end of 2016, an increase of 30.3% in year-on-year comparison. Their share in the sector's total liabilities was 19.9%, up by 3.2 percentage points on a year earlier.

Loans and deposits received from credit institutions made up almost half (49.5%) of total non-resident liabilities. Debt securities issued owned by non-residents accounted for 22.1% and client loans and deposits received for 17.7% of the sector's total non-resident liabilities. Other non-resident liabilities including capital and reserves formed the remaining 10.8%.

All the main categories of non-resident liabilities rose at a strong pace. Loans and deposits received from credit institutions increased by 44.8% year on year to CZK 585.7 billion, client loans and deposits received rose by 24.7% to CZK 209.5 billion and non-resident debt securities issued by banks went up by 26.6% to CZK 261.5 billion (see Table B.II.14 and Chart B.II.22).

#### 2.4.9 Territorial focus of banking sector activities

The total exposure of banks in the Czech Republic can be measured by the shares of assets held, receivables provided and deposits accepted in the totals for the banking sector as a whole taking into account the territorial point of view.

The activity of the banking sector in the Czech Republic has long been concentrated in the domestic market. Domestic exposures account for 85.7% and exposures abroad for the remaining 14.3% of all assets. The foreign exposure of the Czech banking sector is oriented largely towards EU countries, which account for 82.9% of the total foreign exposure. The domestic banking sector had the largest foreign exposures to Slovakia (4.9% of total assets) and the Netherlands (2.0%). They were followed some way behind by states whose exposures were between CZK 40 billion and CZK 50 billion at the end of 2016. They included Poland (0.8%), the Russian Federation (0.8%), the UK (0.7%) and Austria (0.7%). (See Chart B.II.23)

Turning to the territorial structure of deposits, i.e. the most important category of liabilities, the domestic banking sector also has cross-border exposures mainly to EU Member States. While 80.8% of all deposits received represented domestic resources, 17.3% were from EU Member States. The remaining 1.9% of deposits were from banks from non-EU countries.

Major exposure to other non-EU states was identified for receivables provided, since 5.1% of aggregate receivables were allocated in non-EU Member States. 81% of total receivables were claims against domestic entities.

CHART B.II.23

#### TERRITORIAL FOCUS OF BANKING SECTOR

(in %; as of 31 December 2016)

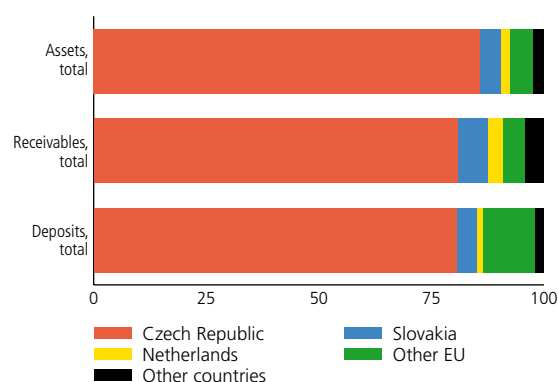


TABLE B.II.15

**BANKING SECTOR OFF-BALANCE SHEET**

(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
<b>OFF-BALANCE SHEET ASSETS</b>				
Loan commitments given	657.6	735.6	773.9	+5.2
Financial guarantees given	179.0	159.2	163.3	+2.6
Other commitments given	200.6	241.6	249.0	+3.0
<b>OFF-BALANCE SHEET LIABILITIES</b>				
Loan commitments received	7.8	7.0	15.3	+119.1
Financial guarantees received	452.3	405.8	371.1	-8.6
Other commitments received	1.3	1.4	2.0	+42.0

**2.4.10 Banking sector off-balance sheet<sup>68</sup>**

Off-balance sheet assets accounted for almost one-fifth of the assets of the banking sector. This share has stayed relatively stable in recent years. Off-balance sheet assets amounted to CZK 1,186.1 billion on 31 December 2016, up by 4.4% compared with the end of 2015. (See Table B.II.15)

At the end of 2016, the banking sector as a whole had loan commitments given amounting to CZK 773.9 billion, accounting for 65% of off-balance sheet assets. In all, 62.1% of total loan commitments were to non-financial corporations and 22.4% were to households. Banks also recorded financial guarantees given of CZK 163.3 billion in this period, i.e. 13.8% of off-balance sheet assets. In all, 84.1% of the guarantee recipients were non-financial corporations and 10% were other financial institutions. Financial guarantees given to households accounted for a mere 2.3% of total guarantees given. Other commitments given totalled CZK 249.0 billion at the end of 2016 (21.0% of off-balance sheet assets). All three categories of off-balance sheet assets increased year on year. Loan commitments given recorded the largest year-on-year growth (5.2%). Financial guarantees given rose by 2.6% and other commitments given by 3.0%.

While off-balance sheet assets have risen in recent years, off-balance sheet liabilities have decreased. Off-balance sheet liabilities amounted to CZK 388.3 billion at the end of 2016, accounting for 6.5% of total assets.

Given the long-sufficient liquidity buffer of the banking sector as a whole, loan guarantees received of CZK 371.1 billion were as usual the largest item of off-balance sheet liabilities, although they dropped by 8.6% year on year. Loan commitments received accounted for 95.6% of total off-balance sheet liabilities. Of these guarantees, 37.0% were received from non-financial corporations, 34.3% from other financial institutions and 15.9% from credit institutions. The remaining two sectors, i.e. general government and households, had equal shares of more than 12% of aggregate financial guarantees received.

The importance of credit commitments and other commitments received remained marginal even though credit commitments received rose by 119.1% year on year.

<sup>68</sup> Only commitments and financial guarantees given and received are now monitored in the off-balance sheet according to the current methodology applied since 30 September 2014. The off-balance sheet has included data on both irrevocable and revocable commitments since the end of September 2014. The data are reported at nominal value, which expresses the maximum potential exposure to credit risk. Collateral held and other credit enhancements are not taken into account.

## 2.5 BANKING SECTOR ASSET QUALITY

### 2.5.1 Default loans and receivables<sup>69</sup>

TABLE B.II.16

#### CLASSIFICATION OF RECEIVABLES – CLIENT RECEIVABLES

(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
Receivables, total (gross)	2,772.9	2,914.5	3,104.2	+6.5
Non-default	2,599.1	2,742.0	2,951.5	+7.6
Standard receivables	2,499.9	2,664.3	2,874.4	+7.9
Watch receivables	99.2	77.7	77.1	-0.8
Default receivables	173.8	172.5	152.8	-11.5
Substandard receivables	50.9	63.7	46.1	-27.7
Doubtful receivables	19.2	13.2	22.9	+73.3
Loss receivables	103.7	95.6	83.8	-12.3
Allowances, total	92.4	90.7	84.9	-6.4
Non-default	9.2	10.6	9.9	-6.2
Standard receivables	4.4	6.0	7.0	+17.0
Watch receivables	4.9	4.6	2.9	-36.7
Default receivables	83.2	80.1	75.0	-6.4
Substandard receivables	9.6	11.2	12.7	+12.8
Doubtful receivables	6.8	4.6	5.5	+19.2
Loss receivables	66.9	64.3	56.8	-11.6
Coverage of non-default receivables (in %)	0.4	0.4	0.3	-12.9
Coverage of default receivables (in %)	47.9	46.4	49.1	+5.7

When performing financial market supervision, part of the CNB's supervisory capacity is devoted to regularly reviewing the quality of receivables. Under the relevant methodology, this review results in the categorisation of receivables into default receivables<sup>70</sup> and non-default receivables.

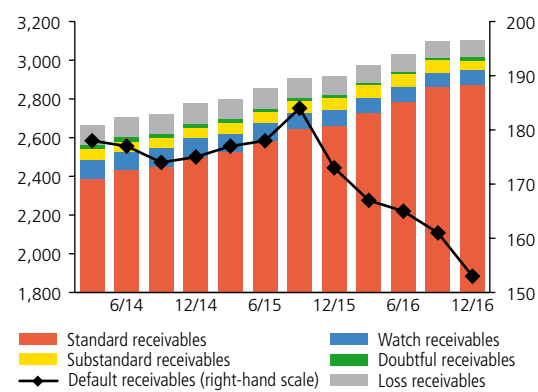
The domestic banking sector has long been reporting relatively favourable characteristics in this area. The vast majority of default receivables are client receivables (99.9% of total default receivables). This size of this category of receivables from other credit institutions is negligible.

The downward linear trend in default loans as a percentage of total client loans continued in the banking sector in 2016. Default client receivables accounted for 4.9% of total client receivables, i.e. 1.0 percentage point less than a year earlier. In 2016,

CHART B.II.24

#### CLASSIFICATION OF RECEIVABLES FROM CLIENTS

(in CZK billions; as of end of period)



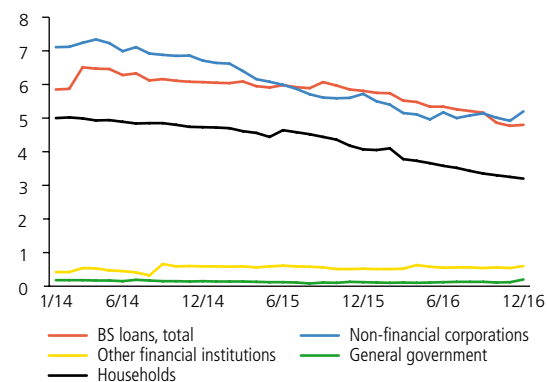
69 Classification of receivables according to CNB rules. See Decree No. 163/2014 Coll., on the pursuit of business of banks, credit unions and investment firms.

70 Default receivables are further broken down into substandard, doubtful and loss receivables.

CHART B.II.25

## DEFAULT LOANS

(in % of total client loans granted by BS)



they decreased (in gross terms, i.e. excluding allowances) by almost CZK 20 billion year on year, to CZK 152.8 billion at the end of the year, equivalent to a year-on-year decline of 11.5% (see Table B.II.16 and Chart B.II.24).

Loss receivables were the largest item of default receivables at the end of 2016, accounting for 54.9%. Substandard receivables accounted for 30.2% and doubtful receivables for the remaining 15.0%.

## 2.5.2 Sector distribution of default loans and receivables

As regards the sector distribution of default receivables, non-financial corporations were the most important sector, with the ratio of default receivables to total client loans provided by the banking sector decreasing annually by 0.6 percentage point to 5.2%. The household sector also recorded a decline in this ratio at the end of 2016, by 0.9 percentage point to 3.2%. The ratios of default receivables from general government and other financial institutions have long been stable, and both stayed below 1%. (See Chart B.II.25)

Default receivables from credit institutions fell by 10.2% year on year to CZK 121.8 billion as of 31 December 2016. (See Table B.II.17)

TABLE B.II.17

## CLASSIFICATION OF RECEIVABLES – CREDIT INSTITUTIONS

(in CZK millions)

	2014	2015	2016	Change 2016/2015 (in %)
Receivables, total (gross)	336,357.2	249,317.4	223,984.3	-10.2
Non-default	335,997.0	249,009.1	223,862.5	-10.1
Standard receivables	333,505.7	246,259.1	221,663.1	-10.0
Watch receivables	2,491.3	2,750.0	2,199.4	-20.0
Default receivables	360.3	308.3	121.8	-60.5
Substandard receivables	0.0	185.9	0.0	-100.0
Doubtful receivables	222.2	0.0	0.0	N/A
Loss receivables	138.1	122.4	121.8	-0.5
Allowances, total	140.3	148.9	152.8	+2.6
Non-default	1.0	25.9	31.0	+19.7
Standard receivables	0.8	11.4	11.3	-1.0
Watch receivables	0.2	14.5	19.7	+36.1
Default receivables	139.3	123.0	121.8	-1.0
Substandard receivables	0.0	0.7	0.0	-100.0
Doubtful receivables	1.2	0.0	0.0	N/A
Loss receivables	138.1	122.4	121.8	-0.5
Coverage of non-default receivables (in %)	0.00	0.01	0.01	+33.1
Coverage of default receivables (in %)	38.7	39.9	100.0	+150.6

The aggregate provisions created by banks to cover potential losses amounted to CZK 85.1 billion for the banking sector as a whole at the end of the year. This meant a decline of 6.4% compared with the previous period.

In 2016, the total coverage of default receivables of the sector as a whole increased by 2.7 percentage points from 46.4% to 49.1%. The default receivables in the credit institutions sector were fully (i.e. 100%) covered by provisions.

## 2.6 BANKING SECTOR PERFORMANCE AND PROFITABILITY

## 2.6.1 Financial and operating profit

Banks operating in the Czech Republic continued to do business in an environment of very low interest rates and a flatter yield curve. The financial and operating profit of the banking sector nonetheless rose by CZK 26 billion year on year to CZK 180.2 billion, a year-on-year change of 3.5%.

TABLE B.II.18

## BANKING SECTOR PROFITS

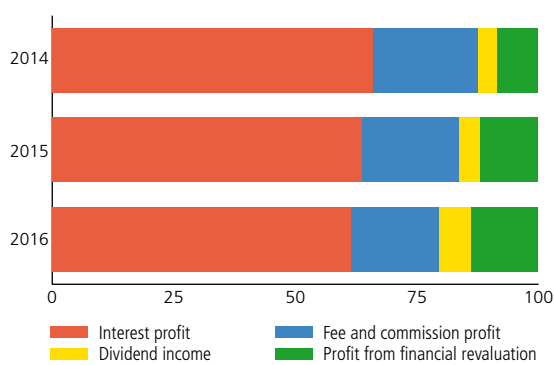
(in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
Financial and operating profit	167.9	174.2	180.2	+3.5
of which:				
Interest profit	110.4	110.9	109.9	-1.0
Interest income	158.9	150.9	143.4	-4.9
Interest expenses	48.4	40.0	33.6	-16.0
Dividend income	6.7	7.7	11.9	+53.7
Fee and commission profit	36.0	34.6	32.4	-6.3
Fee and commission income	49.0	47.9	44.8	-6.5
Fee and commission expenses	12.9	13.3	12.4	-7.0
Administrative expenses	70.2	70.7	71.6	+1.3
Staff expenses	34.7	35.1	36.5	+3.8
Other administrative expenses	35.5	35.6	35.2	-1.2
Depreciation	6.4	6.6	7.0	+6.3
Provisions	1.3	0.8	2.8	+251.2
Impairment	13.8	16.0	11.8	-26.1
Profit before tax	76.1	80.5	87.9	+9.2
Tax expense	13.1	14.2	14.4	+1.3
PROFIT AFTER TAX (current year)	63.1	66.4	73.9	+11.4

CHART B.II.26

## DECOMPOSITION OF FINANCIAL PROFIT

(in %)



Interest profit has stayed relatively stable in absolute terms over the last three years and amounted to CZK 109.9 billion at the end of 2016 (down by CZK 1 billion year on year). Profit from fees and commissions also declined in the same period, from CZK 34.6 billion to CZK 32.4 billion. By contrast, income on dividends from ownership interests grew relatively strongly (by 53.7%) to CZK 11.9 billion. Profit from financial revaluation of assets and liabilities<sup>71</sup> also went up by CZK 3.8 billion to CZK 24.6 billion (by 18.4% in relative terms). The profit from financial revaluation was due mainly to gains from valuation changes amounting to CZK 4.6 billion. On the other hand, the banking sector recorded a loss of CZK 2.6 billion on financial assets and liabilities held for trading in 2016. (See Table B.II.18 and Chart B.II.26)

71 The part of profit consisting mainly of gains or losses on financial assets and liabilities held for trading, hedging transactions and valuation changes.



The financial profit was due as usual mainly to profit stemming from interest margin, which accounted for 61.5% at the end of 2016. Profit from fees and commission accounted for 18.1% and profit from financial evaluation for 13.7% in the same period. The remaining 6.6% was due to dividend income. Recent years have been characterised by a fall in the significance of interest rate profit and fee and commission profit in total profit and a rise in the importance of financial revaluation of assets and liabilities and in the importance of dividend income. (See Chart B.II.26)

The net interest rate margin<sup>72</sup> of the banking sector as a whole was 2.25% at the end of 2016, down by 0.13 percentage point year on year. The largest decreases in net interest rate margin were recorded for small banks (down by 0.57 percentage point to 1.75%) and for large banks (down by 0.22 percentage point to 2.26%). By contrast, medium-sized banks, foreign bank branches and building societies recorded an increase in net interest rate margin. The highest margin was calculated for medium-sized banks (2.85%, again at the end of 2016), while the lowest margin was recorded by building societies (1.69%). (See Chart B.II.27)

### 2.6.2 Administrative expenses and impairment

In 2016, administrative expenses, the level of which is linked with the efficiency with which the banking sector's current operating activities are managed, rose by 1.3% compared with 2015, to CZK 71.6 billion. Personnel expenses accounted for CZK 36.5 billion of total administrative expenses (representing a slight increase in share for the first time ever), while other administrative expenses amounted to CZK 35.1 billion. In percentage terms, personnel expenses rose by 3.4% year on year, while other administrative expenses decreased by 1.2%. The degree of use of financial and operating profit to cover administrative expenses was 39.8% in 2016. This represented a slight decrease of 0.8 percentage point compared with 2015. (See Table B.II.18 and Chart B.II.28)

Asset impairment losses, which partly reflect the quality of risk management in the allocation of banking sector funds, declined by more than 25% year on year in 2016, amounting to CZK 11.8 billion (down by CZK 4.2 billion year on year). Corporate income tax expenses in the banking sector totalled CZK 14.4 billion in 2016, 1.3% more than a year earlier.

CHART B.II.27

#### NET INTEREST MARGIN (ANNUAL)

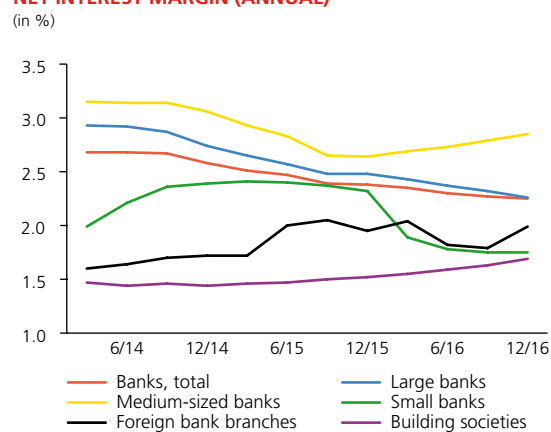
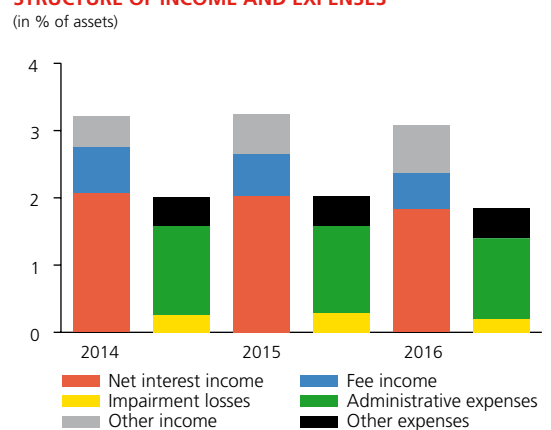


CHART B.II.28

#### STRUCTURE OF INCOME AND EXPENSES

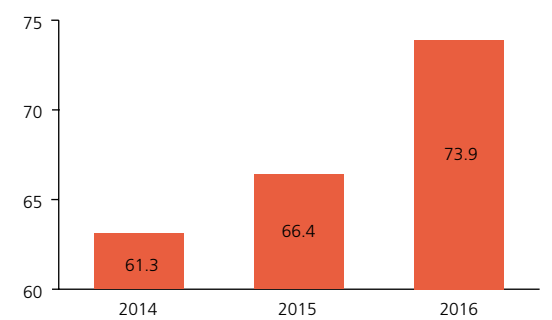


<sup>72</sup> The net interest rate margin is defined as the ratio of interest profit to financial interest-bearing assets.

