Ministerstvo financí
ČESKÉ REPUBLIKY

REPORT ON FINANCIAL MARKET DEVELOPMENTS IN 2012

June 2013

CONTENTS

The data presented in this report were obtained from the specified sources between March and April 2013.

SUMMARY OF DEVELOPMENTS IN 2012

Macroeconomic situation and external development

Year-on-year, the Czech Republic's real GDP decreased by 1.3% in 2012. The decline in household consumption, in particular, played a large role in this downward trend. The only component of aggregate expenditure that recorded growth was foreign trade and the trade surplus attained a record high of CZK 145.8 billion. After a slight strengthening at the start of the year, the Czech crown started to weaken in April. However, in mid-summer this trend was reversed and at the end of the year the Czech crown recorded a year-on-year increase of 4.4% against the dollar to 19.1 CZK/USD and an increase of 2.6% against the euro to 25.1 CZK/EUR.

Funds available in the financial market

The volume of funds available in the financial market continued its long-term growth and attained a level of approximately CZK 4.1 trillion (an increase of 6.4%). The greatest growth was recorded for bank deposits (an increase of CZK 184.6 billion), which represent 69% of all funds available in the financial market.

The structure of household saving

The household saving rate increased by 4.4% year-on-year to approximately CZK 2.5 trillion. However, the structure of household saving has undergone only some slight changes. The greatest volume of savings was deposited with banking institutions (71.1%), where there is a continuing trend in the shifting of funds from term deposits to demand deposits (including the popular savings accounts with no withdrawal restrictions). Households also invested their savings in life insurance (11.1%), supplementary pension insurance (9.9%), and mutual funds (8%).

Entities of the financial market

There were only slight changes in the number of entities included in the institutional structure of the financial market. No new licences were granted in either the banking or the insurance sector. The number of both investment funds as well as mutual funds increased. The number of investment intermediaries decreased while, conversely, the number of insurance intermediaries increased. All sectors excluding leasing companies reported further profit growth.

Banking sector

Capital adequacy within the banking sector increased to 16.4%. Profit before taxes attained a level of CZK 76.7 billion, which reflects a year-on-year increase of 21%. The main reason for this was a decrease in impairment on financial assets. The overall volume of banking sector assets increased by 3.5% to CZK 4,633 billion. The non-performing loan ratio (non-performing loans over total loans) barely changed at all from the previous year and is at 6.0%. The ratio of deposits to loans has been stable over the long-term in the Czech Republic and is at 142.7%.

Interest rates

The CNB gradually decreased its base rate (two-week repo rate) from 0.75% to 0.05%, thus reaching a historical low in the Czech Republic. This decrease was subsequently reflected in a decrease in the average interest rate for new loans and a slightly lower deposit interest rate. The APR from new consumer loans grew by 0.1 pp to 15.9%. The mortgage loan APR fell by 0.4 pp to 3.7%.

Deposits and loans

The volume of bank deposits increased by 7.3% to CZK 3,127.6 billion by the end of the year. As compared to the previous period, bank loans grew less dynamically (2.4%) to reach CZK 2,360.1 billion.

Mortgage market

The volume of mortgage loans provided to the population reached CZK 700.05 billion. The tempo of the year-on-year change shows a slight decrease of 2.7 pp in comparison to 2011 and was 6.3%. Mortgage rates as reported by Hypoindex declined moderately by 0.39 pp to 3.17% at the end of the year.

Building savings banks

At the end of 2012, there were approximately 4.3 million contracts with participants for building savings schemes in the saving phase, which reflects a year-on-year decrease of 233,000 contracts (5.1%) and is a continuation of the trend from previous years. The saved amount slightly increased to approximately CZK 435 billion. The total number of loans corresponds to the decline in the number of contracts and decreased by 62,000 to 894,000. For the first time the volume of unpaid loans decreased year-on-year – from CZK 293.1 billion to CZK 282.2 billion. The amount of disbursed state contributions dropped by almost 50% to CZK 5.3 billion.

Credit unions

The number of credit union members increased by approximately 10,000 to 54,408, which represents a year-on-year increase of 22 %. The balance sheet growth in this sector grew at an even faster pace and increased by almost 39% to the final figure of CZK 39.3 billion. The volume of provided loans increased year-on-year by more than 45% to CZK 28 billion. The credit union sector also saw a significant improvement in the share of non-performing client loans – from 17.2% in 2011 to 9.9% at the end of 2012.

Regulated markets

The main PX index recorded growth of 14% and ranged between 859 to 1,041 points. In addition, its development was more stable than in 2011. The declining trend in trading activities continued in 2012 and the average daily trading volume was only approximately CZK 1 billion, which reflects a year-on-year decrease of 32.5%.

Investment companies and asset management

The trading volume in the investment company sector increased by 6.5% year-on-year to CZK 50,363 billion. Bank investment companies significantly strengthened their dominant position and increased the volume of closed securities trading deals to more than 96% of the trading deals in the entire sector. The volume of managed assets increased by 11.6% in 2012 to CZK 885.2 billion at the end of the year.

Collective investment

The volume of assets placed in collective investment funds increased by 5% year-on-year to CZK 235.3 billion. The value of the assets held increased by CZK 4.0 billion for foreign funds and by CZK 7.2 billion for domestic funds. This brought to a halt the ongoing trend when foreign funds were attracting more assets than the domestic ones. The qualified investment fund segment continued to develop at a dynamic rate – over the past four years, these funds have increased their volume of managed assets by 2.5 times and the number of these funds has exceeded the number of public funds.

Insurance companies

The insurance sector continued to stagnate, thus quite significantly reflecting the overall status of the Czech economy. Total gross premiums written decreased by almost 1% to CZK 153.6 billion. In the life insurance segment gross premiums written increased slightly (by 0.1%) and exceeded CZK 72 billion at the end of the year. As far as non-life insurance is concerned, the downward trend continued and the value of premiums written went down to CZK 81.5 billion (a year-on-year decrease of 1.8%). Reported profit increased by 35% to CZK 12.4 billion, primarily thanks to cost savings and higher investment income.

Supplementary pension insurance

Assets totalling CZK 246.6 billion were recorded for pension funds, reflecting growth of 6.2%. The number of participants in supplementary pension insurance schemes increased by 569,000 reaching a level of 5.1 million by the end of the year. The significant jump in numbers towards the end of the year resulted from increased interest in entering into a contract prior to the effective date for the new conditions for supplementary pension insurance schemes implemented in relation to the pension system reform. The participant structure continues to be dominated by the 30-59 age group, whilst the majority of new participants are in the under 29 age group. The average monthly participant contribution increased by 5.3% to CZK 465. The number of contracts including an employer contribution continues to decrease and is at approximately 18%.

The government sector

In 2012 the financial results in the government sector report a deficit equal to 4.4% of GDP. This is significantly worse (by 1.15 pp) in comparison to the previous year. However, if capital transfers are not included, specifically those associated with the asset settlement with churches and corrections for ineligible European expenditure, the deficit would be only 2.5% of GDP. Total government debt at the end of the year was equal to 45.8% of GDP.

Financial market legislation

On the European level, the priority topics consisted of the implementation of a single supervisory mechanism, crisis management, changes in the EU's rules for capital requirements for banks and investment companies, and the issues associated with a financial transaction tax. As far as Czech legislation is concerned, a number of regulations were adopted, which amend and supplement the legal provisions for Pillar 2 and Pillar 3 of the pensions system that were adopted in 2011. The most important change in the insurance sector was the application of the anti-discrimination ruling of the Court of Justice of the European Union, which prohibits defining different insurance premiums and payout amounts on the basis of gender. As far as the banking sector is concerned, the most important task consisted of the preparation for transposing the CRD IV directive into national law, which is expected to be completed in 2013.

1. MACROECONOMIC SITUATION AND EXTERNAL DEVELOPMENTS

1.1. Macroeconomic Situation

In 2012 the Czech economy found itself in a recession and the entire year was marked by successive quarter-on-quarter drops in real gross domestic product (GDP). During the second half of the year, the decline was not as marked and for the entire year GDP[1] decreased by 1.3% in real terms (refer to Table 1.1). The development of the national economy is highly dependent on the economies of its key trade partners. From Table 1.1 it is obvious that the figures for the European economy, as reported using the aggregate values for the EU-27 and for the eurozone, also decreased in real terms. Nevertheless, foreign trade was the only component of aggregate expenditure that slowed down the decline in the Czech Republic's real GDP.

Table 1.1: GDP growth rates[2]

Annual (in %)	2007	2008	2009	2010	2011	2012
Czech Republic	5.7	3.1	-4.5	2.5	1.9	-1.3
EU-27	3.2	0.3	-4.3	2.1	1.5	-0.3
Eurozone	2.9	0.4	-4.4	2.0	1.4	-0.6
USA	1.9	-0.3	-3.1	2.4	1.8	2.2

Source: Eurostat

As can be seen in Table 1.2 final consumption expenditure and gross capital formation recorded a real decline in 2012. Household consumption in particular recorded an interesting development as it reflects a real decline for the first time since the outbreak of the global financial crisis and this decline is already a high 3.6%. Government consumption decreased for the second year in a row (by 1.0%), primarily due to the adopted strategy for the consolidation of public finances. During the entire year of 2012 only net exports contributed positively to GDP development.[3] Overall, the negative GDP growth was primarily due to a combination of the following factors: the slower dynamics of household disposable income; an effort by households to decrease their indebtedness; the deferment of consumption due to continuing uncertainty; and a low domestic and foreign demand for final output, which, when combined with a higher degree of uncertainty, discourages companies from carrying out investment activities.

Based on a random labour force survey, unemployment rate reached 7.0% in 2012, which reflects an increase of 0.3 pp as compared to the previous year. This may appear to be surprising during a declining phase of the economic cycle, however the impact on the labour market is usually delayed due to nominal and real rigidities.

Table 1.2: Macroeconomic indicators of the Czech economy

(in %)	2009	2010	2011	2012
GDP growth (in constant prices)	-4.5	2.5	1.9	-1.3
Household consumption (change, in constant prices)	0.2	1.0	0.7	-3.6
Government consumption (change, in constant prices)	4.0	0.5	-2.5	-1.0
Gross fixed capital formation (change, in constant prices)	-11.0	1.0	-0.7	-1.7
Unemployment rate (MLSA, average for the period)	6.7	7.3	6.7	7.0
Inflation (CPI, average for the period)	1.0	1.5	1.9	3.3

Source: CNB, CSO, MLSA

When compared to 2011 levels, the average inflation rate as measured by consumer price indices (CPI) increased by 1.4 pp to 3.3%. Inflation was driven primarily by administrative factors. Inflation in the Czech Republic thus reached its highest level in four years. Taking into account the fact that the economy was

[1] The current valid values associated with GDP for 2012 are different from those in effect at the time this document was prepared (i.e. using the second estimate for national accounts of 30 April 2013).
[2] The time series for the individual indicators of indicators vary to one degree or another from the data reported in the Reports on Financial Market Developments for previous years due to the revisions at the national account levels.
[3] The contribution of foreign trades to GDP growth in 2012 was 1.5%.

in a negative output gap[4] during the entire year, the influence of aggregate demand on the growth of price levels was significantly limited. The turning point occurred in January 2012, when consumer prices rose by 1.8% month-on-month. This increase was driven mainly by the increase in the reduced VAT rate from 10% to 14% together with the historically standard price development for food, housing and fuel. As shown in Table 1.3, the rate of inflation in the Czech Republic was relatively high throughout the entire year. It dropped to below 3% only in November and December. Year-on-year inflation throughout the period was well above the CNB's target (inflation as measured by CPI equal to 2%). The prospect of returning domestic inflation back to the inflation target within the monetary transmission mechanism timeframe (approximately six quarters) provided the CNB Bank Board with sufficient latitude to support the Czech economy. The CNB therefore lowered the two-week repo rate by 25 bp to 0.50% in June, by 25 bp to 0.25% in October, and by an additional 20 bp to 0.05% in November.