CHART B.II.29

## NET PROFIT OF BANKING SECTOR

(in CZK billions; in given period)



## 2.6.3 Banking sector net profit

The after-tax profit of the banking sector as a whole amounted to CZK 73.9 billion at the end of 2016, a rise of CZK 7.6 billion on a year earlier (i.e. up by 11.4%). (See Chart B.II.29)

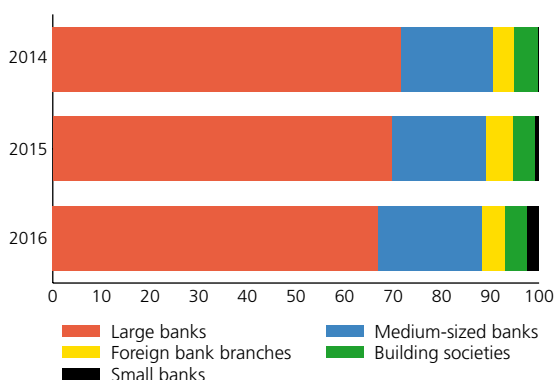
The group of large banks had the largest share in the net profit of the entire sector as usual in 2016. At CZK 49.5 billion, its net profit accounted for around two-thirds of the net profit of the entire sector. However, the share of this group in the sector's total profit has been constantly decreasing over recent years. In 2016, it fell by 2.9 percentage points year on year. The group of medium-sized banks posted a net profit of CZK 15.8 billion, which equates to a share of 21.4%. The share of medium-sized banks increased by 2.3 percentage points year on year. Small banks generated a net profit of CZK 1.7 billion in 2016. The profits of small banks accounted for 2.4% of the sector's total net profit, up by 1.6 percentage points. Foreign bank branches (with a net profit of CZK 3.5 billion) and building societies (with a net profit of CZK 3.4 billion) had roughly the same shares in the total net profit of the sector (4.7% and 4.6% respectively). The share of foreign bank branches increased by 0.5 percentage point and that of building societies declined by 0.5 percentage point year on year. (See Chart B.II.30)

All banks except for six foreign bank branches reported a net profit in 2016. The share of the assets of the group of foreign bank branches that reported a loss in 2016 in the total assets of the banking sector was 0.5%.

CHART B.II.30

## SHARES OF BANK GROUPS IN PROFIT

(in %; banks with licences as of end of period)



## 2.6.4 Banking sector profitability and efficiency

The profit of the domestic banking sector is increasing even in a situation of flat interest rate profit, which is constantly the biggest component of the total profit generated by the banking sector, since the activities of domestic banks are focused on a traditional business model based on providing client loans covered by client deposits.

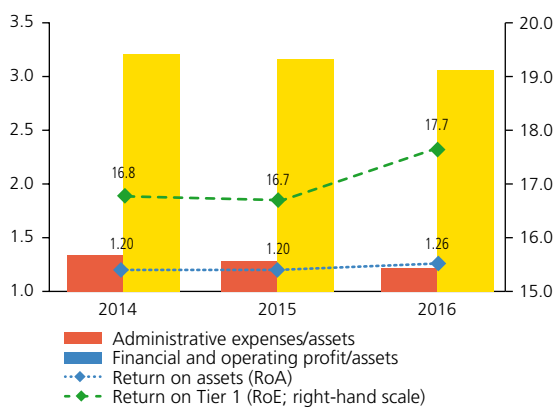
Profitability as expressed by the return on assets (RoA) of the banking sector increased slightly by 0.06 percentage point year on year to 1.26% in 2016. (See Chart B.II.31)

Differences can be identified when one compares the returns on assets across groups of banks. Large banks, which accounted for 59.3% of all banking sector assets at the end of 2016, recorded an RoA of 1.40%. This represented a slight year-on-year decline of 0.04 percentage point. The largest absolute increase in RoA (0.5 percentage point) and simultaneously the highest RoA level (1.64%) were recorded by the group of medium-sized banks. They accounted for 16.6% of the sector's total assets. The largest rise in RoA was recorded by small banks, as this profitability ratio went up from 0.23% to 0.37%, representing a year-on-year increase of almost

CHART B.II.31

## BANKING SECTOR PROFITABILITY AND EFFICIENCY INDICATORS

(in %)



two-thirds. The RoA of branches of foreign banks remained virtually the same as in 2015, i.e. 0.67% (down by 0.01 percentage point from a year earlier). The RoA in the building societies segment rose by 0.11 percentage point year on year to 0.83%. (See Chart B.II.32)

Return on equity (RoE) generally expresses how many korunas/hellers of profit are generated by the use of one koruna of equity. The RoE in the banking sector is usually expressed as the ratio of net profit to Tier 1 capital.<sup>73</sup> The RoE for the sector as a whole was 17.7% at the end of 2016, up by 1 percentage point on a year earlier. The highest RoE (18.3%) was recorded by the group of large banks. This was virtually the same level as at the end of 2015. Medium-sized banks showed the largest increase in RoE (4.75 percentage points). The RoE in this segment was 16.4%. The largest relative increase was recorded by small banks, whose RoE rose by 2.4 percentage points year on year to 6.6%. Despite this considerable positive growth, the RoE of small banks was by far the lowest of all the given groups of banks. The RoE of building societies rose by 1.0 percentage point year on year to 14.7%. (See Chart B.II.33)

The efficiency of the sector, as expressed by the ratio of administrative expenses to assets of the banking sector, has shown minimal improvement in recent years. This ratio amounted to 1.22% in 2016, down by 0.06 percentage point year on year.

The changes in the alternative ratio of financial and operating profit to total assets were similar in nature. This indicator stood at 3.06% at the end of 2016, down by 0.1 percentage point compared with the 2015 figure.

CHART B.II.32

## RETURN ON ASSETS (RoA)

(in %; bank groups)

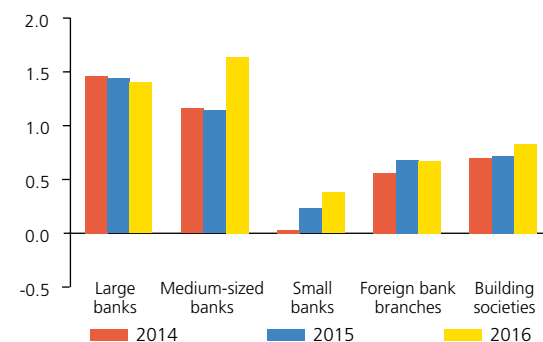
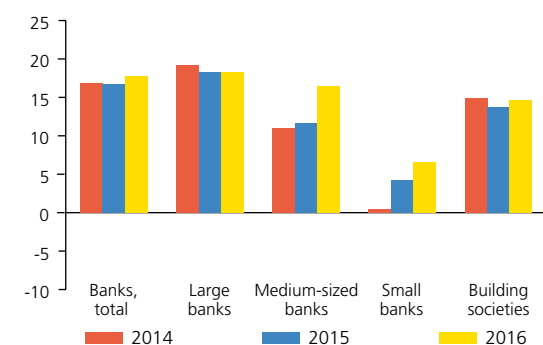


CHART B.II.33

## RETURN ON TIER 1 (RoE)

(in %; bank groups)



<sup>73</sup> Tier 1 is the highest quality and, for banks in the Czech Republic, also the most significant part of regulatory capital. Tier 1 consists mostly of registered capital, retained earnings and mandatory reserve funds.

### 2.7 CAPITALISATION OF THE BANKING SECTOR<sup>74</sup>

The capital ratio is one of the fundamental prudential criteria monitored and assessed as part of the CNB's supervision of the banking sector.<sup>75</sup> The main idea of the updated regulatory framework laying down the capital adequacy rules, which is based on the current Basel III and CRD IV rules, emphasises the need to hold better-quality capital in larger amounts. This would enable banks to use this capital to a larger extent to cover potential losses.

The capitalisation of the banking sector in the Czech Republic has long been satisfactory. The sector's regulatory capital<sup>76</sup> amounted to CZK 440.7 billion at the end of 2016, a rise of CZK 20.1 billion, or 4.8%, on a year earlier. (See Table B.II.19)

The vast majority of the regulatory capital of Czech banks consists of high-quality Tier 1 capital, which accounted for 97.0% of total regulatory capital at the end of 2016. Tier 1 capital recorded a year-on-year increase of CZK 17.6 billion, or 4.3%. Common Equity Tier 1,<sup>77</sup> which accounts for most of total Tier 1 capital, rose by 4.2% year on year to CZK 427.7 billion. A higher year-on-year growth rate of 7.3% was recorded for Additional Tier 1,<sup>78</sup> which amounted to CZK 12.6 billion on 31 December 2016.

The use of Tier 2 capital,<sup>79</sup> which consists primarily of subordinated debt, has long been low, as it accounts for a mere 3.0% of total regulatory capital. This ratio increased by 0.6 percentage point compared with the previous year. A large year-on-year increase in Tier 2 capital of almost 25% was recorded in 2016, from CZK 10.5 billion at the end of 2015 to CZK 13.0 billion a year later.

The risk exposures of the banking sector as a whole amounted to CZK 2,388.8 billion at the end of 2016, up by CZK 100.7 billion (4.4%) year on year in absolute (relative) terms.

74 The capitalisation of the banking sector and the credit union sector reflects the methodology used for macroprudential policy indicators, which is based on the currently applicable rules governing the conduct of credit institutions. These rules have been in force since 2014, when Regulation No. 575/2013 of the European Parliament and of the Council No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR) came into effect.

75 The capital ratio is defined as the ratio of the relevant capital to total risk exposures in per cent. The relevant capital surplus/shortfall is the difference between the relevant capital reported by the reporting entity and the capital that institutions must hold at all times under Article 92 of Regulation No. 575/2013, i.e. such that they satisfy a minimum Common Equity Tier 1 capital ratio of 4.5%, a minimum Tier 1 capital ratio of 6% and a minimum total capital ratio of 8%.

76 In this case, foreign bank branches operating in the Czech Republic are excluded from the Czech banking sector, as the risks to their business activities are covered by the regulatory capital of their head offices. The assessment of capital adequacy falls to the competent foreign supervisory authority.

77 Common Equity Tier 1 (CET1).

78 Additional Tier 1 (AT 1).

79 Tier 2 is the part of a bank's capital comprising subordinated debt, provisions and capital funds.

TABLE B.II.19

#### REGULATORY CAPITAL OF BANKING SECTOR (in CZK billions)

	2014	2015	2016	Change 2016/2015 (in %)
CAPITAL, TOTAL	397.1	420.6	440.7	+4.8
Tier 1 (T1) capital	386.8	410.1	427.7	+4.3
Common Equity T1 (CET1)	384.0	398.3	415.0	+4.2
Additional T1 (AT1)	2.8	11.8	12.6	+7.3
Tier 2 (T2) capital	10.2	10.5	13.0	+24.5

The risk exposure structure of the banking sector is consistent with the conservative business model of banks. Risk-weighted exposures to credit risk amounted to CZK 2,067.1 billion at the end of 2016. They accounted for 86.5% of total risk exposures. This represented a virtually constant level compared with the 2015 figure (a decline of 0.2 percentage point). (See Chart B.II.34)

Banks calculate risk-weighted exposures to credit risk by applying either a standardised approach (STA) or more advanced methods using their own internal risk-rating models (IRB). Risk-weighted exposures defined on the basis of IRB models prevail in domestic banks, accounting for 62.0% of the risk exposures calculated for the sector as a whole in 2016 (risk-weighted exposures determined using IRB models accounted for 71.6% of total exposures to credit risk).

Risk exposures to operational risk rose by CZK 19.7 billion year on year to CZK 225.3 billion in 2016. They made up 10.3% of total risk exposures, a rise of 0.5 percentage point compared with the end of 2015.

Risk exposures to position, foreign exchange and commodity risks, which primarily comprise market risk, recorded a year-on-year decline of CZK 2.3 billion. At CZK 64.4 billion at the end of 2016, they accounted for 2.6% of the sector's risk exposures, 0.2 percentage point less than in 2015.

The capital ratio of banks operating in the Czech Republic initially declined gradually in 2016, but recorded a relatively large increase in the final quarter. As a result, the total capital ratio was 18.4% at the end of 2016, i.e. the same level as at the end of 2015. (See Chart B.II.35).

As total regulatory capital consists largely of high-quality Tier 1 capital, it is clear that the Tier 1 capital ratio will largely correlate with capital adequacy defined on the basis of total regulatory capital. This ratio, too, registered no year-on-year change, as it copied the changes in the capital adequacy ratio defined on the basis of total capital. The Tier 1 capital ratio was 17.9%.

Large banks, which controlled almost 60% of assets, showed similar capital adequacy statistics as the sector as a whole. In this group of banks, the total capital ratio decreased slightly by 0.2 percentage point to 17.8% and the Tier 1 capital ratio fell by 0.3 percentage point to 17.5%. Medium-sized banks reported above-average capital ratios in 2016. Their total capital ratio stood at 20.5% and their Tier 1 capital ratio at 19.3%. Year-on-year increases of 0.7 percentage point were recorded in both cases. The largest absolute year-on-year change in capital ratios was recorded by the group of small banks. The total capital ratio of this segment increased by 2.8 percentage points to 18.9% and the Tier 1 capital ratio by 3.2 percentage points to 17.8%. The total capital of credit unions consists almost entirely of the best-quality CET1 capital. This predetermines equal values of the two capital

CHART B.II.34

## RISK EXPOSURE STRUCTURE

(in %; as of 31 December 2016)

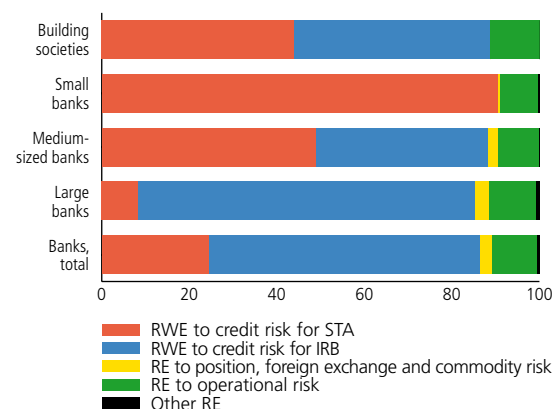


CHART B.II.35

## CAPITAL AND CAPITAL RATIOS

(in CZK billions)

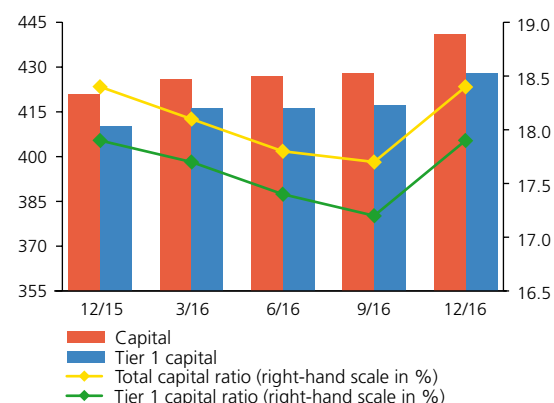
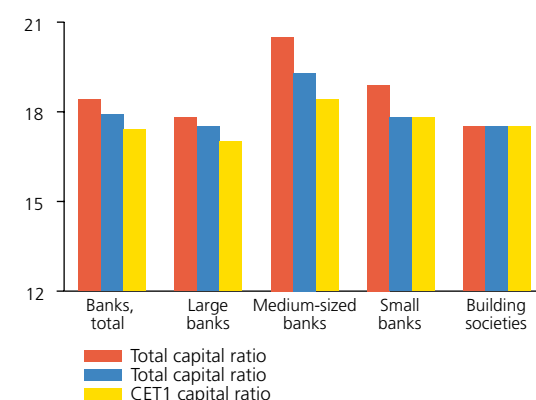


CHART B.II.36

## CAPITAL RATIOS BY BANK GROUP

(in %; as of 31 December 2016)



ratios. This group recorded capital adequacy of 17.5% at the end of 2016. This represented a year-on-year decline of CZK 0.2 billion. (See Chart B.II.36)

The domestic banking sector is safely compliant with the capital requirements as defined by CRD IV/CRR rules. All banks without exception exceeded the prescribed minimum total capital ratio of 8% and Tier 1 capital ratio of 6%.

The leverage ratio of the sector as a whole, as expressed by the ratio of Tier 1 capital to total assets, declined by 0.3 percentage point to 7.2% in 2016. Leverage defined as the ratio of Tier 1 capital to total loans and receivables fell by 1.0 percentage point year on year to 10.7% at the end of 2016.

## 2.8 THE CREDIT UNION SECTOR<sup>80</sup>

### 2.8.1 Structure of the credit union sector

A total of 11 credit unions were active in the Czech Republic at the end of 2016. The number of entities was unchanged since June 2014.<sup>81</sup> (see Table B.II.20)

The assets of the credit union sector as a whole accounted for 0.57% of the total assets of the credit institutions sector (i.e. banks and credit unions). This share has stayed stable over the last three years. Compared with the end-2015 figure, it declined by 0.02 percentage point year on year.

The Czech credit union sector is highly concentrated. The biggest credit union accounted for 34.4% of the sector's aggregate assets. The three largest entities accounted for more than three-quarters and the five largest entities for more than 90% of the total assets of the sector as a whole. High concentration is also apparent for loans and receivables and for deposits. (See Chart B.II.37)

### 2.8.2 Activities of the credit union sector

TABLE B.II.20

NUMBER OF CREDIT UNIONS				
(as of end of period)				
	2014	2015	2016	
CREDIT UNIONS, TOTAL	11	11	11	
Number of members of CUs	57,179	51,183	51,586	
Number of new memberships	16,158	3,890	3,851	
Number of memberships terminated	1,719	9,850	2,279	
Number of employees of CUs (in CZ) <sup>i)</sup>	463	458	483	

i) Registered number of employees

CHART B.II.37

#### CONCENTRATION OF CREDIT UNION SECTOR

(shares in %; as of 31 December 2016)

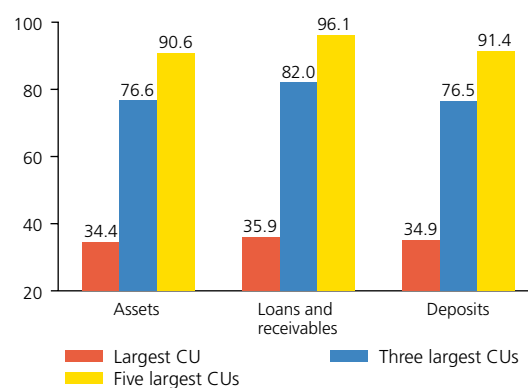


TABLE B.II.21

#### CREDIT UNION SECTOR ASSETS

(in CZK millions; as of end of period)

	2014	2015	2016	Structure 2016 (in %)
TOTAL NET ASSETS	31,278.4	32,316.4	34,178.0	100.0
Cash, cash balances at central banks and other demand deposits	6,865.5	8,067.0	8,489.4	24.8
Financial assets held for trading	678.3	631.0	436.7	1.3
Financial assets designated at fair value through profit or loss	635.4	913.2	1,184.7	3.5
Available-for-sale financial assets	54.1	1.1	1.1	0.0
Loans and receivables	22,029.5	21,699.1	22,454.3	65.7
Held-to-maturity investments	90.5	60.3	0.0	0.0
Tangible and intangible assets	661.3	714.8	790.9	2.3
Tax assets	54.3	75.5	80.5	0.2
Other assets	209.5	154.3	740.3	2.2

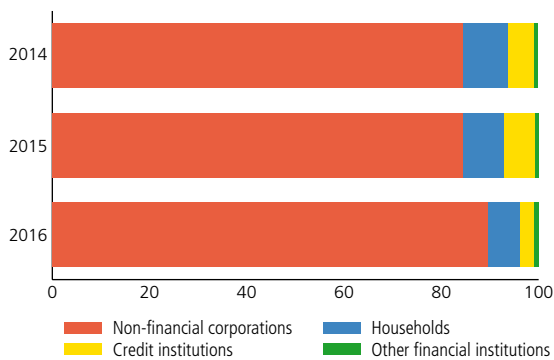
<sup>80</sup> End-2016 data on the credit union sector valid as of 20 May 2017. Internal audits are being conducted at individual credit unions, so the figures presented in this section may differ from the CNB's updated statistics.