Inflation, although at a lower level than in the Czech Republic, was also an important topic of discussion abroad. Like the CNB, the ECB also failed in its efforts to push down the level of inflation in 2012 in order to meet its monetary policy target (inflation just below 2%). In July the ECB lowered its key interest rate by 25 bp to 0.75%[5], primarily as a response to the deepening debt crisis in the eurozone. The ECB was very active in 2012 when, amongst other things, it launched the second round of its three-year liquidity facility – the Long-Term Refinancing Operation (LTRO) – which banks did ultimately use for restructuring their assets even though this was not stated in the original intention. During both rounds of the LTRO the ECB provided banks with over EUR 1 trillion in the form of three-year loans at a 1% interest rate. The most troubled countries used the funds received through these operations primarily for the purchase of government bonds. The ECB also launched the Outright Monetary Transactions (OMT) programme in 2012. Under this programme the ECB will purchase short-term bonds on the secondary market issued by those countries who request assistance from the European bailout funds (EFSF and ESM) and who agree to implement certain budget constraints.

In the USA the inflation rate generally fluctuated at a lower level than in the eurozone and the Czech Republic. In addition, at the start of 2012, the Fed voiced its intent to adopt explicit inflation targeting and established a long-term objective of price stability defined by a target inflation rate of about 2%. The Fed's short-term objective continues to be maintaining a low unemployment rate. The Fed already exhausted its ability to ease monetary conditions through the interest rate channel last year, when it decreased the key interest rate to almost zero. In September 2012 the Fed launched the third round of quantitative easing, which is based on the purchase of mortgage-backed bonds. As opposed to the previous rounds, the Fed did not specify a final end date for this programme or the total volume that will be purchased.

Table 1.3: Comparison of economic indicators

2012	Inflation[6] (year-on-year)			Key interest rate of central bank (in %)		
	Czech Republic	Eurozone	USA	Czech Republic	Eurozone	USA
January	3.5	2.7	3.0	0.75	1.00	0.00 - 0.25
February	3.7	2.7	2.9	0.75	1.00	0.00 - 0.25
March	3.8	2.7	2.6	0.75	1.00	0.00 - 0.25
April	3.5	2.6	2.3	0.75	1.00	0.00 - 0.25
May	3.2	2.4	1.7	0.75	1.00	0.00 - 0.25
June	3.5	2.4	1.7	0.50	1.00	0.00 - 0.25
July	3.1	2.4	1.4	0.50	0.75	0.00 - 0.25
August	3.3	2.6	1.7	0.50	0.75	0.00 - 0.25
September	3.4	2.6	2.0	0.50	0.75	0.00 - 0.25
October	3.4	2.5	2.2	0.25	0.75	0.00 - 0.25
November	2.7	2.2	1.8	0.05	0.75	0.00 - 0.25
December	2.4	2.2	1.8	0.05	0.75	0.00 - 0.25

Source: CSO, CNB, Eurostat, ECB, Fed

[4] The percentage output gap is defined as the difference between actual and potential (trend-based) output in relation to potential output and is calculated as $(Y - Y^*)/ Y^*$, where Y = actual output and Y* = potential output.
[5] On 8 May 2013 the ECB lowered its key interest rate to 0.50%.
[6] In the case of the Czech Republic and the US expressed as the year-on-year increase in the CPI; in the case of the eurozone expressed as the year-on-year increase in HICP.

In 2012 the ratio of the balance of payments current account deficit to GDP decreased by 0.3 pp to 2.4% as compared to the previous year. The position of the Czech economy as a debtor in relation to its external environment corresponds to the level of its development, and, taking into account its significantly positive trade balance, when in 2012 the ratio of trade balance to nominal GDP reached a level of 3.8%, this position can be assessed as fully sustainable. As in the past, the development in the balance of payments current account was influenced by a significant income deficit resulting primarily from the disbursement of dividends to foreign investors, the amount of which increased as compared to the previous year. The income deficit specifically associated with direct investments was offset by a growing balance of payments surplus, which, as in the past, was positively affected by the export of machinery and means of transport. The trade balance[7] reached a historical high even though the balance of services declined year-on-year and reached its lowest level since 2006. The main reason for the increase in the trade balance surplus was the relatively weak Czech crown and a decline in the import of goods, which can be explained by a weak domestic demand. The balance of payments financial account surplus grew year-on-year to CZK 121.8 billion, primarily as a result of the highest level of direct foreign investment the country has seen in the past five years and the significant increase in the purchase of Czech bonds by foreign investors. The financial account surplus was sufficient to easily cover the balance of payments current account deficit.

Table 1.4: External financial relations

Annual (CZK bn)	2008	2009	2010	2011	2012
Balance of payments - current account	-81.3	-89.3	-146.6	-104.0	-94.0
Current account balance to GDP (%, current prices)	-2.1	-2.4	-3.9	-2.7	-2.4
Trade balance	25.7	87.3	53.8	90.3	145.8
Trade balance to GDP (%, current prices)	0.7	2.3	1.4	2.4	3.8
Balance of payments - capital account	27.1	51.2	32.5	14.7	51.7
Balance of payments - financial account	92.2	143.2	174.3	59.4	121.8

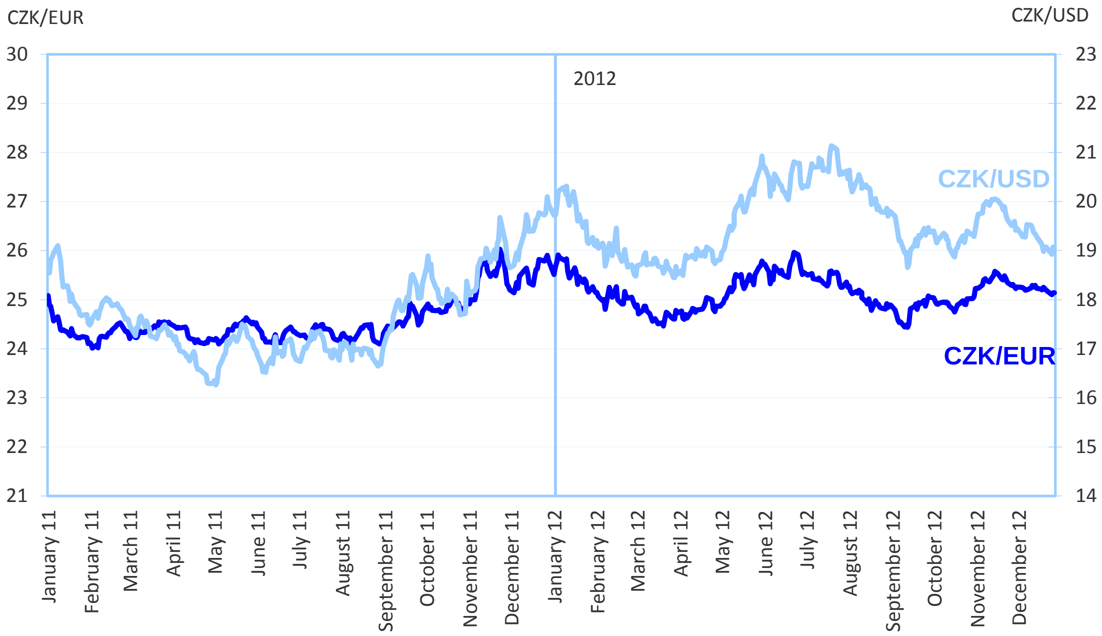
Source: CNB - ARAD

1.2. Foreign Exchange Market

During 2012, the Czech crown recorded similar developments in relation to two of the world's main currencies but with varying levels of fluctuation. During the first quarter the crown strengthened relative to both the euro and the dollar but then started to weaken in relation to both currencies at the end of March and beginning of April. By early summer the crown had weakened relative to the euro and was at the same level as at the start of the year. It weakened much more significantly in relation to the dollar, down to an exchange rate of 21.1 CZK/USD. The strong depreciation of the crown against the dollar was due to the strengthening of the dollar relative to the euro that resulted from the escalation of the debt crisis in the eurozone. However, this trend was broken during the second half of the summer and by the end of the year the crown recorded a year-on-year strengthening against the dollar by 4.4% to 19.1 CZK/USD and against the euro by 2.6% to 25.1 CZK/EUR.

[7] Trade balance = merchandise trade balance + services balance. The services balance is only a marginal component of the trade balance and thus only the values for the merchandise trade balance are specified in Table 1.3.

Graph 1.1: CZK exchange rates relative to major currencies



Source: CNB

In relation to other Central European currencies (HUF and PLN) the Czech crown recorded a significant lag (refer to Tables 1.5 and 1.6). This was due to the domestic economic recession and the gradual easing of monetary policy, which led to a decline in the interest rate differential and consequently the decreased attractiveness of the crown for investors. The Hungarian forint (HUF) was supported by high interest rates, which prevailed over the macroeconomic problems of the economy and thus the crown recorded a year-on-year weakening against the forint by 4.8% to 8.6 CZK/100 HUF. The strengthening of the Polish zloty (PLN) was assisted not only by relatively high interest rates, but also thanks to fairly good results in the real economy. As a result the Polish zloty recorded a year-on-year strengthening against the crown by 6.6% and the exchange rate at the end of the year was 6.2 CZK/PLN.

Table 1.5: CZK exchange rates relative to major and regional currencies at the end of the year

Exchange rate as at the end of	2008	2009	2010	2011	2012	Year-on-year change (%)
CZK/EUR	26.9	26.5	25.1	25.8	25.1	-2.6
CZK/USD	19.3	18.4	18.8	19.9	19.1	-4.4
CZK/100 HUF	10.1	9.8	9.0	8.2	8.6	4.8
CZK/PLN	6.5	6.5	6.3	5.8	6.2	6.6

Source: CNB, CSO

The highly volatile development of the CZD/USD exchange rate can be seen in the considerable difference between the year-on-year change in the average crown to dollar exchange rate (the crown weakened by 10.6% in relation to the dollar) and the year-on-year change in the actual exchange rate at the end of the year (the crown strengthened in relation to the dollar by 4.4%). On the other hand, there is only a minimal difference between the year-on-year change in the average exchange rate and the year-on-year change in the actual exchange rate for the crown in relation to the euro, which indicates that the development for the CZK/EUR currency pair is relatively stable.