<sup>81</sup> The current structure of the credit union sector was affected by changes that occurred in 2013 and 2014. On 18 December 2013, the CNB revoked the credit union licence of Metropolitní spořitelni družstvo (MSD). On 24 June 2014, it took the same action against WPB Capital, spořitelni družstvo. These two entities together accounted for more than 40% of the total assets of the credit union sector (end-2012 data).

CHART B.II.38

## STRUCTURE OF LOANS PROVIDED BY CREDIT UNION SECTOR

(in %; as of end of period)



The credit union sector was managing assets worth CZK 34.2 billion at the end of 2016. This meant an increase in total assets of CZK 1.9 billion (or 5.8%) compared with the previous year. The contributions of credit unions to the sector's growth were uneven. Only six entities recorded growth in their total assets in 2016, while five showed a decline in total assets. (See Table B.II.21)

Loans and receivables, totalling CZK 22.5 billion, accounted for the largest share of the sector's assets (65.7%) at the end of 2016. Cash items, including demand deposits, accounted for 24.8% of total assets, amounting to CZK 8.5 billion. Both these largest asset categories recorded year-on-year growth in 2016, rising by CZK 755.2 million (or 3.5%) and CZK 422.4 million (or 5.2%) respectively.

The largest amount of loans<sup>82</sup> provided by credit unions was received by non-financial corporations. These loans accounted for 89.6% of the total lending of credit unions. This ratio increased by 5.2 percentage points year on year. Loans allocated to households made up 6.7% of total lending, down by 1.9 percentage points compared with the end of 2015. Credit institutions accounted for 2.7% of total loans provided by credit unions (down by 3.4 percentage points). The remaining 1% of loans were provided to other financial institutions (an increase of 0.1 percentage point). (See Chart B.II.38)

Given the nature of credit unions' business, deposits are traditionally the largest item on the sector's liability side, accounting for 85.0% at

TABLE B.II.22

## CREDIT UNION SECTOR LIABILITIES

(in CZK millions; as of end of period)

	2014	2015	2016	Structure 2016 (in %)
LIABILITIES AND EQUITY	31,278.4	32,316.4	34,178.0	100.0
Liabilities, total	31,110.1	28,080.1	29,402.2	86.0
Financial liabilities held for trading	13.4	0.0	0.3	0.0
Financial liabilities measured at amortised cost	27,373.6	27,547.7	29,043.0	85.0
Derivatives – hedge accounting	0.0	0.0	0.0	0.0
Provisions	10.7	8.7	13.4	0.0
Tax liabilities	49.9	31.2	17.0	0.0
Share capital repayable on demand	3,406.4	0.0	0.0	0.0
Other liabilities	256.1	228.8	167.0	0.5
Equity, total	168.3	4,236.3	4,775.8	14.0
Capital	0.0	4,012.0	4,650.0	13.6
Accumulated other comprehensive income	1.8	0.0	0.0	0.0
Retained earnings	55.2	101.3	8.9	0.0
Other reserves	93.0	115.4	148.1	0.4
Profit or loss	18.3	7.6	-31.3	-0.1

82 In this context, "loans" comprise all loans and receivables reported in credit unions' balance sheets in net terms.



the end of 2016. They totalled CZK 29.0 billion, up by CZK 1.5 billion (or 5.4%) year on year. (See Table B.II.22 and Chart B.II.39)

Turning to the structure of deposits, the household sector is the biggest source of deposits, accounting for 84.1% of the aggregate deposits of credit unions. The share of deposits of households at credit unions recorded a year-on-year decline of 2.4 percentage points to CZK 24.4 billion. Non-financial corporations had CZK 4.3 billion deposited at credit unions at the year-end. This represented a share of 14.8%. The share of deposits of non-financial corporations managed by credit unions rose by 2.6% year on year. Deposits of other financial institutions (CZK 207.6 million), deposits of general government (CZK 61.8 million) and deposits of credit institutions (CZK 47.9 million) made up the remaining 1.1%.

Under the current accounting methodology, the off-balance sheet consists of commitments and financial guarantees given and received. Loan commitments given were the largest off-balance sheet item at the end of 2016, but they shrank by 17% year on year to CZK 1,017 million (mainly due to base effects). Financial guarantees received also decreased by 11.6% in 2016, amounting to CZK 531.7 million at the end of the year. On the other hand, financial guarantees given recorded a relatively significant jump compared with 2015, reaching CZK 64.1 million, and other guarantees received rose to CZK 9.8 million. (See Table B.II.23)

### 2.8.3 Profits of the credit union sector

The cumulative bottom line of the credit union sector as a whole was negative in 2016. The sector recorded an accounting loss after tax of CZK 31.3 million. This loss was due mainly to a decline in financial and operating profit of CZK 820.3 million. This represented a year-on-year decrease of CZK 262.6 million (or 24.2%). The decline in financial and operating profit reflected a year-on-year fall in interest profit of CZK 106.3 million, a decrease in fee and commission profit of CZK 44.8 million, a decline in gains on financial assets and liabilities held for trading of CZK 25.4 million and most of all a reported loss on derecognition of financial assets and liabilities not reported in the profit and loss account in the reference period, amounting to CZK 145.8 million (as against gains on derecognition of CZK 3.5 million reported at the end of 2015).<sup>83</sup> The credit union sector recorded a loss despite a decline in losses arising from impairment of realised financial assets (of CZK 151.8 million) and a decline in administrative expenses (of CZK 40.1 million year on year). (See Table B.II.24)

Only two entities in the credit union sector recorded a loss, while the remaining nine credit unions were profitable. The aggregate asset share of the loss-making credit unions was 42.6% of total assets at the end of 2016.

<sup>83</sup> This is the negative difference between realised gains and realised losses reported by credit unions on securities and held-to-maturity receivables on their derecognition.

CHART B.II.39

#### DEPOSITS IN CREDIT UNION BALANCE SHEET

(as of end of period; in CZK billions; in %)

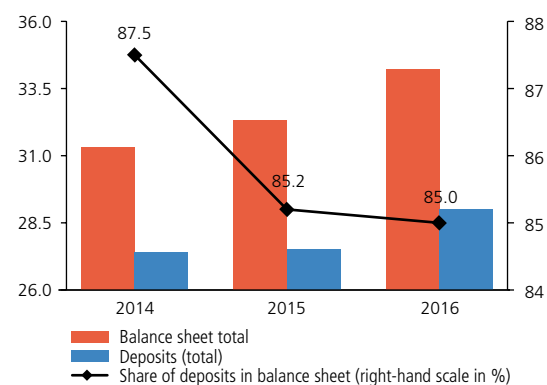


TABLE B.II.23

#### CREDIT UNION SECTOR OFF-BALANCE SHEET

(in CZK millions; as of end of period)

	2014	2015	2016
Loan commitments given	582.1	1,225.1	1,017.0
Financial guarantees given	58.4	32.5	64.1
Other commitments given	7.9	2.6	9.8
Loan commitments received	285.0	285.0	0.0
Financial guarantees received	554.7	601.5	531.7
Other commitments received	0.6	0.6	0.6

TABLE B.II.24

#### CREDIT UNION SECTOR PROFITS

(as of end of period; in CZK millions)

	2014	2015	2016
FINANCIAL PROFIT	1,151.8	1,082.9	820.3
Of which:			
Interest profit	1,156.0	948.6	842.3
Fee and commission profit	99.0	97.3	52.5
Gains on financial assets not measured at fair value through profit or loss	-80.9	3.5	-145.8
Gains on financial assets held for trading	18.8	31.0	5.7
Gains on financial assets designated at fair value through profit or loss	-5.0	-6.4	14.5
Gains from hedge accounting	-1.1	0.4	-2.1
Gains from other activities	-35.1	8.5	53.2
ADMINISTRATIVE EXPENSES	639.0	757.2	717.1
DEPRECIATION AND PROVISIONS	45.5	42.1	42.0
IMPAIRMENT	375.8	226.9	75.1
GROSS PROFIT before tax	86.8	60.2	-15.4
Tax expense	68.5	52.6	15.9
NET PROFIT	18.3	7.6	-31.3

#### 2.8.4 Asset quality of the credit union sector

The risk-weighted exposure to credit risk of CZK 26.2 billion accounted for 91.5% of the sector's risk exposures at the end of 2016. Risk exposure to operational risk amounted to CZK 2.3 billion, representing 7.9% of the total risk exposure. Other risk exposures in the credit union sector were negligible.

The loan portfolio receivables of credit unions recorded a slight year-on-year rise of CZK 177.8 million, or 0.7%. Default loans decreased by CZK 361.8 million (6.5%). (See Table B.II.25)

TABLE B.II.25

#### CLASSIFICATION OF CREDIT UNION RECEIVABLES

(in CZK billions; as of end of period)

	2014	2015	2016	Change 2016/2015 (in %)
INVESTMENT PORTFOLIO RECEIVABLES BY DEFAULT STATUS	27.7	26.6	26.8	+0.7
Non-default	21.4	21.0	21.6	+2.6
Standard	15.4	16.3	14.3	-12.5
Watch	6.0	4.7	7.3	+54.8
Default	6.3	5.6	5.2	-6.5
Substandard	2.5	1.6	2.1	+37.0
Doubtful	1.2	0.9	0.3	-65.6
Loss	2.6	3.1	2.8	-11.7
INVESTMENT PORTFOLIO DEFAULT RECEIVABLES FROM CLIENTS	6.3	5.6	5.2	-6.5
Substandard	2.5	1.6	2.1	+37.0
Doubtful	1.2	0.9	0.3	-65.6
Loss	2.6	3.1	2.8	-11.7
ALLOWANCES AND LOSS OF VALUE	1.2	1.0	0.9	-10.5
Allowances for individually assessed financial assets	1.2	1.0	0.9	-10.5
Allowances for individually non-impaired assets	0.0	0.0	0.0	
Allowances for portfolio of individually immaterial assets	0.0	0.0	0.0	+16.7
DEFAULT RECEIVABLES (in %)				
Share of default receivables in total investment portfolio	22.7	21.0	19.5	-7.1

Default client receivables<sup>84</sup> recorded in the credit union sector's assets accounted for 19.5% of the sector's total receivables in 2016. The share of loss receivables in receivables in credit unions' portfolios was 10.3%. Both these shares decreased by 1.5 percentage points compared with the end of 2015.

<sup>84</sup> Client receivables consist of receivables from non-financial corporations, households, other financial institutions and general government. Receivables from credit institutions are reported separately. As credit unions reported no watch receivables or default receivables from credit institutions, the figures for credit unions' receivables from clients and credit unions' total receivables from all entities are identical in these categories of receivables.

The decline in the shares of default receivables and loss receivables was accompanied by a decrease in allowances, which amounted to CZK 924,400 at the year-end, i.e. CZK 108,200 lower than reported by credit unions at the end of 2015.

Given the reported data on assets, the credit union sector can be considered sufficiently liquid even though the share of quick assets in the sector's total assets fell from 26.6% to 25.9%. Quick assets in the credit union sector amounted to CZK 8.9 billion, up by CZK 253.3 million (or 2.9%) year on year. The increase in quick assets was driven by growth in cash of CZK 422.4 million, which offset a decline of CZK 169.1 million in government debt securities in credit unions' portfolios. (See Table B.II.26)

### 2.8.5 Capitalisation of the credit union sector

The capitalisation of the sector improved in 2016, as the stock of reported regulatory capital rose from CZK 4.2 billion to CZK 4.6 billion year on year. This represented a year-on-year increase of 11.0%. Most of the regulatory capital (98.4%) was made up of high-quality Tier 1 capital, which increased by 11.7% year on year. (See Table B.II.27)

The Tier 1 capital ratio of the sector as a whole was 15.92% at the end of 2016, a slight increase of 0.83 percentage point compared with the end of 2015. The total capital ratio stood at 16.18% at the end of 2016, having risen by 0.73 percentage point year on year. All credit unions were compliant with the required minimum regulatory capital ratios.<sup>85</sup>

Tab. B.II.26

#### CREDIT UNION LIQUIDITY RATIOS

(as of end of period; in CZK millions; in %)

	2014	2015	2016
Quick assets	7,459.2	8,597.7	8,851.0
Quick assets/assets	23.8	26.6	25.9
Deposits/loans	124.1	128.1	130.0

TABLE B.II.27

#### CAPITAL STRUCTURE OF CREDIT UNION SECTOR

(as of end of period; in CZK millions; in %)

	2014	2015	2016
CAPITAL	3,715.1	4,176.9	4,634.5
Tier 1 (T1) capital	3,421.0	4,081.3	4,560.1
Tier 2 (T2) capital	294.1	95.6	74.4
T1 capital ratio	12.45	15.09	15.92
Surplus (+) / deficit (-) of T1 capital	1,771.6	2,458.7	2,841.4
Total capital ratio	13.51	15.44	16.18
Surplus (+) / deficit (-) of total capital	1,516.0	2,013.4	2,342.9

<sup>85</sup> These include the required minimum total capital ratio of 8% and the required minimum Tier 1 capital ratio of 6%.

### 3. THE INSURANCE MARKET

The year 2016 saw the launch of the new Solvency II<sup>86</sup> regulatory framework, which constitutes a major reform of the EU insurance market. It introduced a number of changes for insurance undertakings and supervisory authorities, e.g. a risk-oriented approach to determining capital requirements, an emphasis on high-quality risk management, group supervision and a significantly widening of the scope of disclosed information.<sup>87</sup> The Czech insurance sector remained profitable in 2016 and showed no major structural changes. Based on the initial results, it successfully adapted to the capital solvency requirements of the new regulatory system. Since 2016 was a transitional year for insurance undertakings in terms of the reporting method, this section uses information submitted under both the previous and current regulatory rules.

#### 3.1 INSURANCE MARKET ENTITIES

As of 31 December 2016, the Czech insurance market was made up of a total of 28 domestic insurance undertakings, i.e. insurance undertakings having their registered office in the Czech Republic, and 24 branches of foreign insurance undertakings. Compared with 2015, the total number of insurance undertakings fell from 53 to 52. This figure and the other analyses in section III exclude the Czech Insurers' Bureau (CIB),<sup>88</sup> Exportní garanční a pojišťovací společnost, a.s. (EGAP)<sup>89</sup> and VIG RE zajišťovna, a.s.<sup>90</sup> (See Table B.III.1).

Compared with 2015, the number of domestic insurance undertakings operating in the Czech insurance market decreased by two.<sup>91</sup> Of the total of 28 domestic insurance undertakings, 16 were controlled by foreign owners as at the end of 2016. Four had owners from France,

<sup>86</sup> The European directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) took effect on 1 January 2016. The Solvency II regime took effect in the Czech Republic through an amendment to the Insurance Act on 23 September 2016.

<sup>87</sup> Solvency II is based on three pillars. Pillar 1 sets quantitative requirements containing procedures for computing technical provisions and capital requirements, which are calculated using either a standard formula or internal models. Pillar 2 contains qualitative requirements laying down rules for the internal control systems of insurance companies, for the assessment of such systems and for risk management. Pillar 3 consists of rules for reporting and information disclosure.

<sup>88</sup> The Czech Insurers' Bureau (Česká kancelář pojistitelů, ČKP) is a professional organisation of insurers licensed to provide motor third party liability insurance. For details on its activities and financial performance, see [www.ckp.cz](http://www.ckp.cz).

<sup>89</sup> EGAP was established in 1992 as a wholly state-owned joint-stock company. It is a credit insurance undertaking specialising in market-uninsurable political and commercial risks associated with the financing of exports of goods, services and investment from the Czech Republic. Detailed information is available at [www.egap.cz](http://www.egap.cz).

<sup>90</sup> VIG RE zajišťovna, a.s. has been operating on the Czech market since 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.

<sup>91</sup> Wüstenrot pojišťovna, a.s. and Wüstenrot, životní pojišťovna, a.s., which merged with Allianz pojišťovna, a.s. on 30 June 2016.

Tab. B.III.1

#### NUMBER OF INSURANCE UNDERTAKINGS BY FOCUS OF ACTIVITY

	2014	2015	2016
NUMBER OF INSURANCE UNDERTAKINGS, TOTAL	51	53	52
of which:			
non-life	30	32	32
life	6	7	6
both life and non-life	15	14	14
NUMBER OF DOMESTIC INSURANCE UNDERTAKINGS	31	30	28
of which:			
non-life	14	14	13
life	2	2	1
both life and non-life	15	14	14
NUMBER OF BRANCHES OF INSURANCE UNDERTAKINGS FROM EU AND THIRD COUNTRIES	20	23	24
of which:			
non-life	16	18	19
life	4	5	5
both life and non-life	0	0	0

Note: Excluding the CIB, EGAP and VIG

while owners from Germany and Austria each controlled three and owners from Belgium, Italy and the Netherlands each controlled two. Domestic insurance undertakings focusing on both life and non-life insurance (14 entities) predominated, followed by 13 insurance undertakings specialising in non-life insurance. Only one domestic insurance undertaking specialised in life insurance. (See Chart B.III.1)

The number of branches of foreign insurance undertakings operating in the Czech market increased by one year on year.<sup>92</sup> All branches belonged to insurance undertakings based in EU states. Of the total of 24 branches, insurance undertakings from the UK (four branches), Germany, Austria and Slovakia (three branches each) enjoy the largest representation via branches in the Czech insurance market.

Insurance undertakings based in Belgium, France, Ireland and the Netherlands each had two branches in the Czech Republic, while insurance undertakings from Luxembourg, Hungary and Spain each operated one branch. Most branches (a total of 19) focused on non-life insurance, while five specialised in life insurance only.

In addition to the above-mentioned domestic insurance undertakings and branches of foreign insurance undertakings licensed by the CNB, insurance undertakings and branches of insurance undertakings from other EEA countries may provide cross-border services in the Czech insurance market under the freedom to provide services on a temporary basis. In all, 882 of these entities were registered as of 31 December 2016, a rise of 7% compared with the end of 2015.

CHART B.III.1

**OWNERSHIP STRUCTURE OF DOMESTIC INSURANCE UNDERTAKINGS**

(numbers of entities)

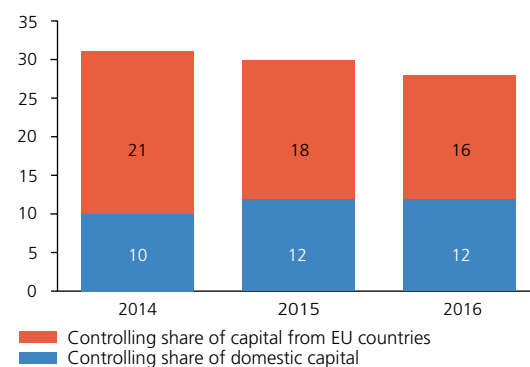
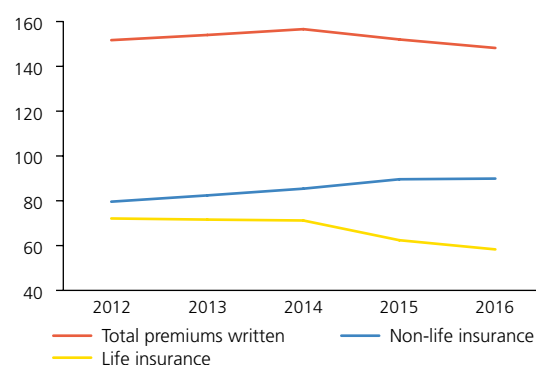


CHART B.III.2

**GROSS PREMIUMS WRITTEN**

(in CZK billions)



92 Compañía Española de Seguros y Reaseguros de Crédito y Caución, S.A., odštěpný závod.

CHART B.III.3

## GROSS PREMIUMS WRITTEN IN QUARTERS OF 2016

(in CZK billions)

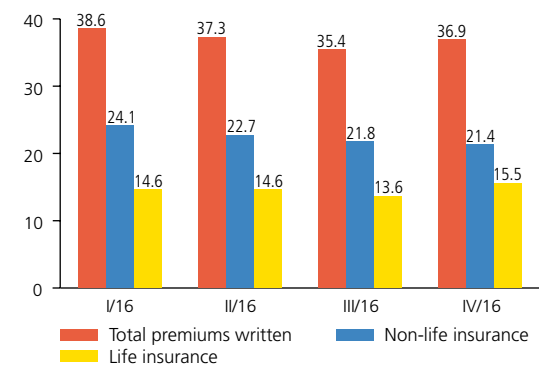


CHART B.III.4

## SHARES OF LIFE INSURANCE AND NON-LIFE INSURANCE IN GROSS PREMIUMS WRITTEN

(in %)

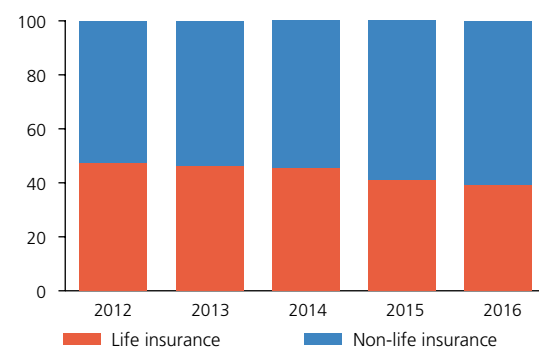
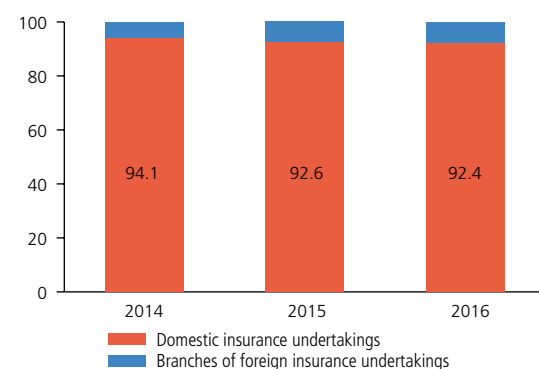


CHART B.III.5

## SHARES OF ENTITIES IN GROSS PREMIUMS WRITTEN

(in %)



## 3.2 PREMIUMS WRITTEN

Gross premiums written<sup>93</sup> are one of the key indicators of the insurance market. They amounted to CZK 148.2 billion in 2016, down by 2.5% compared with 2015. This decline was due to a decrease of 6.6% in premiums written in life insurance to CZK 58.3 billion, while premiums written in non-life insurance totalled CZK 89.9 billion in 2016, up by 0.3% on a year earlier. This year-on-year decline in total gross premiums written followed a drop in premiums of around 3% between 2014 and 2015. (See Chart B.III.2)

The gradual downward trend in the share of life insurance in total gross premiums written continued into 2016. This share declined by 1.8 percentage points compared with the previous period, to 39.3%. It reached its historical high of 47.5% in 2012. (See Chart B.III.4)

As regards the breakdown of total gross premiums written by type of entity, domestic insurance undertakings remained dominant in the Czech Republic in terms of this indicator in 2016, accounting for 94% of gross premiums written, despite a slight increase of 0.2 percentage point in the share of branches of foreign insurance undertakings. (See Chart B.III.5)

Insurance penetration, as measured by the ratio of gross premiums written to GDP at current prices, is an important macroeconomic indicator relating to the insurance market. Insurance penetration in the Czech Republic declined by 0.2 percentage point year on year to 3.1% in 2016. (see Table B.III.2 and Chart B.III.6)

An important instrument used by insurance companies to mitigate risks is reinsurance. It is used primarily by non-life insurers in cases where high claim settlement limits could put their financial stability and solvency at risk. In 2016, non-life insurance premiums ceded to reinsurers amounted to CZK 25.7 billion, representing 28.6% of gross premiums written. The share of premiums ceded to reinsurers is significantly lower in life insurance than in non-life insurance. Of the total volume of premiums written in life insurance, premiums of CZK 4.6 billion were ceded to reinsurers in 2016. This represents 7.9% of total premiums written in life insurance.

The share in gross premiums written can also be used to quantify the importance of the individual insurance classes. As of 31 December 2016, under the Solvency II methodology, index-linked and unit-linked life insurance had the biggest share in life insurance (43.4%), followed by insurance with profit participation (21.4%) and health insurance (20.2%). The share of other life insurance, which falls outside the above categories, was 15.1%. (See Chart B.III.7)

<sup>93</sup> Gross premiums written consist of all amounts of premiums payable under insurance policies during the accounting period, regardless of whether these amounts relate fully or partly to subsequent accounting periods. They also include premiums ceded to reinsurers.

At the end of 2016, domestic insurers were focused, in terms of the amount of gross premiums written, on insurance against fire and other damage to property (26.6%), motor vehicle liability insurance (26%) and other motor insurance (20.4%). Lower shares were recorded for general liability insurance (8.9%) and workers' compensation insurance (6.9%). Other forms of non-life insurance, which under the Solvency II framework include income protection insurance, health insurance and miscellaneous financial loss insurance, had a total share of 11.1%. (See Chart B.III.8)

TABLE B.III.2

## TOTAL INSURANCE PENETRATION IN CZECH REPUBLIC

	Amount (in CZK billions)			Change 2016/2015 (in %)
	2014	2015	2016	
Premiums written	156.6	152.0	148.2	-2.5
GDP (at current prices)	4,313.8	4,554.6	4,715.1	+3.5
	in %			
Premiums written/GDP	3.6	3.3	3.1	x

CHART B.III.6

## SHARES OF PREMIUMS WRITTEN IN GDP

(in %)

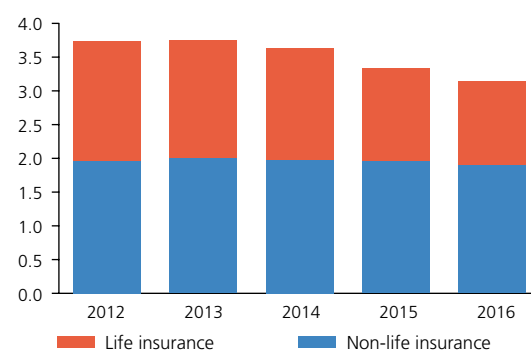


CHART B.III.7

## CLASSES OF LIFE INSURANCE OF DOMESTIC INSURANCE UNDERTAKINGS

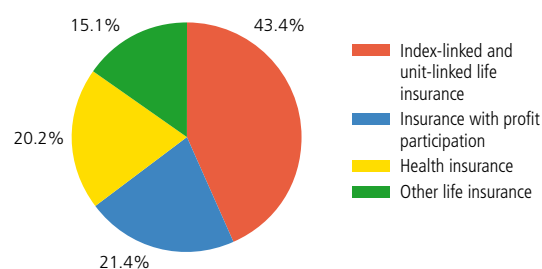


CHART B.III.8

## CLASSES OF NON-LIFE INSURANCE OF DOMESTIC INSURANCE UNDERTAKINGS

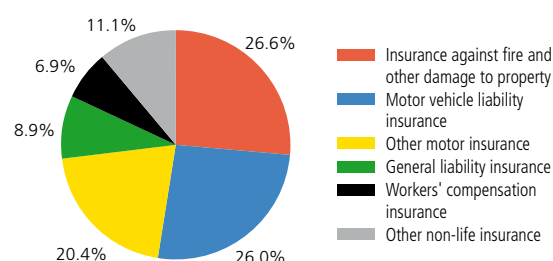
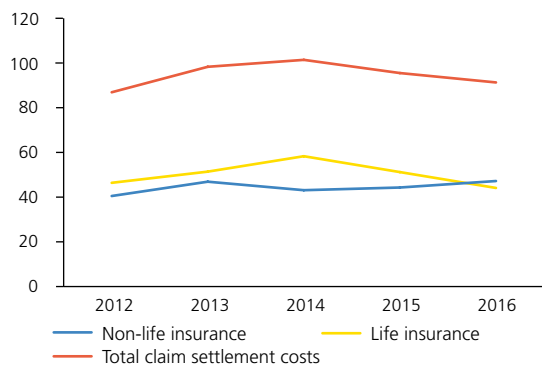


CHART B.III.9

**GROSS CLAIM SETTLEMENT COSTS**

(in CZK billions)

**3.3 CLAIM SETTLEMENT COSTS**

Gross claim settlement costs<sup>94</sup> totalled CZK 91.3 billion in 2016, decreasing by 4.4% compared with 2015. A significant reduction in claim settlement costs was recorded in life insurance, where such costs decreased by 13.9% compared with 2015 to CZK 44.1 billion in 2016. Non-life insurance claim settlement costs increased by 6.5% compared with 2015, reaching CZK 47.2 billion. (See Chart B.III.9)

The share of reinsurers in claim settlement costs is approximately equal to their share in premiums written. In 2016, the share of reinsurers in claim settlement costs in non-life insurance was 26.3%, which is 0.3 percentage point less than in 2015. In life insurance, the share of reinsurers increased by 0.8 percentage point to 4.3%. In absolute terms, claim settlement costs borne by reinsurers totalled CZK 14.3 billion in 2016, a CZK 0.7 billion increase compared with 2015.

94 Claim settlement costs gross of the share of reinsurers.



### 3.4 ASSETS OF INSURANCE UNDERTAKINGS<sup>95</sup>

The total assets of insurance undertakings amounted to CZK 466.2 billion as of 31 December 2016, a year-on-year increase of 2.4%. Domestic insurance undertakings account for most of this amount, with total assets of CZK 414.6 billion in 2016, a year-on-year decrease of 2.9%. The assets of branches of foreign insurance undertakings totalled CZK 51.6 billion in 2016. This represents a decrease of 1.5% compared with 2015. (See Table B.III.3)

Investments have long been the largest item of domestic insurance undertakings' assets. In 2016 they amounted to CZK 298.7 billion, a 0.3% increase compared with 2015. In 2016, as in previous years, debt securities – with a total volume of CZK 233.7 billion – accounted for the biggest share of domestic insurance companies' investments. Debt securities therefore represent over half of the total assets of domestic insurance undertakings in terms of value. Participating interests (CZK 23.2 billion) and shares and other securities (CZK 23 billion) were also major items in the investments of domestic insurance undertakings. (See Table B.III.4)

TABLE B.III.3

#### SHARES OF INSURANCE UNDERTAKINGS IN TOTAL ASSETS

	Amount (in CZK billions)			Share 2016
	2014	2015	2016	
TOTAL ASSETS	460.0	455.3	466.2	100.0
Domestic insurance undertakings	423.6	402.9	414.6	88.9
Branches of insurance undertakings	36.4	52.4	51.6	11.1

TABLE B.III.4

#### ASSET STRUCTURE OF DOMESTIC INSURANCE UNDERTAKINGS

	Amount (in CZK billions)			Structure 2016 (in %)
	2014	2015	2016	
TOTAL ASSETS	423.6	402.9	414.6	100.0
Financial placements (investment)	316.6	297.9	298.7	72.0
of which:				
real estate	4.1	4.1	3.5	0.8
participating interests	21.2	22.3	23.2	5.6
shares, variable-yield securities	23.6	23.8	23.0	5.5
debt securities	255.3	234.8	233.7	56.4
deposits at financial institutions	11.4	12.5	8.9	2.1
other financial placements	1.0	0.4	6.4	1.5
Investments of life insurance where investment risk is borne by policy holders	68.8	65.9	69.8	16.8
Debtors (receivables)	14.3	13.5	16.1	3.9
Other assets	23.9	25.6	30.0	7.2

Investments of life insurance where the investment risk is borne by the policy holders are another important asset item. They increased in value by 5.9% compared with 2015, to CZK 69.8 billion. The amount of receivables also increased – by CZK 2.6 billion to CZK 16.1 billion. Other assets, which include cash at financial institutions, cash in hand and deferred acquisition costs for insurance contracts, amounted to CZK 30 billion in 2016.

<sup>95</sup> The overview of domestic insurance undertakings' assets and liabilities is based on balance sheets reported in accordance with accounting standards, not the Solvency II methodology.

TABLE B.III.5

**LIABILITY STRUCTURE OF DOMESTIC INSURANCE UNDERTAKINGS**

	Amount (in CZK billions)			Structure 2016 (in %)
	2014	2015	2016	
TOTAL LIABILITIES	423.6	402.9	414.6	100.0
Shareholders' equity	71.0	71.7	72.0	17.4
Technical provisions <sup>a)</sup>	243.3	225.7	223.1	53.8
Provision for life insurance where investment risk is borne by policy holders <sup>a)</sup>	68.8	65.9	69.8	16.8
Creditors (liabilities)	22.7	21.2	30.6	7.4
Other liabilities	17.8	18.4	19.1	4.6

a) net amount

**3.5 LIABILITIES OF INSURANCE UNDERTAKINGS**

Technical provisions are the most important, and also a specific, liability item for insurance undertakings. In 2016, the net technical provisions<sup>96</sup> of domestic insurance undertakings decreased by 1.2% year on year to CZK 223.1 billion. (See Table B.III.5)

Net technical provisions make up over half of the liabilities of domestic insurance undertakings and consist of the provision for unearned premiums, the life insurance provision, the outstanding claims provision, the provision for bonuses and rebates and other provisions. The item of technical provisions of life insurance where the investment risk is borne by the policy holders is given separately. Compared with 2015, this item increased by CZK 3.9 billion to CZK 69.8 billion in 2016.

Shareholders' equity formed more than 17% of the liabilities of domestic insurance undertakings. The amount of equity has not changed significantly in recent years and stood at CZK 72 billion in 2016. The ratio of equity to liabilities of domestic insurance undertakings was 17.4%. Liabilities to creditors rose by 44.3% compared with the previous period, to CZK 30.6 billion. Other liabilities of domestic insurance undertakings, such as passive reinsurance deposits, amounted to CZK 19.1 billion.

96 Net of the share of reinsurers in technical provisions.

### 3.6 PROFITS OF INSURANCE UNDERTAKINGS

The profits of the Czech insurance market in 2016 were in line with those for the previous two years. Despite a 7.7% decrease compared with 2015, domestic insurance undertakings and branches of foreign insurance undertakings generated a net profit of CZK 12 billion, the same as in 2014. The technical account<sup>97</sup> for non-life insurance ended in a profit of CZK 5.9 billion, down by CZK 0.7 billion compared with 2015. The technical account for life insurance recorded a profit of CZK 8.4 billion in 2016, CZK 0.4 billion less than 2015. (See Chart B.III.10)

Domestic insurance undertakings accounted for 93.3% of the net profit of the Czech insurance sector. In 2016, they recorded a net profit of CZK 11.2 billion, which represents a decrease of 7.4% compared with the previous year. Branches of foreign insurance undertakings posted a net profit of only CZK 0.8 billion, a drop of 11.1% year on year. (See Table B.III.6)

There were no significant changes in the profitability and efficiency ratios of domestic insurance undertakings compared with the previous two years. Return on assets (RoA), as measured by the ratio of net profit to total assets, decreased by 0.3 percentage point compared with 2015, to 2.7%. Return on equity (RoE), as measured by the ratio of net profit to equity, fell by 1.3 percentage points to 15.6% and the ratio of net profit to earned premiums<sup>98</sup> dropped by 0.6 percentage point to 10.4%. (See Table B.III.7)

CHART B.III.10

#### PROFITS OF INSURANCE UNDERTAKINGS

(in CZK billions)

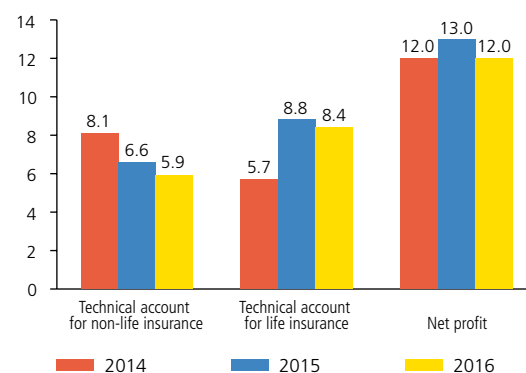


TABLE B.III.6

#### PROFIT OF INSURANCE UNDERTAKINGS

	Amount (in CZK billions)			Structure 2016 (in %)
	2014	2015	2016	
NET PROFIT, TOTAL	12.0	13.0	12.0	100.0
Domestic insurance undertakings	11.3	12.1	11.2	93.3
Branches of insurance undertakings	0.7	0.9	0.8	6.7

TABLE B.III.7

#### PROFITABILITY AND EFFICIENCY OF DOMESTIC INSURANCE UNDERTAKINGS

(in %)

	2014	2015	2016
<b>DOMESTIC INSURANCE UNDERTAKINGS, TOTAL</b>			
Net profit/assets (RoA)	2.7	3.0	2.7
Net profit/shareholders' equity (RoE)	15.9	16.9	15.6
Net profit/earned premiums	9.7	11.0	10.4
<b>NON-LIFE INSURANCE</b>			
Profit on technical account for non-life insurance/earned premiums	9.3	2.6	0.2
Claims incurred, including change in TPs/earned premiums	60.8	66.1	60.6
Net operating costs/earned premiums	31.8	31.8	30.5
Acquisition costs for insurance contracts/earned premiums	25.0	25.2	24.7
Administrative expenses/earned premiums	16.2	16.1	15.5
<b>LIFE INSURANCE</b>			
Profit on technical account for life insurance/earned premiums	8.3	15.6	16.3
Claims incurred, including change in TPs/earned premiums	83.7	85.0	77.8
Net operating costs/earned premiums	22.0	22.9	23.7
Acquisition costs for insurance contracts/earned premiums	16.5	17.4	18.2
Administrative expenses/earned premiums	6.7	7.4	8.5

97 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 insurance and a non-technical account, which comprises income and expenses that cannot be assigned to life or non-life insurance.