Table 1.6: Average CZK exchange rates relative to major and regional currencies

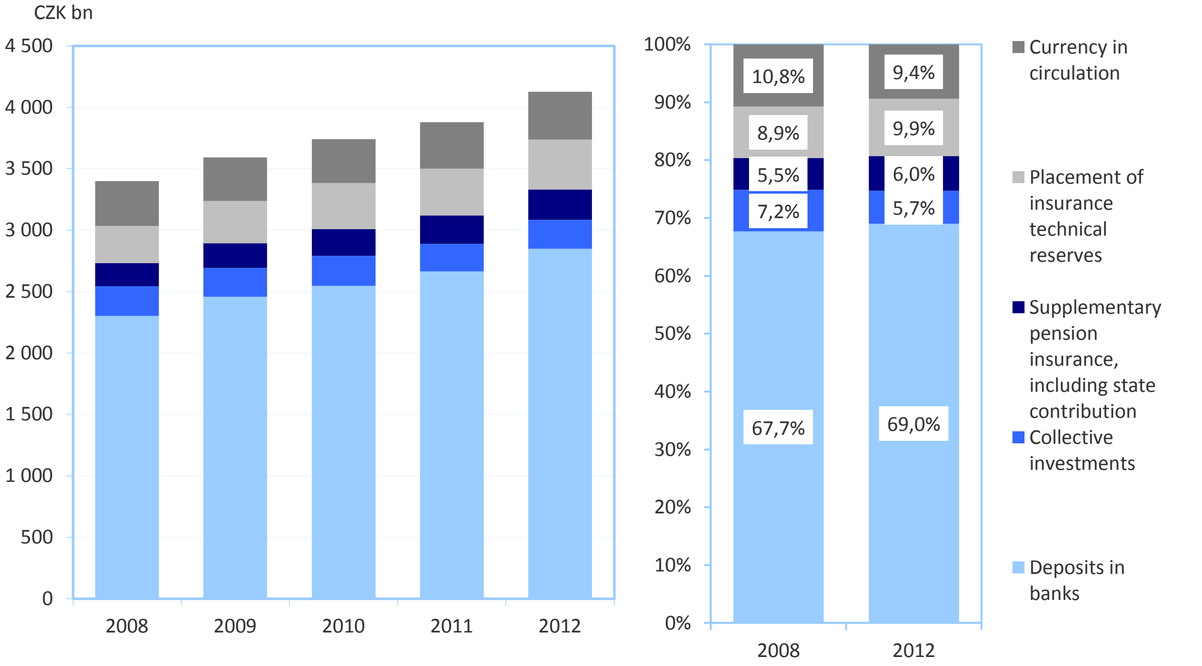
Average exchange rate	2008	2009	2010	2011	2012	Year-on-year change (%)
CZK/EUR	24.9	26.4	25.3	25.6	25.1	-1.8
CZK/USD	17.0	19.1	19.1	17.7	19.6	10.6
CZK/100 HUF	9.9	9.4	9.2	8.8	8.7	-1.4
CZK/PLN	7.1	6.1	6.3	6.0	6.0	0.5

Source: CNB, CSO

2. FUNDS AVAILABLE IN THE FINANCIAL MARKET

The volume of usable funds in the financial market has been increasing over the long-term. In 2012 it increased by 6.4% to approximately CZK 4.1 trillion (refer to Graph 2.1 and Table 2.1). This reflects growth that is more dynamic when compared to the period of 2008 to 2011 (when the year-on-year increases were between 4 and 5%), but less dynamic than during the 2004 to 2007 timeframe (when the year-on-year increases exceeded 10%).

Graph 2.1: Funds available in the financial market



Source: MoF, CNB – ARAD, AKAT
Note: The right side of the graph shows the differences in structure between 2008 and 2012.

The highest absolute growth (CZK 184.6 billion) was recorded in the most significant category, i.e. deposits in banks, which represented 69% of all of the funds in the financial market in 2012. The other categories also registered year-on-year increases, but in absolute terms they did not exceed a few tens of billions of crowns (single percentage points).

Table 2.1: Funds available in the financial market

As at 31 Dec (in billions of CZK)	2011	2012	Year-on-year change	
			Abs.	(%)
Deposits in banks[8]	2,664.5	2,849.1	184.6	6.9
of which: building savings schemes	433.4	435.0	1.6	0.4
Collective investments	224.1	235.3	11.2	5.0
Supplementary pension insurance, including state contribution	232.1	246.6	14.5	6.3
Placement of insurance technical reserves	381.0	407.9	26.9	7.1
Currency in circulation	377.9	388.9	10.9	2.9
Total	3,879.6	4,127.8	248.2	6.4

Source: MoF, CNB – ARAD, AKAT

The uneven rate of change can be seen in a more detailed view of the 2008 to 2012 timeframe. Stable growth (between 6 and 8%) was recorded for supplementary pension insurance. In the case of the other categories, the percentage changes were irregular, with regard to both the amount as well as value sign.

Overall, during the past four years (2008 to 2012 – refer to Graph 2.1) the aforementioned category of deposits in banks grew to a significant degree (its share increased from 67.7% in 2008 to 69.0% in 2012) as did the category of supplementary pension insurance (which increased from 5.5% to 6.0%). After a period of moderate growth between 2008 and 2010, the placement of insurance technical reserves has maintained a stable share of approximately 10%. The logical conclusion is that the last two categories – currency in circulation and collective investments – are slightly losing their level of importance within the overall structure (currency in circulation has decreased from 10.8% to 9.4% and collective investments from 7.2% to 5.7%), thus continuing the trend of recent years.