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

As regards non-life insurance, the ratio of claims incurred, including change in technical provisions, to earned premiums of domestic insurance undertakings saw a slight increase of 0.9 percentage point to 57.2% in 2016. Compared with 2015, the ratio of net operating costs to earned premiums also rose slightly from 30.8% to 31.5%. The ratio of administrative expenses to earned premiums conversely showed a positive change, falling from 15.5% in 2015 to 13% in 2016.

Turning to life insurance indicators, the ratio of the result of the technical account to earned premiums rose by 0.7 percentage point to 16.3% in 2016. The ratio of claims incurred, including change in technical provisions, to earned premiums decreased from 85% in 2015 to 77.8% in 2016. On the other hand, the ratio of net operating expenses to earned premiums rose by 0.8 percentage point to 23.7% and the ratio of acquisition expenses for insurance contracts to earned premiums also went up by 0.8 percentage point to 18.2% in 2016.

### 3.7 SOLVENCY AND MINIMUM CAPITAL REQUIREMENT

Under Solvency II, domestic insurance undertakings report two important indicators to the Czech National Bank: the ratio of eligible own funds to the solvency capital requirement (SCR<sup>99</sup>), and the ratio of eligible own funds to the minimum capital requirement (MCR<sup>100</sup>). If the ratio of the eligible own funds to the SCR of the insurance undertaking falls below 100%, the supervisory authority must intervene. If the insurance undertaking is unable to cover the MCR with its eligible own funds, its licence should be withdrawn.

The data reported by domestic insurance undertakings at the beginning and end of 2016 reveal that the Czech insurance market is sufficiently able to fulfil the Solvency II capital requirements. No domestic insurance undertaking reported a ratio of eligible own funds to the MCR of lower than 100%. As of 31 December 2016, the median ratio of eligible own funds to the MCR was 362% and the median ratio of eligible own funds to the SCR was 214%. (See Table B.III.8)

TABLE B.III.8

#### COMPLIANCE WITH SOLVENCY II CAPITAL REQUIREMENTS BY DOMESTIC INSURANCE UNDERTAKINGS

	31 December 2016	1 January 2016*
Aggregate eligible own funds for compliance with SCR		
Median ratio of eligible own funds to SCR	214%	227%
Aggregate eligible own funds for compliance with MCR	CZK 112,4 billions	CZK 107,6 billions
Median ratio of eligible own funds to MCR	362%	383%

\* According to initial statements submitted by domestic insurance undertakings as part of the process of preparation for implementing the Solvency II directive in the Czech Republic

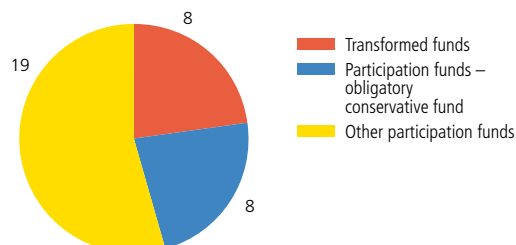
99 The SCR is calculated at least once a year using the standard formula, using the standard formula in combination with a partial internal model, or using a full internal model. In the calculation, the domestic insurance undertaking must take into account all the measurable risks to which it is exposed.

100 The MCR is the level of eligible own funds under which policy holders and beneficiaries would be exposed to unacceptable risk if the insurance undertaking was allowed to continue operating. It is calculated quarterly as a linear function of a set or subset of variables, such as the insurance undertaking's technical provisions, premiums written, capital at risk, deferred taxes and administrative expenses. The minimum MCR levels are stipulated by law.

CHART B.IV.1

**THIRD-PILLAR FUNDS**

(numbers of funds; as of 31 December 2016)

**4. THE CAPITAL MARKET****4.1 PENSION MANAGEMENT COMPANIES AND THEIR FUNDS**

For the sector of pension management companies and their funds in the Czech Republic, 2016 was marked by the termination of retirement savings, i.e. the second pension pillar. This was associated with the dissolution and liquidation of retirement funds and the related settlement of retirement savings. By contrast, in 2016 it became possible for the first time for persons under 18 years of age to enter into a supplementary pension savings contract.

**4.1.1 Pension management companies**

A total of eight pension management companies were active in the Czech private pension and supplementary pension savings sector, as of 31 December 2016, the same number as at the end of 2015. At the end of 2016, pension management companies were managing assets in 27 participation funds and eight transformed funds. Following the decision to terminate retirement savings, all 20 retirement funds went into liquidation on 30 June 2016. (See Chart B.IV.1)

Pension management companies generated a net after-tax profit of CZK 1.5 billion in 2016 (up by CZK 0.7 billion year on year). Financial and operating profit rose by CZK 0.6 billion year on year to CZK 2.5 billion. The net profit generated from fees and commissions increased by 40.3% year on year to CZK 2.5 billion in 2016. Fee and commission income rose by 18.5% year on year to CZK 3.3 billion, owing mainly to year-on-year growth in remuneration for fund asset management (up by 41.6% to CZK 3.0 billion), whereas fee and commission expenses declined by CZK 0.1 billion year on year to CZK 0.9 billion, primarily because of a drop in remuneration for intermediation (of 33.7% to CZK 0.4 billion). The administrative expenses of pension management companies edged up by CZK 0.1 billion year on year to CZK 1.1 billion.

The total capital of pension management companies rose by 1.2% year on year to CZK 8.9 billion, representing a capital ratio of 119.9% (down by 12.7 percentage points year on year) in relation to the specified capital requirements of CZK 7.4 billion. (See Table B.IV.1)

TABLE B.IV.1

**CAPITAL AND CAPITAL REQUIREMENTS****Pension management companies**

	2014	2015	2016	Change 2016/2015 (in %)
Capital, total (in CZK billions)	8.3	8.8	8.9	+1.2
Capital requirements (in CZK billions)	6.0	6.6	7.4	+11.9
Capital ratio (in %)	139.7	132.6	119.9	N/A

### 4.1.2 Planholders in the third pillar

At the end of 2016, the CNB registered more than 4.5 million planholders in the third pension pillar. The number of supplementary pension savings planholders in participation funds rose by 47.6% year on year, from 367,200 to 542,000. By contrast, as policies were terminated and no new planholders could enter the scheme, the number of pension scheme planholders in transformed funds fell further from 4.3 million at the end of 2015 to 4.0 million at the end of 2016. (See Table B.IV.2)

TABLE B.IV.2

#### NUMBERS AND STRUCTURE OF PARTICIPANTS

(in thousands; as of end of period)

	2014	2015	2016
Numbers of second and third pillar participants			
Number of retirement savings planholders	83.2	84.5	0.0
Number of supplementary pension savings planholders	224.3	367.2	542.0
Number of private pension scheme planholders	4,569.4	4,259.9	3,979.4
Third pillar participants by contribution type			
Planholders with own contribution	4,680.3	4,525.4	4,414.7
Planholders with employer contribution	1,318.8	1,283.4	1,304.1
Planholders with state contribution	3,733.8	3,789.6	3,576.0

### 4.1.3 Assets of pension management company funds

At the end of 2016, pension management companies were managing assets totalling CZK 402.1 billion in their third pillar funds, up by 7.8% on 2015. Transformed funds had a majority share (95.5%) of the assets of pension management company funds, while participation funds accounted for 4.5%. (See Chart B.IV.2)

Transformed funds managed by pension management companies placed the bulk of their assets in debt securities (90.0% of total assets), while investing just 2.0% of total assets in shares and units and 7.4% in time deposits and on term accounts. Investment in other assets accounted for 0.6% of their assets.

The asset structure of participation funds is generally less conservative than that of transformed funds and is affected by the investment profiles of the individual funds. Investment in bonds issued by general government is dominant in obligatory conservative and bond funds (75.4% of their assets). By contrast, other participation funds have higher shares of investment in shares (10.4% of assets) and units (18.1% of assets), while they invest 51.5% of their total assets in debt securities. (See Chart B.IV.3)

CHART B.IV.2

#### ASSETS BY FUND TYPE

##### Pension management company funds

(in CZK billions; at end of period)

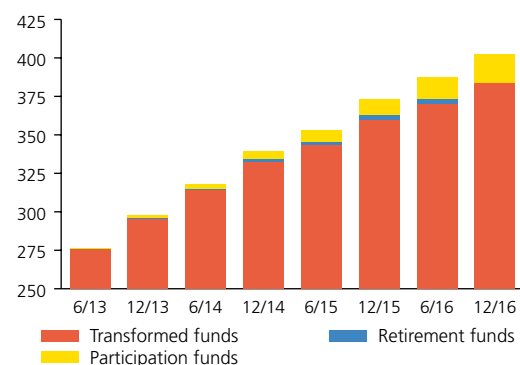


CHART B.IV.3

#### ASSETS OF THIRD-PILLAR FUNDS

(in %; as of 31 December 2016)

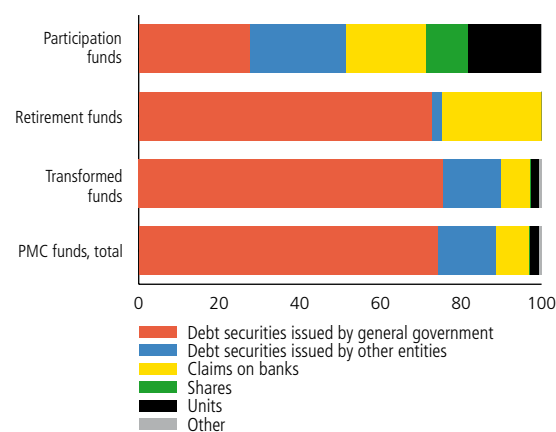


CHART B.IV.4

**CONTRIBUTIONS RECEIVED BY PENSION MANAGEMENT COMPANY FUNDS**

(in CZK billions; at end of period)

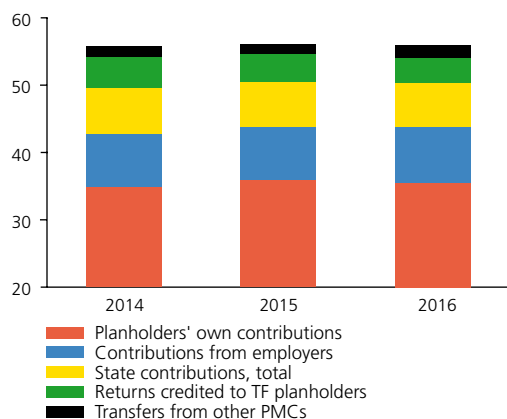


CHART B.IV.5

**CONTRIBUTIONS RECEIVED  
Third-pillar funds**

(in %; as of 31 December 2016)

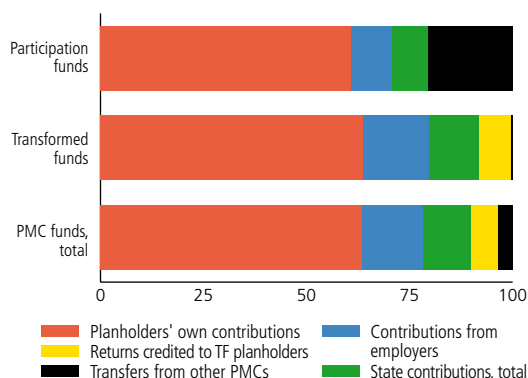
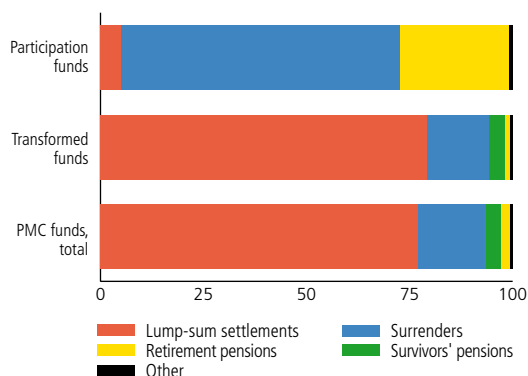


CHART B.IV.6

**BENEFITS PAID TO PLANHOLDERS  
Third-pillar funds**

(in %; as of 31 December 2016)

**4.1.4 Planholders' own funds in pension management company funds**

Pension management companies were managing planholders' own funds totalling CZK 381.3 billion in third-pillar funds at the end of 2016, i.e. 8.3% more than in 2015, of which transformed funds accounted for CZK 363.3 billion and participation funds for CZK 18.0 billion. Both fund types saw year-on-year growth in funds – 7.2% for transformed funds and 78.9% for participation funds.

In 2016, third-pillar pension management company funds received contributions totalling CZK 56.0 billion, down by 0.2% from 2015. Of this amount, 84.6% (i.e. 2.1 percentage points less than in 2015) went into transformed funds and 15.4% into participation funds.

With regard to structure, the majority of the contributions were planholders' own contributions (63.4%), while contributions from employers represented 14.9% and state contributions accounted for 11.7%. Roughly 6.6% were returns on contributions credited to transformed fund planholders. About 2.8% (CZK 1.5 billion) were funds transferred from transformed funds to participation funds and 0.4% were transfers among pension management companies. The remainder (0.2%) were funds received from other sources and as yet unidentified payments which have been credited to the depositary's account but not to a specific retirement savings, supplementary pension savings or private pension scheme planholder. (See Charts B.IV.4 and B.IV.5)

Pension management company funds paid out a total of CZK 24.2 billion to planholders in 2016, up by 13.7% compared with 2015. Of this amount, 88.3% (CZK 21.4 billion) were funds paid to planholders and 7.1% (CZK 1.7 billion) funds transferred from transformed funds to participation funds and transfers among pension management companies. The remainder were funds returned to the state budget (2.3%), funds returned to planholders (1.4%) and other funds paid (0.9%). The balance of funds received and paid was CZK 31.7 billion in 2016 (down by CZK 3.0 billion year on year). The difference between planholders' own funds and the funds paid to them amounted to CZK 14.1 billion in 2016, a year-on-year decrease of CZK 2.8 billion. (See Chart B.IV.6)

Transformed funds of pension management companies paid out a total of CZK 20.8 billion to planholders in 2016. This was 10.6% more than in 2015. Lump-sum settlements represented the largest part of this figure (79.3%, 173,465 cases). Surrenders also accounted for a significant proportion (15.0%, 64,461 cases).



Participation funds of pension management companies paid out a total of CZK 0.63 billion to planholders in 2016, with surrenders accounting for the largest share (67.8%, 9,308 cases), followed by retirement pensions (26.4%, 1,971 cases).

In addition, pension management companies paid out all the funds (CZK 3.4 billion) to the planholders of terminated retirement savings plans between 15 October and 31 December 2016.

CHART B.IV.7

## INVESTMENT FIRMS

(numbers of firms at end of period)

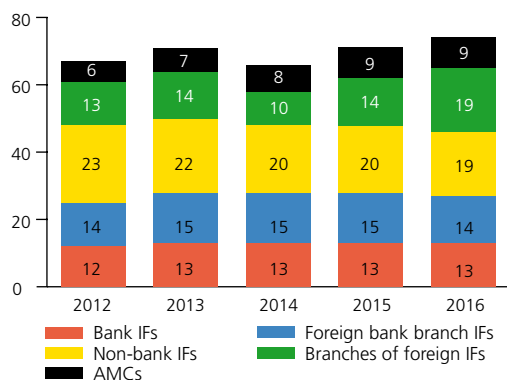


CHART B.IV.8

## CLIENT ASSETS

## Licensed investment firms

(in CZK billions; at end of period)

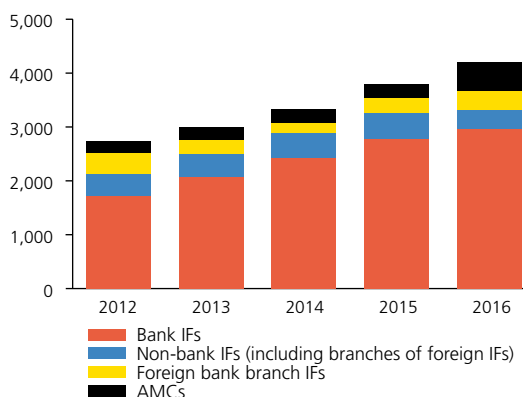
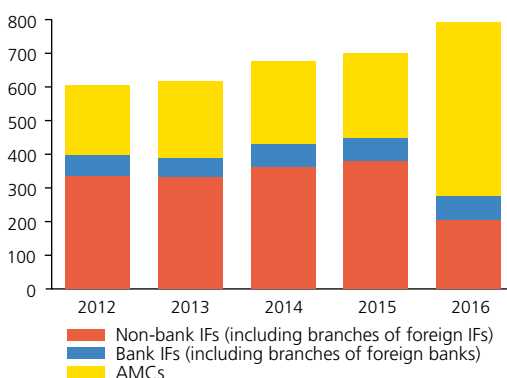


CHART B.IV.9

## FUNDS MANAGED

## Licensed investment firms

(in CZK billions; at end of period)



## 4.2 INVESTMENT FIRMS

## 4.2.1 Licensed investment firms

There were 65 investment firms registered on the Czech capital market as of the end of 2016, 13 of them banks, 19 non-bank investment firms, 14 foreign bank branches and 19 branches of foreign non-bank investment firms. Nine domestic management companies managing assets of clients under contract (asset management companies<sup>101</sup>) held investment firm licences at the end of 2016. (See Chart B.IV.7)

Licensed investment firms<sup>102</sup> had almost 1.3 million clients at the end of 2016. Domestic non-bank investment firms accounted for 317,300 and bank investment firms for 891,800 of the total number of clients. Foreign bank branches and branches of foreign investment firms had 29,100 and 15,800 clients respectively at the end of 2016. Domestic asset management companies had 892 clients.

## 4.2.2 Client assets and managed funds

At the end of 2016, the assets of clients of licensed investment firms totalled CZK 4,196.5 billion, up by 10.5% on the same period a year earlier. Of the total, the assets of clients of domestic non-bank investment firms amounted to CZK 334.8 billion (down by 31.8% year on year), the assets of clients of domestic banks CZK 2,978.8 billion (up by 7.4%) and the assets of clients of asset management companies CZK 525.3 billion (more than double the amount recorded a year earlier). The assets of clients of branches of foreign banks and branches of foreign investment firms amounted to CZK 355.3 billion and CZK 2.3 billion respectively, representing an increase of 30.0% and 95% year on year respectively. (See Chart B.IV.8)

As of 31 December 2016, investment firms were managing funds totalling CZK 791.6 billion (up by 13.2% on a year earlier), of which CZK 205.9 billion fell to domestic non-bank investment firms (down by 46.1% from a year earlier), CZK 67.7 billion to domestic bank investment firms (up by 4.2% on a year earlier) and CZK 515.5 billion to asset management companies (up by 105.0% on a year earlier).

<sup>101</sup> Management companies which provide the core investment service of asset management for a client if an investment instrument is part of such assets pursuant to Article 4(2)(d) of the Capital Market Undertakings Act (referred to as "asset management companies" or "AMCs").

<sup>102</sup> Entities licensed by the CNB and branches of entities registered in another EU Member State and authorised to provide investment services in the Czech Republic.

Minimal levels of managed funds (CZK 2.6 billion) were registered by foreign bank branches and zero levels for foreign investment firms. (See Chart B.IV.9)

As regards structure, most of the funds managed were investment securities (82.2%), in particular bonds (79.5%, or CZK 553.3 billion). Collective investment securities and cash also had significant shares, accounting for 15.3% and 3.2% respectively.

### 4.2.3 Volumes of trading in securities

Investment firms carried out trades for their clients totalling CZK 12,690.5 billion<sup>103</sup> in 2016. Trades under a management relationship accounted for 39.2% of this figure. As regards structure, bond trades were dominant (75.6%). (See Chart B.IV.10)

Securities trades carried out for clients by bank investment firms totalled CZK 4,976.2 billion. Non-bank investment firms carried out trades for their clients amounting to CZK 5,956.4 billion, while client trades of asset management companies reached CZK 813.3 billion, client trades of foreign bank branches totalled CZK 933.4 billion and client trades of foreign investment firm branches amounted to CZK 11.2 billion. (See Table B.IV.3)

Investment firms carried out trades for their own account totalling CZK 49,449.4 billion in 2016, up by 19.0% compared with 2015. The largest proportion (85.8%) of the total volume of trades for own account were executed by bank investment firms. Non-bank investment firms carried out trades for their own account amounting to CZK 1,215.6 billion (2.5% of the total volume), while foreign bank branches' trades for their own account over the same period totalled CZK 5,802.1 billion (11.7% of the total volume). The structure of trades for own account carried out by investment firms was dominated by bonds, which accounted for 97.6%. (See Chart B.IV.11)

CHART B.IV.10

#### SECURITIES TRADES BY SECURITY TYPE

(in %; structure in 2016)

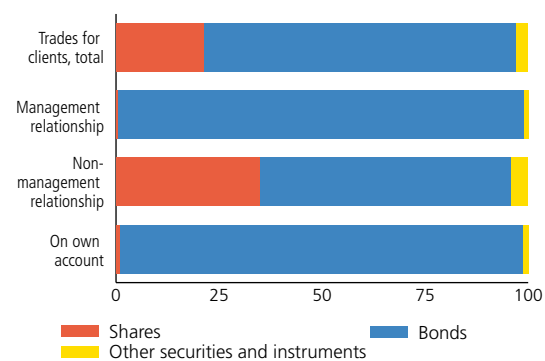


TABLE B.IV.3

#### VOLUMES OF SECURITIES TRADES BY INVESTMENT FIRMS

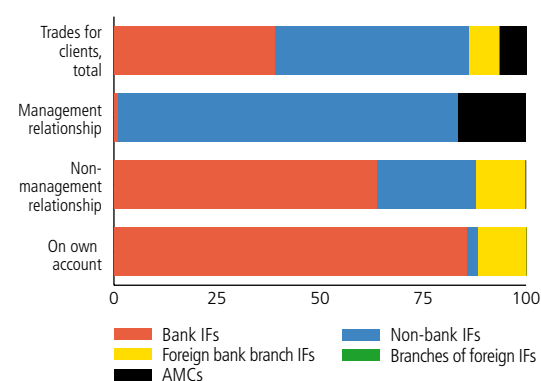
(in CZK billions)

	2014	2015	2016
<b>Securities trades for clients</b>			
IFs, total	39,406.2	17,699.1	12,690.5
Bank IFs	4,576.5	4,576.6	4,976.2
Non-bank IFs	33,248.8	12,059.4	5,956.4
Foreign bank branch IFs	1,502.6	989.0	933.4
Branches of foreign IFs	1.4	11.3	11.2
AMCs	76.8	62.8	813.3
<b>On own account</b>			
IFs, total	53,817.3	41,548.2	49,449.4
Bank IFs	50,778.9	36,290.2	42,431.7
Non-bank IFs	357.1	653.9	1,215.6
Foreign bank branch IFs	2,681.3	4,604.2	5,802.1
Branches of foreign IFs	0.0	0.0	0.0
AMCs	0.0	0.0	0.0

CHART B.IV.11

#### SECURITIES TRADES BY ENTITY

(in %; structure in 2016)



<sup>103</sup> The overall volume of trades comprises spot transactions, custody transfers, repos, buy/sell-back trades and sell/buy-back trades.

CHART B.IV.12

**RISK EXPOSURES****Non-bank investment firms**

(structure in %, at end of period)

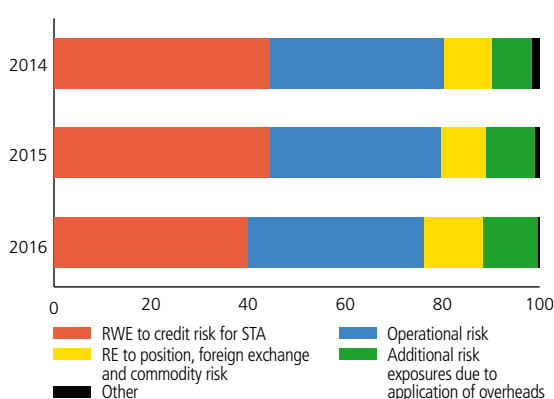


TABLE B.IV.4

**PROFIT AND LOSS ACCOUNT – NON-BANK INVESTMENT FIRMS**

(in CZK millions)

	2014	2015	2016	Change 2016/2015 (in %)
Financial and operating profit	2,714.6	3,178.5	2,892.2	-9.0
of which:				
Interest profit	93.6	83.9	59.0	-29.7
Dividend income	36.0	41.8	36.2	-13.3
Fee and commission profit	2,297.6	2,582.0	2,212.2	-14.3
Profit from revaluation of assets	303.2	492.6	534.3	+8.5
Other operating gain/loss	-15.8	-21.7	50.6	-333.4
Administrative expenses	1,750.7	2,073.0	1,951.5	-5.9
Depreciation and provisions	85.6	73.8	89.2	+21.0
Impairment	4.5	25.5	0.9	-96.4
Profit or (-) loss from other activities	-2.8	0.8	2.3	-
Tax expense	173.3	210.3	178.8	-15.0
PROFIT for year after tax	697.9	796.7	674.0	-15.4

**4.2.4 Capital, ratios and profits of investment firms<sup>104</sup>**

The investment firm sector was sufficiently capitalised in 2016. The regulatory capital of domestic non-bank investment firms (19 entities) totalled CZK 2.5 billion (down by 12.6% year on year), of which Common Equity Tier 1 (CET1) accounted for 99.2%.

Calculated risk exposures<sup>105</sup> for individual types of risk amounted to CZK 11.1 billion for domestic non-bank investment firms, of which CZK 1.2 billion were risk exposures for investment firms with a restricted licence to provide investment services and investment firms with a restricted licence for own-account trading under Articles 95(2) and 98 of the CRR and Articles 96(2) and 98 of the CRR respectively.

Risk-weighted exposures to credit risk under the standardised approach (STA) accounted for the largest part of risk exposures (40.0%). Risk exposures to operational risk also recorded a significant share (36.2%), while lower risk exposures were calculated for position, foreign exchange and commodity risk (12.2%). Additional risk exposures due to the application of overheads accounted for 11.2% of total risk exposures for non-bank investment firms. (See Chart B.IV.12)

Domestic non-bank investment firms recorded lower profits in 2016 than in 2015. The total net profit of non-bank investment firms fell by 15.4% year on year to CZK 0.7 billion. The net profit represented 7.1% of the average assets of domestic non-bank investment firms and 26.2% of Tier 1 capital. This was 1.9 and 1.8 percentage points lower, respectively, than in 2015.

The worse profit was largely due to a year-on-year decrease in financial and operating profit of 9.0% to CZK 2.9 billion, caused mainly by a decline in the net margin on fees and commissions of 14.3% to CZK 2.2 billion. Financial and operating profit represented 31.5% of the average assets of domestic non-bank investment firms, down by 5.3 percentage points from 2015. (See Table B.IV.4)

Turning to the costs of domestic non-bank investment firms, administrative expenses accounted for 21.6% of their average assets and 68.6% of their financial and operating profit.

<sup>104</sup> This section analyses the capital and profits of domestic non-bank investment firms, unless stated otherwise.

<sup>105</sup> Following a change in methodology due to the coming into effect of Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR), risk exposures have been monitored for non-bank investment firms since 2015 (capital requirements were monitored until 2013).

### 4.3 FUND INVESTMENT

Unlike in previous years, when the fund investment sector and its structure were affected by a series of significant regulatory and legislative changes,<sup>106</sup> the sector saw only minor changes in the conditions for doing business in 2016.

#### 4.3.1 Structure of the management companies and investment funds sector

A total of 27 management companies, one branch of a foreign management company, 27 autonomous investment funds with legal personality, 201 mutual funds and 81 non-autonomous investment funds with legal personality were registered in the management companies and investment funds sector at the end of 2016. More than two-thirds (141) of the total number of mutual funds were collective investment funds intended for the public (of which 54 were standard funds) and the rest (60) were mutual funds for qualified investors. All 108 investment funds with legal personality were funds for qualified investors.

In 2016, the structure of the investment funds market was significantly affected by the option of establishing investment funds taking the still relatively new legal form of a SICAV. While at the end of 2015 a total of 48 SICAV funds had been registered in the Czech Republic (of which 17 had had at least one sub-fund) and the assets invested in them had totalled CZK 27.1 billion, by the end of 2016 the number of such funds had risen to 82 (of which 25 had at least one sub-fund) and their assets totalled CZK 58.1 billion.

In addition, investment in 1,250 foreign funds comparable to standard funds and 21 foreign funds comparable to special funds could be publicly offered in the Czech Republic at the end of 2016. According to figures from the Czech Capital Market Association, a total of CZK 195.5 billion was invested in foreign collective investment funds at the end of 2016. These funds thus represent major competition for domestic funds.

Following the implementation of the AIFMD (2013), investment in 127 foreign funds comparable to funds for qualified investors from other EU Member States is offered in the Czech Republic. Specialised European Venture Capital Funds (EuVEECAs) and European Social Entrepreneurship Funds (EuSEFs) may also be established. No domestic funds of this type have been set up, but 15 EuVEECAs are offered in the Czech Republic on a cross-border basis.

<sup>106</sup> In particular, the Act on Management Companies and Investment Funds (2013) had a significant impact on the market. It introduced new legal forms of investment funds: a joint-stock company with variable registered capital (SICAV), a limited partnership with units (SICAR) and a trust. However, only funds for qualified investors, not collective investment funds, can take the form of a SICAR or a trust.

TABLE B.IV.5

**CAPITAL AND CAPITAL REQUIREMENTS****Management companies**

	2014	2015	2016	Change 2016/2015 (in %)
Capital, total (in CZK billions)	1.4	1.3	1.5	+15.0
Capital requirements (in CZK billions)	0.2	0.2	0.3	+29.1
Capital ratio (in %)	656.8	623.9	556.1	N/A

**4.3.2 Management companies**

Management companies generated a net after-tax profit of CZK 0.88 billion in 2016 (up by 36.8% year on year). Financial profit rose by 27.9% year on year to CZK 2.2 billion, owing mainly to an increase in net profit from fees and commissions, which rose by 29.4% year on year to CZK 2.2 billion in 2016. Administrative expenses of management companies grew by 19.0% year on year to CZK 0.95 billion.

The total capital of management companies increased by 15.0% year on year to CZK 1.5 billion, representing a capital ratio of 441.6% in relation to the specified capital requirements of CZK 0.33 billion. (See Table B.IV.5)

**4.3.3 Assets in domestic investment funds**

At the end of 2016, the assets in investment funds managed by Czech management companies, the branch of a foreign management company and autonomous investment funds were up by 19.4% year on year to CZK 405.7 billion. Since 2012, investments in these funds have increased by more than 90%. Compared with 2010, they have gone in up value 2.5 times. (See Chart B.IV.13)

The assets in collective investment funds managed by Czech management companies and the branch of a foreign management company totalled CZK 258.1 billion at the end of 2016. The value of the assets in these funds was double that in 2008. Market concentration in terms of the value of assets managed by collective investment funds recorded a decline during 2016. At the end of 2016, the three companies with the largest market shares were managing 60.8% of the assets of collective investment funds (down by 3.8 percentage points year on year). (See Chart B.IV.14)

As regards fund type, mixed funds were managing the largest amount of assets at the end of 2016. They accounted for 40.9% of the total assets of collective investment funds (up by 0.2 percentage point). At the end of 2016, mixed funds were managing assets of CZK 105.5 billion, an increase of 18.8% compared with the end of 2015. (See Chart B.IV.15)

Bond funds were managing assets totalling CZK 82.1 billion, 9.6% higher than in the same period of 2015. The share of assets in bond funds in the total assets of all domestic collective investment funds fell slightly by 2.5 percentage points year on year to 31.8%.

Assets of CZK 49.4 billion were being managed by equity funds at the end of 2016. This represents 19.1% of the assets of collective investment funds. Real estate funds were managing CZK 19.2 billion of the assets of collective investment funds (7.4%). The other types of funds had relatively low asset levels at the end of 2016: CZK 0.7 billion in money market funds and CZK 1.2 billion in other funds.

CHART B.IV.13

**INVESTMENT FUND ASSETS****Domestic investment funds**

(in CZK billions; at end of period)

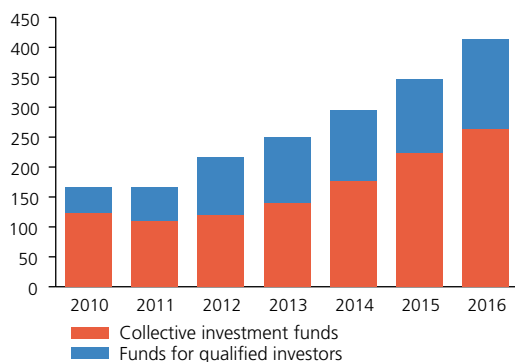
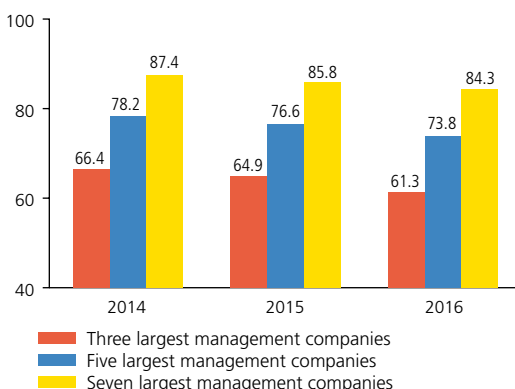


CHART B.IV.14

**CONCENTRATION OF COLLECTIVE INVESTMENT FUNDS BY VOLUME OF ASSETS MANAGED**

(in %; at end of period)



The assets in funds for qualified investors managed by Czech management companies, the branch of a foreign management company and autonomous investment funds totalled CZK 147.5 billion at the year-end, i.e. 21.9% more than in the same period of 2015 (of which the assets managed by autonomous investment funds amounted to CZK 48.2 billion at the year-end, i.e. 15.0% more than in the same period of 2015).

#### 4.3.4 Structure of collective investment fund assets

As regards the structure of investment, the largest part (37.4%) of the assets of collective investment funds was invested in debt securities at the end of 2016, with 20.0% invested in bonds issued by general government and 17.4% in bonds issued by other entities. In a year-on-year comparison, the share of debt securities in total assets was almost unchanged (down by 0.2 percentage point). Investments in shares and similar investment securities amounted to 15.7% of assets at the end of 2016, down by 0.4 percentage point from the end of 2015. (See Chart B.IV.16)

Collective investment funds had 28.6% of their assets invested in securities of collective investment funds, 1.7 percentage points more than in the same period of 2015. In all, 14.3% of assets were invested in deposits and other receivables, down by 2.0 percentage points from the same period of 2015. Other investments, for instance real estate and holdings in real estate companies, accounted for the remainder (4.0%) of the assets of collective investment funds.

The structure of the assets in the individual types of funds reflects the funds' investment orientation. The bulk of bond funds' assets (76.4%) are invested in debt securities, followed by deposits at banks (13.7%) and collective investment fund securities (9.7%). Mixed funds invest a large part of their assets in collective investment fund securities (48.1%) and bonds (31.0%). A smaller proportion of the assets of these funds is invested in deposits at banks (11.4%) and shares (9.2%). In line with their investment strategy, equity funds invest mainly in shares (61.8%) and to a lesser extent in collective investment fund securities (29.1%) and deposits at banks (8.6%). (See Chart B.IV.17)

CHART B.IV.15

**ASSETS BY FUND TYPE**  
Collective investment funds  
(in CZK billions; at end of period)

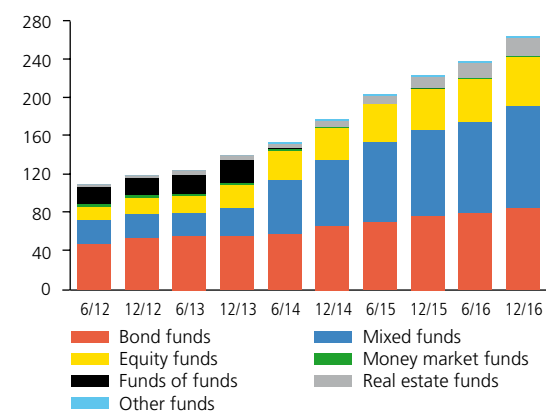


CHART B.IV.16

**ASSET STRUCTURE**  
Collective investment funds  
(in %; at end of period)

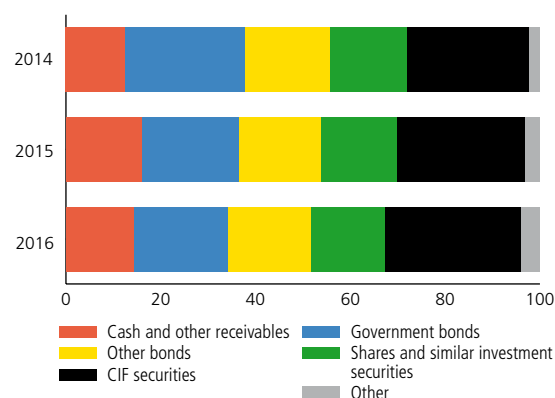


CHART B.IV.17

**ASSET STRUCTURE BY FUND TYPE**  
Collective investment funds  
(in %; as of 31 December 2016)

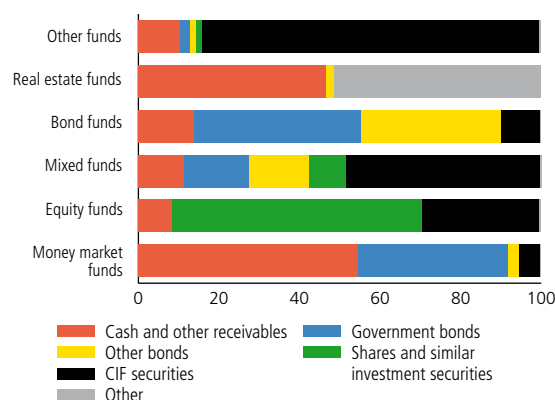
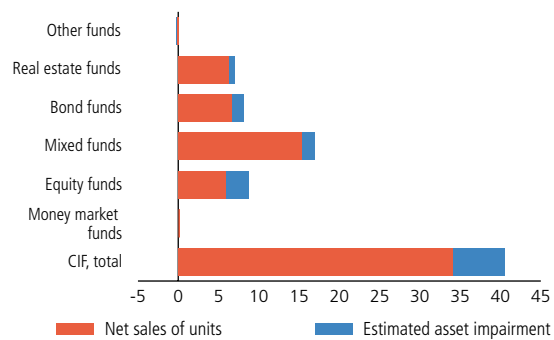


CHART B.IV.18

**DECOMPOSITION OF YEAR-ON-YEAR CHANGE IN ASSETS****Collective investment funds**

(in CZK billions; as of 31 December 2016)

**4.3.5 Sales and redemptions of fund units**

The total assets of collective investment funds managed by Czech management companies and the branch of a foreign management company are significantly affected by the net value of unit issues and redemptions. Positive net sales of units were recorded in 2016 (except for other funds). Only minimum amounts were recorded in money market funds, which also have a negligible market share.