3. STRUCTURE OF HOUSEHOLD SAVINGS

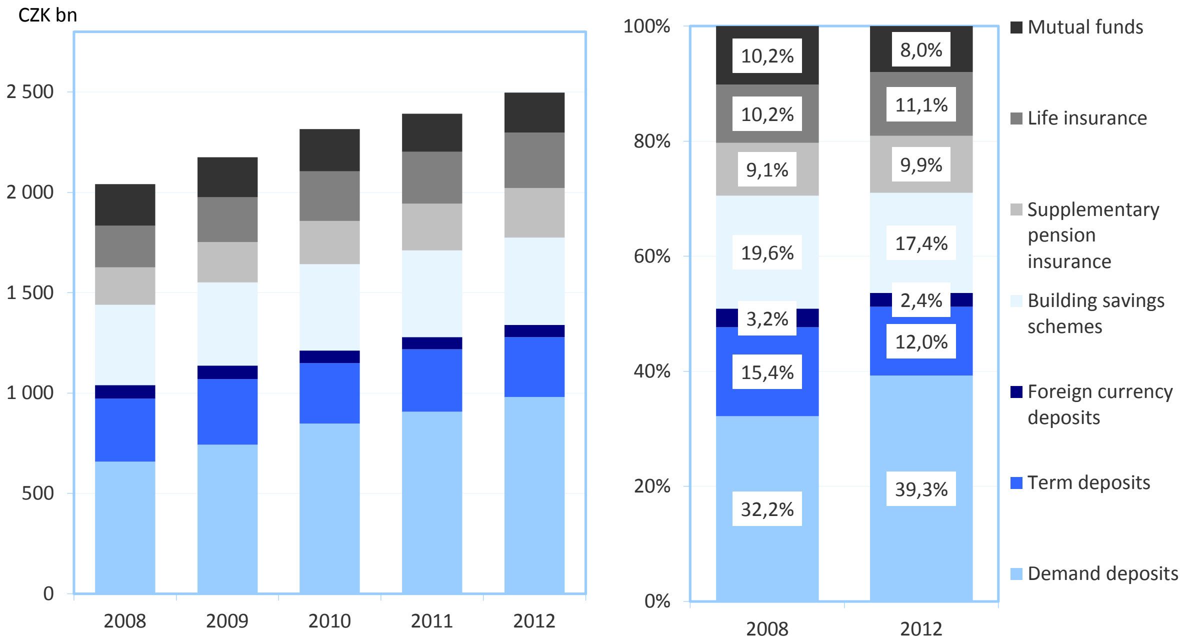
As in previous years, household savings recorded moderate growth (a year-on-year increase of 4.4%) and reached an overall volume of approximately CZK 2.5 trillion.

The structure of the savings changed only to an insignificant degree (no more than 1.5 pp year-on-year). As a result, the individual product segments in which households save their funds more or less retained the same shares. The most significant, although still minimal change, resulted from the transfer of funds from term deposits to demand deposits. The share of household demand deposits has thus gradually grown from 32.2% in 2008 to 39.3% in 2012. This shift is most likely caused by the continuing popularity of savings accounts that pay a higher interest rate but also allow immediate withdrawal. Thanks to the preferential allocation for household savings (high liquidity and low risk), the banking sector has been able to maintain an approximately 70% share of the household savings market over the long-term.

Outside of the banking sector, moderate growth has been recorded both by the supplementary pension insurance segment (from 9.1% in 2008 to 9.9% in 2012) as well by as the life insurance segment (from 10.2% in 2008 to 11.1% in 2012). This growth has been at the expense of household investments in mutual funds, which has been gradually decreasing (from 10.2% in 2008 to 8.0% in 2012). This is probably due to the lower level of confidence in the capital market in combination with the influence of financial advisors, who are focusing on products that meet the need of households to prepare for expected financially unfavourable periods (old age, illness, and death). It is also not possible to ignore the role played at the end of November 2012 by the termination of the ability to purchase supplementary pension insurance under the original conditions (refer to Chapter 8); the benefits associated with the state contribution for building savings schemes, supplementary pension insurance, and life insurance; and last, but not least, various commission schemes. All of these factors have acted to the detriment of investments in collective funds. A more detailed analysis of the individual sectors is presented in Chapters 5 to 8.

[8] Includes the Czech crown deposits of clients (residents and non-residents) in banks (including building savings banks) and branches of foreign banks, but not including CNB.

Graph 3.1: Structure of household savings in the Czech Republic



Source: CNB, MoF, AKAT

4. INSTITUTIONAL ASPECTS OF THE FINANCIAL MARKET

4.1. Financial Market Entities

The Czech financial market is considered to be an advanced, stable and sufficiently competitive component of the Czech Republic's economy. The minor changes that occur each year in the number of entities active in the individual sectors of the financial market are natural and cannot be viewed as significant interference in the structure, which would systematically change the institutional configuration or require increased attention on the part of the regulator or supervisory authority.

The banking sector plays a crucial role in the Czech financial market not only from the perspective of the volume of activities it administers. In particular, as a result of the comprehensive activities performed by its subsidiaries, a group of large banks even exceed the boundaries of banking and cross over into other sectors of the financial market. As a result, the banks positioned at the head of financial groups[9] dominate the market even from the institutional perspective. The ownership of the decision-making entities, both in the banking sector as well as in the insurance industries, is distributed amongst important financial groups registered in various EU member states.

[9] The largest financial groups fall under Česká spořitelna, ČSOB, and Komerční banka.

Table 4.1: Numbers of selected entities providing services in the financial market

As at 31 Dec	2008	2009	2010	2011	2012
Credit institutions					
Banks	37	39	41	44	43
of which: branches of foreign banks	16	18	19	21	20
of which: building savings banks	5	5	5	5	5
Credit unions	17	17	14	14	13
Capital market					
Securities dealers	55	53	53	58	61
Investment funds	16	25	47	60	77
Investment companies	19	22	23	21	21
Open-ended mutual funds	142	139	150	156	165
of which: special OMF	101	103	113	119	125
of which: standard OMF	41	36	37	37	40
Foreign funds /sub-funds	1,596	1,480	1,320	1,244	1,202
of which: based on Single European Passport	1,569	1,453	1,293	1,239	1,173
of which: special funds	27	27	27	28	29
Investment intermediaries	12,870	9,112	9,064	10,072	8,457
Tied agents	-	9,123	11,250	14,729	20,045
Pension funds	10	10	10	9	9
Insurance					
Insurance companies	53	52	53	54	53
of which: branches of foreign insurance companies	18	17	17	18	18
Reinsurance companies	1	1	1	1	1
Insurance intermediaries	86,230	105,980	126,123	149,729	161,630

Source: CNB

As far as banks are concerned, there were only a few insignificant changes. The number of branches of foreign banks decreased, because two terminated their activities and one new one was established. There were no new banking licences granted in 2012. In order to complete the institutional perspective of the banking sector, it should be mentioned that there was a change in the ownership of Volksbank CZ, which culminated with the renaming of this institution to Sberbank CZ.[10] The bank is continuing to do business under its original licence and thus this change is not reflected in the number of entities or with regard to the legal relationships with the bank's clients.