The amount received for units issued (CZK 80.3 billion) was higher than the amount paid out of the assets of collective investment mutual funds for units redeemed (CZK 46.2 billion). The resulting difference between units issued and redeemed was thus positive at CZK 34.1 billion, contributing to a rise in the total balance sheet assets of collective investment funds. (See Table B.IV.3 and Chart B.IV.18)



## 4.4 REGULATED MARKETS

### 4.4.1 Trading on the Prague Stock Exchange<sup>107</sup>

A total of 25 share issues could be traded on the share and unit market of the Prague Stock Exchange (PSE) at the end of 2016 (the same as at the end of 2015), of which 14 were domestic issues. In all, 115 issues were registered on the bond market, three more than at the end of 2015. As regards the other PSE product markets, a total of 21 issues of non-leveraged investment certificates, 14 issues of leveraged investment certificates, 36 issues of warrants, 16 issues of separated coupons and 17 issues of investment fund shares had been admitted to trading as of 31 December 2016. Moreover, 37 investment fund shares could be traded on the PSE at the end of 2016. (See Chart B.IV.19)

The total volume of trades on the PSE stock market was flat (up by 0.1%) in 2016, amounting to CZK 168.0 billion. The most successful month was November with CZK 23.6 billion and the weakest month was July with CZK 10.8 billion. The average daily trading volume fell year on year from CZK 674.3 million to CZK 666.8 million in 2015. This was the second-lowest annual average daily trading volume on the PSE in eight years. (See Chart B.IV.20)

As usual, ČEZ shares were the most traded issue on the PSE (CZK 51.6 billion), accounting for 30.7% of the total volume of share trades in 2016, followed by Komerční banka (CZK 49.9 billion, 29.7%) and Moneta Money Bank (CZK 23.6 billion), although the Moneta Money Bank share issue only started to be traded on the PSE's Prime Market on 6 May 2016. Trading on the PSE remained highly concentrated in 2016, with the three most traded share issues accounting for 76.9%, the five most traded issues for 94.0% and the ten most traded issues for almost 99.4% of the total volume of share trades. (See Chart B.IV.21)

The market capitalisation of shares traded on the PSE fell by 5.1% year on year to CZK 1,044.5 billion at the end of 2016. (See Chart B.IV.22)

Domestic issues accounted for 57.4% (CZK 599.7 billion) of the total market capitalisation. The Erste Group Bank issue was the largest in terms of market capitalisation, accounting for 31.2% of total market capitalisation, followed by ČEZ with a share of 22.2% and Komerční banka with a share of 16.1%.

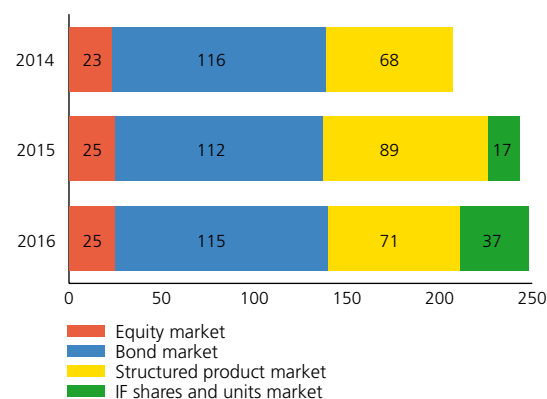
The official price index of the most liquid shares on the PSE, the PX index, was down by 3.6% (34.7 points) year on year at the end of 2016 and ended the year below 1,000 points again, at 921.6 points.

<sup>107</sup> Burza cenných papírů Praha, a.s. (Prague Stock Exchange, PSE), a member of CEE Stock Exchange Group together with the exchanges in Budapest, Ljubljana and Vienna.

CHART B.IV.19

#### NUMBERS OF REGISTERED ISSUES ON PSE

(at end of period)

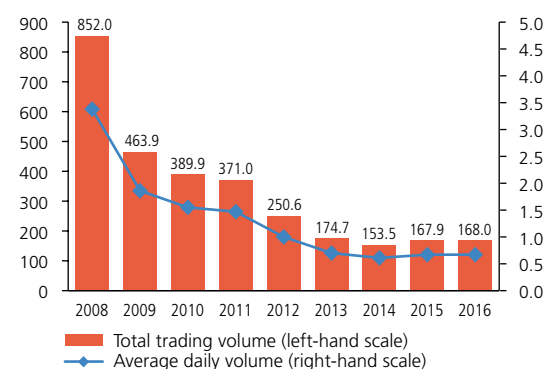


Source: PSE Statistical Fact Book

CHART B.IV.20

#### SHARE TRADING ON PSE

(in CZK billions; at end of period)

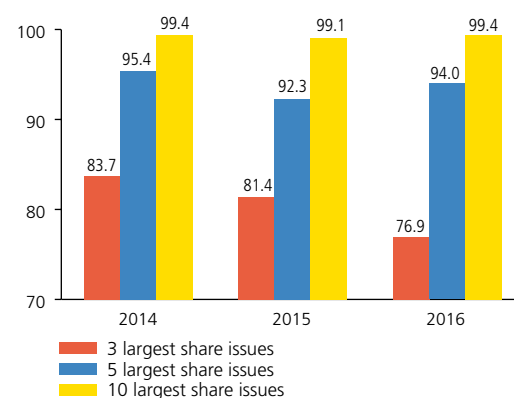


Source: PSE Statistical Fact Book

CHART B.IV.21

#### CONCENTRATION OF SHARE TRADING ON PSE

(in %; shares in total annual trading volume)

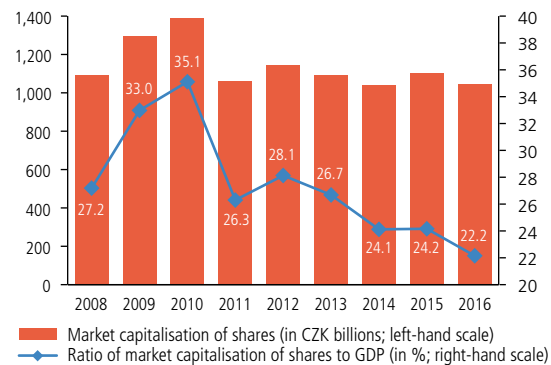


Source: PSE Statistical Fact Book

CHART B.IV.22

## MARKET CAPITALISATION OF SHARES ON PSE

(in CZK billions; at end of period)



Source: CZSO, PSE Statistical Fact Book

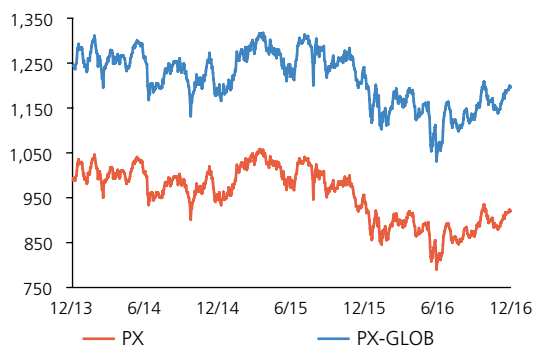
The PX index recorded its yearly maximum of 941.1 points right at the beginning of the year on 5 January 2016 and its yearly minimum of 790.1 points on 27 June 2016. The PX-GLOB index, comprising all traded shares, followed a similar trend. (See Chart B.IV.23)

Corporate issues totalling CZK 4.2 billion were the only bonds traded on the PSE bond market in 2016.

Only very small volumes were traded again on the structured product market in 2016. The volume of trading more than halved year on year, falling from CZK 262.0 million to CZK 126.4 million. Trading in investment fund shares and units amounted to CZK 62.7 million in 2016.

CHART B.IV.23

## PSE PRICE INDICES

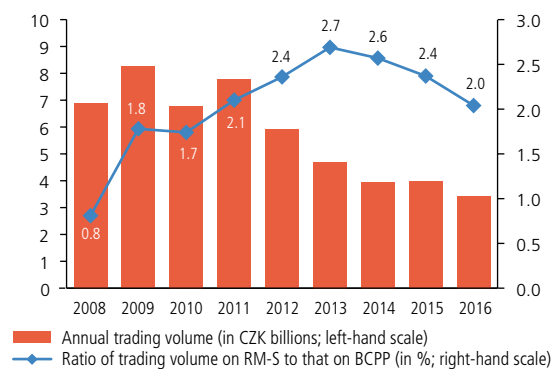


Source: PSE statistics

CHART B.IV.24

## SHARE TRADING ON RM-S

(share trading volumes; all markets)



Source: RM-S statistics

#### 4.4.2 Trading on the RM-SYSTÉM exchange<sup>108</sup>

Total share trading on the other domestic regulated market, RM-S, amounted to CZK 3.4 billion in 2016, down by 13.8% from a year earlier. (See Chart B.IV.24)

The volume of bond trades totalled CZK 12.1 million, representing a year-on-year increase of 38.7%.

The RM index stood at 1,158.7 points at the end of 2016, a decrease of 44.3% compared with the end-2015 level (2,081.2 points). The RM index recorded its yearly maximum of 2,050.3 points on 6 January 2016 and its yearly minimum of 950.2 points on 27 June 2016, the same as the PX index. (See Chart B.IV.25)

CHART B.IV.25

#### RM INDEX



Source: RM-S statistics

108 RM-SYSTÉM, česká burza cenných papírů a.s.

## PART C – ANNEXES

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(Detailed information on the individual financial market sectors falling under the supervision of the CNB is published regularly for each quarter on the CNB website: [www.cnb.cz](http://www.cnb.cz)).

## Annex 1

## MAIN INDICATORS OF MONETARY AND ECONOMIC DEVELOPMENTS IN THE CZECH REPUBLIC

		2012	2013	2014	2015	2016
Gross domestic product	Volume (in CZK billions) <sup>1)</sup>	3,999.6	3,980.2	4,088.2	4,276.9	4,376.4
	Increase (in %) <sup>2)</sup>	-0.7	-0.5	2.7	4.6	2.3
Final consumption expenditure of households	Increase (in %) <sup>2)</sup>	-1.2	0.5	1.8	3.1	2.9
Final consumption expenditure of government	Increase (in %) <sup>2)</sup>	-2.0	2.5	1.1	2.0	1.2
Gross capital formation	Increase (in %) <sup>2)</sup>	-3.8	-5.1	8.5	10.2	-1.0
Gross fixed capital formation	Increase (in %) <sup>2)</sup>	-2.9	-2.5	3.9	9.1	-3.9
Output – percentage increase	Industry (sales) <sup>3)</sup>	-0.8	-0.1	5.0	4.6	2.9
	Construction <sup>3)</sup>	-7.6	-6.7	4.3	7.1	-5.9
Prices	Inflation rate (in %) <sup>4)</sup>	3.3	1.4	0.4	0.3	0.7
Unemployment	Unemployment rate (in %)	7.0	7.1	6.2	5.1	4.0
Foreign trade	Exports of goods and services (in %) <sup>2)</sup>	4.5	0.2	8.7	7.9	4.0
	Imports of goods and services (in %) <sup>2)</sup>	2.8	0.1	10.1	8.4	3.0
Average wage	Nominal (in %) <sup>5)</sup>	2.5	-0.1	2.9	2.7	4.2
	Real (in %) <sup>5)</sup>	-0.8	-1.5	2.5	2.4	3.5
Balance of payments	Current account (in CZK billions) <sup>6)</sup>	-63.3	-21.8	7.9	11.3	52.6
Exchange rates	CZK/USD <sup>7)</sup>	19.6	19.6	20.8	24.6	24.4
	CZK/EUR <sup>7)</sup>	25.1	26.0	27.5	27.3	27.0
Average interbank deposit rate (PRIBOR)	7-day <sup>7)</sup>	0.64	0.21	0.17	0.16	0.14
	3-month <sup>7)</sup>	1.00	0.46	0.36	0.31	0.29
	6-month <sup>7)</sup>	1.24	0.58	0.43	0.39	0.36
Discount rate	(in %) <sup>8)</sup>	0.05	0.05	0.05	0.05	0.05
Lombard rate	(in %) <sup>8)</sup>	0.25	0.25	0.25	0.25	0.25
2W repo rate	(in %) <sup>8)</sup>	0.05	0.05	0.05	0.05	0.05
PX capital market index		1,038.7	989.0	946.7	956.3	921.6

Source: CZSO (macroeconomic indicators); PSE; CNB; data as of 21 April 2017

1) Constant prices of 2010, seasonally adjusted

2) Percentage increase on a year earlier in real terms, seasonally adjusted

3) Percentage increase on a year earlier in real terms

4) Inflation rate, end of period

5) Percentage increase on a year earlier, recalculated numbers, whole national economy

6) Current prices

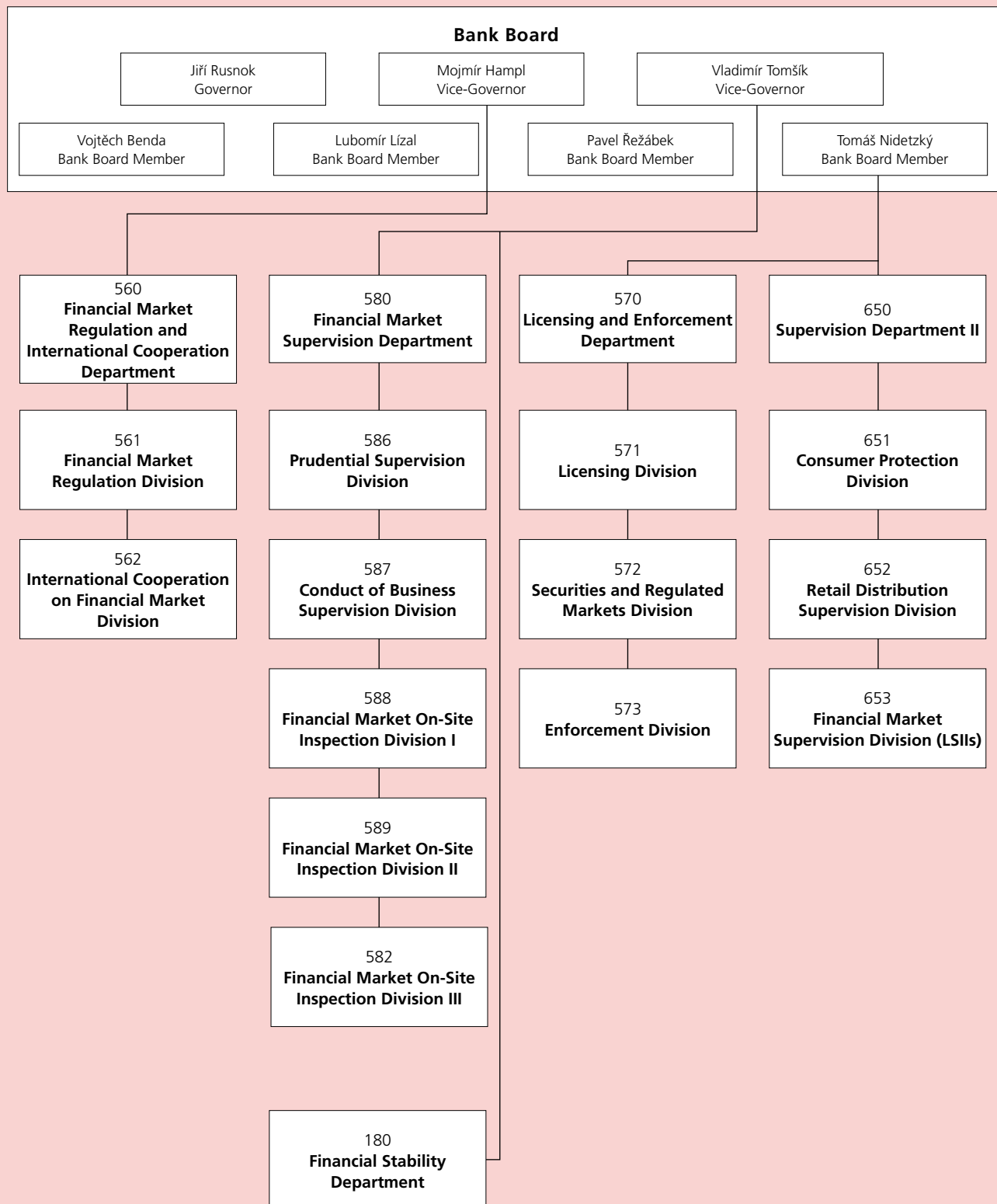
7) Annual averages from monthly averages

8) As of 31 December of given year

## Annex 2

## ORGANISATIONAL STRUCTURE OF CNB FINANCIAL MARKET SUPERVISION

as of 31 December 2016





**Annex 4****CREDIT UNIONS**  
(as of 31 December 2016)

1. AKCENTA, spořitelní a úvěrní družstvo
2. ANO spořitelní družstvo
3. Artesa, spořitelní družstvo
4. Citfin, spořitelní družstvo
5. České spořitelní družstvo
6. Družstevní záložna Kredit
7. Družstevní záložna PSD
8. Moravský Peněžní Ústav – spořitelní družstvo
9. Peněžní dům, spořitelní družstvo
10. Podnikatelská družstevní záložna
11. Záložna CREDITAS, spořitelní družstvo

**Annex 5****PENSION MANAGEMENT COMPANIES**  
(as of 31 December 2016)

1. Allianz penzijní společnost, a.s.
2. AXA penzijní společnost a.s.
3. Conseq penzijní společnost, a.s.
4. Česká spořitelna - penzijní společnost, a.s.
5. ČSOB Penzijní společnost, a. s., člen skupiny ČSOB
6. KB Penzijní společnost, a.s.
7. NN Penzijní společnost, a.s.
8. Penzijní společnost České pojišťovny, a.s.



**Annex 6****MANAGEMENT COMPANIES AND BRANCHES OF FOREIGN MANAGEMENT COMPANIES**

(as of 31 December 2016)

1. AKRO investiční společnost, a.s.
2. AMISTA investiční společnost, a.s.
3. Art of Finance Investiční společnost, a.s.
4. AVANT investiční společnost, a.s.
5. AXA investiční společnost a.s.
6. CARDUUS Asset Management, investiční společnost, a.s.
7. Conseq Funds investiční společnost, a.s.
8. ČSOB Asset Management, a.s., investiční společnost
9. DELTA Investiční společnost, a.s.
10. Erste Asset Management GmbH, pobočka Česká republika
11. Generali Investments CEE, investiční společnost, a.s.
12. Investiční kapitálová společnost KB, a.s.
13. INVESTIKA, investiční společnost, a.s.
14. Jet Investment Management, a.s.
15. J&T INVESTIČNÍ SPOLEČNOST, a.s.
16. Partners investiční společnost, a.s.
17. Patria investiční společnost, a.s.
18. Pioneer investiční společnost, a.s.
19. PROSPERITA investiční společnost, a.s.
20. QI investiční společnost, a.s.
21. Raiffeisen investiční společnost a.s.
22. REDSIDE investiční společnost, a.s.
23. REICO investiční společnost České spořitelny, a.s.
24. Safety invest funds, investiční společnost, a.s.
25. VIG Asset Management investiční společnost, a.s.
26. WMS investiční společnost, a.s.
27. WOOD & Company investiční společnost, a.s.
28. ZFP Investments, investiční společnost, a.s.