The number of credit unions decreased by one, specifically UNIBON, a credit union with a balance sheet total of CZK 3.4 billion (as at 30 June 2012). The CNB issued the decision to revoke this credit union's licence in November 2012, but it did not become legally enforceable until March 2012. The reason for rescinding the licence was because the institution had long been violating the limits of engagement with regard to some of its members and economically linked groups of entities in spite of receiving repeated warnings from the CNB.

Eighteen investment funds were granted licences to operate in the capital market sector and one fund terminated its activities. The number of mutual funds increased by nine due to the high number of new applications submitted by investment companies for a permit to establish a mutual fund. There are twenty-one investment companies in operation and their number did not change during the year.

The number of investment intermediaries decreased by 1,615 and at the end of 2012 there were 8,457 active in the Czech Republic. This declining trend started in 2009, when the number of investment intermediaries decreased by 3,758 as a result of the amended Act on Capital Market Undertakings, on the basis of which level 2 investment intermediaries became tied agents. These tied agents are no longer included in the register of

[10] The process for changing the bank's name was completed in February 2013.

investment intermediaries but in a separate register. Since the aforementioned amendment took effect, the number of tied agents is increasing at the expense of the number of investment intermediaries. At the end of 2012 the CNB had a record of 20,045 tied agents, which is 5,316 more than at the end of 2011.

The number of pension funds did not change in 2012, however, in connection with the preparations for the pension reform, at the CNB an intensive authorisation procedure was underway during which all nine of the existing funds were granted licences to operate as pension companies. The actual transformation process of the pension funds into pension companies occurred on 1 January 2013, at which time a portion of the assets and liabilities associated with supplementary pension insurance were allocated to the transformed fund, thus, from the accounting perspective, separating the assets of the shareholders in the pension fund from the assets held by the participants in the supplementary pension insurance schemes. (Refer to Chapter 8 for more information.)

In addition to the aforementioned existing pension funds, two newly established entities were also granted licences to operate as pension companies, specifically Conseq Pension Company and Raiffeisen Pension Company. Therefore, starting in 2013 there are eleven fund managers active in this new sector. Given the varied scope of permitted activities, six pension companies will be active within Pillar 2 of the pension system and all eleven of the pension companies will be active with regard to the supplementary pension savings schemes under Pillar 3 of the pension system.[11]

The process of granting licences to distribute pension products was initiated in 2012. This activity may now be performed by some of the entities authorised to provide investment services and their existing licences were expanded to include this new activity. Specifically this includes securities dealers from the banking and non-banking sectors and their tied agents, investment intermediaries and their tied agents, and the tied agents of pension companies.

There were only slight changes in the number of insurance companies in the insurance sector. The Amcico and Aviva Life Insurance Companies merged and are now known as MetLife Insurance Company. Within the area of insurance intermediation, the expected annual increase in registered entities did take place. More detailed information regarding the development in the insurance intermediation segment can be found in the overview provided in Chapter 7.3, which addressed the insurance market.

Within the context of the principle of free movement, the entities active in the Czech Republic's financial market supplement and expand the financial products offered by internally licensed entities on the basis of a "Single European Passport". As they do not have reporting obligations and are not even supervised by the CNB, there is no definite information available with regard to the exact scope of their activities. It is assumed that they do not focus on standard retail clients but rather that they specialise in the different requirements of individual clients. Although the products they offer are limited, they contribute towards increasing competitiveness and, for this reason, they are considered to be an integral part of the financial market in the Czech Republic. The number of these entities who are authorised to operate in the Czech financial market is not negligible.

Table 4.2: Number of entities operating in the Czech Republic under the Single European Passport

As at 31 Dec	Banks	Insurance companies	Funds	Investment companies	Investment services providers
2009	275	621	1 449	47	1 009
2010	284	658	1 347	48	1 226
2011	302	696	1 239	46	1 389
2012	329	730	1 173	45	1 536

Source: CNB

4.2. Guarantee Schemes

The financial market in the Czech Republic includes two guarantee schemes which protect both savers/investors as well as financial institutions and subsequently also provide protection for the entire market

[11] Generali Pension Company manages only assets in the transformed fund and did not establish a participant fund.

against the negative consequences that are associated with the insolvency of any of the involved entities. Both guarantee systems are harmonised at the EU-wide level.

The Deposit Insurance Fund (DIF) plays a preventive role with regard to banks (it decreases the risk of panic withdrawals by the public should any problems arise) and provides a recovery function for depositors. If the CNB announces that a credit institution participating in the DIF is unable to meet its obligations, the DIF will pay out to all individuals and legal entities 100% of their deposit balance, including interest, up to a maximum of EUR 100,000. The disbursement of funds must start within twenty working days of the date the announcement is published.