## Annex 7

## INSURANCE UNDERTAKINGS AND BRANCHES OF FOREIGN INSURANCE UNDERTAKINGS

(as of 31 December 2016)

I. Life insurance undertakings and branches of foreign insurance undertakings	III. Mixed life and non-life insurance undertakings
1. AEGON Pojišťovna, a.s.	1. Allianz pojišťovna, a.s.
2. Basler Lebensversicherungs-Aktiengesellschaft, pobočka pro Českou republiku	2. AXA životní pojišťovna a.s.
3. MetLife Europe d.a.c., pobočka pro Českou republiku	3. BNP Paribas Cardif Pojišťovna, a.s.
4. NN Životná poisťovňa, a.s., pobočka pro Českou republiku	4. Česká podnikatelská pojišťovna, a.s., Vienna Insurance Group
5. NN Životní pojišťovna N.V., pobočka pro Českou republiku	5. Česká pojišťovna a.s.
6. NOVIS Poisťovňa a.s., odštěpný závod	6. ČSOB Pojišťovna, a. s., člen holdingu ČSOB
<b>II. Non-life undertakings and branches of foreign insurance undertakings</b>	7. ERGO pojišťovna, a.s.
1. ACE European Group Ltd, organizační složka	8. Generali Pojišťovna a.s.
2. AEGON Hungary Closed Company Ltd., organizační složka	9. Hasičská vzájemná pojišťovna, a.s.
3. AIG Europe Limited, organizační složka pro Českou republiku	10. Komerční pojišťovna, a.s.
4. Atradius Credit Insurance N.V., organizační složka	11. Kooperativa pojišťovna, a.s., Vienna Insurance Group
5. AWP P&C Česká republika – odštěpný závod zahraniční právnické osoby	12. MAXIMA pojišťovna, a.s.
6. AXA pojišťovna a.s.	13. Pojišťovna České spořitelny, a.s., Vienna Insurance Group
7. Basler Sachversicherungs – Aktiengesellschaft, pobočka pro Českou republiku	14. UNIQA pojišťovna, a.s.
8. Cestovní pojišťovna ADRIA Way družstvo	
9. CG Car- Garantie Versicherungs-Aktiengesellschaft organizační složka pro Českou republiku	
10. Colonnade Insurance S.A., organizační složka	
11. COMPAGNIE FRANCAISE D' ASSURANCE POUR LE COMMERCE EXTERIEUR organizační složka Česko	
12. Compañía Española de Seguros y Reaseguros de Crédito y Caución, S.A., odštěpný závod	
13. Česká kancelář pojistitelů <sup>1</sup>	
14. Česká pojišťovna ZDRAVÍ a.s.	
15. D.A.S. Rechtsschutz AG, pobočka pro ČR	
16. DIRECT pojišťovna, a.s.	
17. ERV Evropská pojišťovna, a. s.	
18. EULER HERMES SA, organizační složka	
19. Exportní garanční a pojišťovací společnost, a.s. <sup>1</sup>	
20. HALALI, všeobecná pojišťovna, a.s.	
21. HDI Versicherung AG, organizační složka	
22. ING pojišťovna, a.s.	
23. INTER PARTNER ASSISTANCE, organizační složka	
24. KUPEG úvěrová pojišťovna, a.s.	
25. MetLife Europe Insurance d.a.c., pobočka pro Českou republiku	
26. Österreichische Hagelversicherung – Versicherungsverein auf Gegenseitigkeit, Agra pojišťovna, organizační složka	
27. Pojišťovna VZP, a.s.	
28. PRVNÍ KLUBOVÁ pojišťovna a.s.	
29. QBE INSURANCE (EUROPE) LIMITED, organizační složka	
30. Servisní pojišťovna a.s.	
31. Slavia pojišťovna a.s.	
32. Stewart Title Limited, organizační složka	
33. Union poisťovňa, a.s., pobočka pro Českou republiku	
34. Vitalitas pojišťovna, a.s.	

Note: The Czech Insurers' Bureau (CIB) and Exportní garanční a pojišťovací společnost, a.s. (EGAP) are not included in the analyses in Part B of this report.

## Annex 8

## LICENSED INVESTMENT FIRMS

(as of 31 December 2016)

**I. Investment firms – banks**

1. Česká exportní banka, a.s.
2. Česká spořitelna, a.s.
3. Českomoravská záruční a rozvojová banka, a.s.
4. Československá obchodní banka, a. s.
5. Expobank CZ a.s.
6. Fio banka, a.s.
7. J & T BANKA, a.s.
8. Komerční banka, a.s.
9. MONETA Money Bank, a.s.
10. PPF banka a.s.
11. Raiffeisenbank a.s.
12. Sberbank CZ, a.s.
13. UniCredit Bank Czech Republic and Slovakia, a.s.

**III. Investment firms – branches (organisational units) of foreign banks**

1. Bank Gutmann Aktiengesellschaft, pobočka Česká republika
2. BNP Paribas Fortis SA/NV, pobočka Česká republika
3. Citibank Europe plc, organizační složka
4. COMMERZBANK Aktiengesellschaft, pobočka Praha
5. Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka
6. HSBC Bank plc – pobočka Praha
7. ING Bank N.V.
8. mBank S.A., organizační složka
9. MUFG Bank (Europe) N.V. Prague Branch
10. Oberbank AG pobočka Česká republika
11. Saxo Bank A/S, organizační složka
12. The Royal Bank of Scotland plc, organizační složka
13. Všeobecná úverová banka a.s., pobočka Praha; zkráceně: VUB, a.s., pobočka Praha
14. Western Union International Bank GmbH, organizační složka

**II. Investment firms – non-banks**

1. 42 Financial Services a.s.
2. AKCENTA CZ a.s.
3. ATLANTA SAFE, a.s.
4. ATLANTIK finanční trhy, a.s.
5. BH Securities a.s.
6. brokerjet České spořitelny, a.s.
7. Citfin – Finanční trhy, a.s.
8. Colosseum, a.s.
9. Conseq Investment Management, a.s.
10. CYRRUS, a.s.
11. CYRRUS CORPORATE FINANCE, a.s.
12. EFEKTA CONSULTING, a.s.
13. HighSky Brokers, a.s.
14. NN Investment Partners C.R., a.s.
15. Patria Finance, a.s.
16. Pioneer Asset Management, a.s.
17. Roklen360 a.s.
18. RSJ a.s.
19. WOOD & Company Financial Services, a.s.

**IV. Investment firms – branches****(organisational units) of foreign non-bank investment firms**

1. Admiral Markets AS, organizační složka
2. Admiral Markets AS, org.sl.
3. AISA Direct Ltd, pobočka
4. Catus AG Vermögensverwaltung
5. COVERDEAL HOLDINGS LIMITED, odštěpný závod
6. Dom Maklerski Banku Ochrony Środowiska Spółka Akcyjna, organizační složka Česká republika
7. eBrókerház Befektetési Szolgáltató Zártkörűen Működő Részvénytársaság
8. European Investment Centre, o.c.p., a.s. – organizační složka
9. GKFX Financial Services Limited
10. Goldenburg Group Limited
11. LaSalle Investment Management, organizační složka
12. Leadcapital Markets Ltd
13. Lynx B.V., organizační složka
14. Monecor (London) Ltd
15. Nuntius Brokerage and Investment Services S.A., odštěpný závod
16. OKTAVEST GmbH
17. R Capital Solutions Ltd
18. RELIANTCO INVESTMENTS LTD, organizační složka
19. X-TRADE BROKERS DOM MAKLERSKI SPÓŁKA AKCYJNA, organizační složka

**V. Investment companies carrying on asset management**

1. AXA investiční společnost a.s.
2. CARDUUS Asset Management, investiční společnost, a.s.
3. ČSOB Asset Management, a.s., investiční společnost
4. Erste Asset Management GmbH, pobočka Česká republika
5. Generali Investments CEE, investiční společnost, a.s.
6. Investiční kapitálová společnost KB, a.s.
7. Partners investiční společnost, a.s.
8. WOOD & Company investiční společnost, a.s.
9. FP Investments, investiční společnost, a.s.

## Annex 9

## (BASE) BOND PROSPECTUSES AND SUPPLEMENTS THERETO IN 2016

Issuer	Document type	Decision date	Decision
UniCredit Bank Czech Republic and Slovakia, a.s.	Base prospectus	07 January 2016	Agreed
Česká zbrojovka a.s.	Prospectus	25 January 2016	Agreed
HB Reavis Finance CZ, s.r.o.	Prospectus	02 February 2016	Agreed
Wüstenrot hypoteční banka a.s.	Supplement to base prospectus	05 February 2016	Agreed
UniCredit Bank Czech Republic and Slovakia, a.s.	Prospectus	15 March 2016	Agreed
Palone a.s.	Prospectus	23 March 2016	Denied
Hypoteční banka, a.s.	Supplement to base prospectus	24 March 2016	Agreed
MCI Venture Projects Spółka z ograniczoną odpowiedzialnością VI spółka komandytowo – akcyjna	Prospectus	01 April 2016	Agreed
GES REAL, a.s.	Prospectus	04 May 2016	Agreed
Czech property investments, a.s.	Prospectus	04 May 2016	Agreed
Czech property investments, a.s.	Prospectus	04 May 2016	Agreed
Czech property investments, a.s.	Prospectus	04 May 2016	Agreed
Czech property investments, a.s.	Prospectus	04 May 2016	Agreed
Czech property investments, a.s.	Prospectus	04 May 2016	Agreed
GES REAL, a.s.	Supplement to prospectus	19 May 2016	Agreed
eFi Palace, s.r.o.	Supplement to base prospectus	24 May 2016	Agreed
ČEZ, a.s.	Base prospectus	07 June 2016	Agreed
DRFG ENERGY s.r.o.	Base prospectus	22 June 2016	Agreed
GEEN General Energy a.s.	Prospectus	30 June 2016	Agreed
Hypoteční banka, a.s.	Base prospectus	01 July 2016	Agreed
e-Finance, a.s.	Base prospectus	13 July 2016	Agreed
UNICAPITAL ENERGY, a.s.	Base prospectus	22 July 2016	Agreed
Czech property investments, a.s.	Prospectus	18 August 2016	Agreed
Czech property investments, a.s.	Prospectus	18 August 2016	Agreed
eFi Palace, s.r.o.	Base prospectus	18 August 2016	Agreed
Garanční systém finančního trhu	Base prospectus	07 September 2016	Agreed
Hypoteční banka, a.s.	Supplement to base prospectus	13 September 2016	Agreed
ČEPS, a.s.	Prospectus	27 September 2016	Agreed
Moravská stavební - INVEST, a.s.	Prospectus	17 October 2016	Agreed
Arca Capital Bohemia, a.s.	Prospectus	04 November 2016	Denied
Photon Energy N.V.	Prospectus	23 November 2016	Agreed
J&T Global Finance VII., s.r.o.	Prospectus	24 November 2016	Agreed
IMPERA INVEST, investiční fond s proměnným základním kapitálem, a.s.	Prospectus	06 December 2016	Agreed
EPH Financing CZ, a.s.	Prospectus	08 December 2016	Agreed
CZECHOSLOVAK GROUP a.s.	Prospectus	13 December 2016	Agreed
FINEP BARRANDOV ZÁPAD, k.s.	Prospectus	14 December 2016	Agreed
UNICAPITAL Invest I a.s.	Base prospectus	21 December 2016	Agreed
ThomasLloyd Cleantech Infrastructure (Czech) a.s.	Prospectus	21 December 2016	Agreed
ThomasLloyd Cleantech Infrastructure (Czech) a.s.	Prospectus	21 December 2016	Agreed
ČD Cargo, a.s.	Prospectus	23 December 2016	Agreed

■ Debt securities with a unit face value of greater than EUR 100,000

**Annex 10****SHARE PROSPECTUSES AND SUPPLEMENTS THERETO IN 2016**

Issuer	Purpose of prospectus	Decision date	Decision
CENTRAL GROUP uzavřený investiční fond a.s.	Admission to trading on RM	12 January 2016	Agreed
GE Money Bank, a.s.	Public offering and admission to trading on RM	22 April 2016	Agreed
EP Infrastructure, a.s.	Public offering and admission to trading on RM	13 May 2016	Discontinued (application retracted)
CENTRAL GROUP uzavřený investiční fond II a.s.	Admission to trading on RM	21 December 2016	Agreed

NOTE: RM = regulated market

**Annex 11****(BASE) PROSPECTUSES OF OTHER SECURITIES AND SUPPLEMENTS THERETO IN 2016**

Issuer	Typ dokumentu	Typ cenného papíru	Decision date	Decision
Československá obchodní banka, a.s.	Base prospectus	Investment certificate	30 August 2016	Agreed
GRAMEXO PLC	Prospectus	Discount certificate	09 September 2016	Agreed

**Annex 12****TAKEOVER BIDS, PUBLIC CONTRACT OFFERS AND COMPULSORY PURCHASES IN 2016**

Proposer	Target company	Type of transaction	Decision date	Decision
LAPASAN s.r.o.	Pivovary Lobkowicz Group, a.s.	Additional takeover bid	24 February 2016	Agreed
LAPASAN s.r.o.	Pivovary Lobkowicz Group, a.s.	Squeeze-out	15 April 2016	Agreed
ISTROKAPITAL SE	ENERGOCHEMICA SE	Mandatory takeover bid	10 June 2016	Agreed

**Annex 13****LICENSING DECISIONS IN THE MARKET INFRASTRUCTURE AREA IN 2016**

Regulated entity	Subject of proceedings	Decision date	Decision
POWER EXCHANGE CENTRAL EUROPE, a.s.	Prior consent to acquisition of qualifying holding (European Energy Exchange AG)	11 May 2016	Agreed
Centrální depozitář cenných papírů, a.s.	Change in Settlement System Rules	30 August 2016	Agreed
POWER EXCHANGE CENTRAL EUROPE, a.s.	Prior consent to acquisition of qualifying holding (Deutsche Börse AG)	08 July 2016	Agreed

## Annex 14

## STATISTICS ON ADMINISTRATIVE PENALTY PROCEEDINGS CONDUCTED IN 2016

Area of imposition of penalty	No. of administrative penalty proceedings continuing from 2015	No. of administrative penalty proceedings opened in 2016	No. of administrative penalty proceedings closed in 2016	Total fines imposed (in CZK thousands)
Supervision of credit institutions	5	7	9	7,300
Insurance market supervision	20	33	43	6,585
Supervision of insurance companies	3	3	3	0
Supervision of insurance intermediaries	17	30	40	6,585
Capital market supervision	20	41	33	19,225
Supervision of pension management companies and retirement funds	0	4	0	0
Supervision of investment firms	3	5	5	1,100
Supervision of management companies and investment funds	5	2	4	3,050
Supervision of investment intermediaries	9	23	17	12,655
Securities issuers	3	7	7	2,420
Violation of the Bureau-de-change Act	4	43	42	4,014
Consumer protection	1	0	0	0
Payment system	3	4	5	2,210
Circulation of banknotes and coins	5	2	7	1,050
Act on the CNB	0	0	0	0
Financial market supervision, total	58	130	139	40,384

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**ABBREVIATIONS**

AIF	alternative investment fund
AIFMD	Alternative Investment Fund Managers Directive
AMA	Advanced Measurement Approaches
AMC	asset management company
AML/CFT	anti-money laundering/combating the financing of terrorism
AMM	additional liquidity monitoring metrics
AnaCredit	Analytical Credit Datasets
AT1	Additional Tier 1
ATC	Advisory Technical Committee
AVA	additional valuation adjustment
AWG	Analysis Working Group
BCBS	Basel Committee on Banking Supervision
BCG	Basel Consultative Group
BRRD	Bank Recovery and Resolution Directive
BS	banking sector
CA	capital adequacy
CCD	Consumer Credit Directive
CCR	Central Credit Register
CDS	credit default swap
CET1	Common Equity Tier 1
CFD	contract for difference
CFM	Committee on Financial Markets
CIB	Czech Insurers' Bureau
CIF	collective investment fund
CMU	Capital Market Union
CoCos	contingent convertible capital instruments
CRA	credit risk adjustment
CRA	Central Register of Accounts
CRD IV	fourth Capital Requirements Directive
CRR	Capital Requirements Regulation
CSDP	Central Securities Depository Prague
CSDR	Central Securities Depositories Regulation
CSMAD	Directive on Criminal Sanctions for Market Abuse
CU	credit union
CVA	credit valuation adjustment
CZK	Czech koruna

CZSO	Czech Statistical Office
DGSD	Directive on Deposit Guarantee Schemes
DLT	distributed ledger technology
DTI	debt-to-income ratio
EBA	European Banking Authority
EC	European Commission/European Communities
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EDIS	European Deposit Insurance Scheme
EEA	European Economic Area
EEC	European Economic Community
EFC	Economic and Financial Committee
EGAP	Exportní garanční a pojišťovací společnost, a.s.
EIOPA	European Insurance and Occupational Pensions Authority
ELTIFs	European Long-Term Investment Funds
EMIR	European Market Infrastructure Regulation
ERPB	European Retail Payment Board
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EuSEF	European Social Entrepreneurship Fund
EuVECA	European Venture Capital Fund
FATF	Financial Action Task Force on Money Laundering
FinTech	financial technology
FRA	forward rate agreement
FSC (ECB)	Financial Stability Committee (ECB)
FSC (EU)	Financial Services Committee (EU)
GDP	gross domestic product
HFT	high-frequency trading
IAASB	International Auditing and Assurance Standards Board
ICAAP	Internal Capital Adequacy Assessment Process
IF	investment firm
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IORP	institution for occupational retirement provision
IOSCO	International Organization of Securities Commissions
IRB	internal ratings based approach

IWG	Instruments Working Group
LCR	liquidity coverage ratio
LTV	loan-to-value
MAR	Market Abuse Regulation
MCD	Mortgage Credit Directive
MCR	Minimum Capital Requirement
MIB	Market Infrastructure Board
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MIPC	Market Infrastructure and Payments Committee
MMoU	Multilateral Memorandum of Understanding
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
OECD	Organisation for Economic Cooperation and Development
ORSA	Own Risk and Solvency Assessment
OTC	over-the-counter
PMC	pension management company
PRIIPs	packaged retail and insurance-based investment products
PSD	Payment Services Directive
PSE	Prague Stock Exchange
PXE	Power Exchange Central Europe, a.s.
RE	risk exposure
RIAD	Register of Institutions and Affiliates Database
RM-S	RM-SYSTÉM, česká burza cenných papírů a.s.
RoA	return on assets
RoE	return on equity
RWE	risk-weighted exposure
SCR	solvency capital requirement
SFT	securities financing transaction
SF-TDS	Secured Financing Transaction Data Store
SICAR	société d'investissement en capital à risqué
SICAV	société d'investissement à capital variable
SKD	Short-term Bond System
SREP	Supervisory Review and Evaluation Process
SRF	Single Resolution Fund
SRMR	Single Resolution Mechanism Regulation
SSM	Single Supervisory Mechanism
STA	standardised approach



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SVYT	Transaction Settlement System
T1	Tier 1
T2	Tier 2
T2	TARGET2
T2S	TARGET2-Securities
TARGET2	Trans-European Automated Real-time Gross Settlement Express Transfer System
TD	Transparency Directive
TF	transformed fund
TIPS	Target Instant Payment System
TLAC	total loss-absorbing capacity
UCITS	undertaking for collective investment in transferable securities
UFR	ultimate forward rate
VaR	value at risk

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