The annual contribution of banks and credit unions to the DIF is equal to 0.04% of the average volume of their insured deposits (including interest) for the relevant quarter. In the case of building savings banks, as the probability of their insolvency is lower, their contribution is one half of that specified above. In 2012 the DIF collected almost CZK 3.6 billion. As a result of the compensation disbursed to the more than 2,500 clients of the failed UNIBON Credit Union, the total reserve the DIF has available for any possible future reimbursement increased year-on-year by only CZK 2.9 billion and at the end of the year had a balance of CZK 24.7 billion.[12]

The Securities Traders' Guarantee Fund (STGF) compensates the clients of securities dealers who are not able to meet their obligations towards clients. The STGF therefore does not cover the risk of loss of value of investments in securities. Clients receive compensation equal to 90% of the value calculated in accordance with the applicable provisions of the Act on Capital Market Undertakings up to an amount of EUR 20,000 within three months of the date their claim is verified.

As with the DIF, the main source of STGF assets consists of the contributions made by the involved players, i.e. securities dealers and investment companies that manage client assets. As, unlike in the situation of the DIF, the covered client assets remain in the hands of the securities dealer only for a relatively short period of time but repeatedly, the amount of the annual contribution is calculated as 2% of the amount of fees and commissions for the investment services provided during the past year. In 2012 the STGF collected contributions of CZK 113 million and at the end of the year had a balance of CZK 543 million available for any possible future reimbursement.[13] This relatively low level of reserves is a result of previous disbursements of compensation, which exceeded the fund's capacity several times over and required additional resources from the state budget.[14]

4.3. Economic Results of Financial Institutions

As compared to 2011, profit generation rallied in the majority of the financial market sectors (refer to Table 4.3). The most dynamic growth was recorded by non-bank financial institutions (a year-on-year increase of 58.1%), followed by insurance companies (with an increase of 32.5%). In these two sectors, however, the decline from 2011 was only partially recovered.

In the case of the largest sector, i.e. banking institutions, after the temporarily dampened profit generation of 2010-2011, last year marked the return to the growth trajectory. The year-on-year growth recorded in 2012 (21%), combined with only a small decline in profits in 2011, allowed the banks to record the best profits of the last five years. As is described in more detail in Chapter 5.3, a reduction in costs contributed more to the greater profitability of the banks than did an actual increase in profits. From the perspective of the last five years, pension funds also experienced the best results in 2012.

The only sector in which there was an absolute decline in profits is the leasing company sector. In this case it is most likely still a reflection of the austerity measures implemented within the business sector in previous years, when companies postponed the renewal of their technical equipment, including their vehicle fleets.

[12] More information is available on the website of the Deposit Guarantee Fund at http://www.fpv.cz.
[13] More information is available on the website of the Securities' Traders Guarantee Fund at http://www.gfo.cz.
[14] Funds from the state budget were provided to the STGF in the form of several tranches of repayable financial assistance between 2002 and 2004. The total amount of assistance was CZK 1.1 billion. In 2008 the STGF received a subsidy of CZK 0.8 billion.

Table 4.3: Profit/loss of financial institutions before tax

As at 31 Dec in CZK (in bn)	2008	2009	2010	2011	2012	Year-on-year change (%)
Banking institutions	54.1	71.3	65.9	63.4	76.7	21.0
Non-bank financial institutions[15]	6.3	35.2	48.5	24.6	38.9	58.1
Financial leasing companies	2.6	3.4	4.9	8.6	7.4	-14.0
Pension funds	0.6	2.8	4.6	4.6	4.9	6.5
Insurance companies	13.0	23.1	28.4	12.0	15.9	32.5

Source: CSO

The overall employment rate in the financial sector saw moderate growth for the second year in a row, thus confirming that the declining trend from previous years has come to an end. If we look at the development in individual sectors (Table 4.4) there are, however, some obvious differences. Although some of the large banking groups announced employment cuts in the second half of 2012, this has not yet been reflected in the overall figures for the banking sector, which, with its 56% share, is the largest employer. After the crisis years of 2008 to 2010, during which time the employment rate in banks was dropping, 2011 saw the start of a new growth trend that was maintained in 2012 (year-on-year growth of 1.7%). In the case of insurance companies, the development was very similar, except that the declining trend was not broken until 2012. Conversely, financial leasing companies have not broken their downward trend yet. The employment rate for non-bank financial institutions has developed differently in the past, as it continued to grow steadily during the previous years with the exception of 2011. Pension funds employ a very low number of people; however this particular segment recorded the greatest relative growth (13%). This is explained by the need to strengthen personnel capacity in relation to the preparations for the pension reform.

Table 4.4: Average headcount of financial institutions[16]

As at 31 Dec	2008	2009	2010	2011	2012	Year-on-year change (%)
Banking institutions	39,284	38,263	38,189	39,124	39,804	1.7
Non-bank financial institutions	14,032	14,174	14,311	13,855	14,119	1.9
Financial leasing companies	2,989	2,724	2,630	2,586	2,464	-4.7
Pension funds	487	484	452	470	531	13.0
Insurance companies	14,726	14,498	14,359	14,260	14,459	1.4
Total	71,818	70,143	69,941	70,295	71,377	1.5

Source: CSO

5. CREDIT INSTITUTIONS AND OTHER PROVIDERS OF ASSET FINANCING

This section primarily focuses on credit institutions, specifically banks (most of the chapters) and credit unions (Chapter 5.9). General interest rate issues are covered in Chapter 5.4 and the Chapter 5.10 deals primarily with other providers of asset financing. The sub-sector covered in the last chapter offers products that are fairly close substitutes for bank loans and, if they are offered to retail clients, are a part of a household's total indebtedness.

Given the importance of households as the key customer segment, a separate chapter (5.6) provides attention on the development in household indebtedness with regard to both banking as well as non-bank institutions that provide credit.

[15] Includes primarily credit unions, money market funds, and collective investment funds.
[16] Average headcount (full-time equivalent), individuals.

5.1. Stability of the Banking Sector

Even in 2012 the Czech Republic's banking sector successfully proved its resistance to the ongoing uncertainty in the world's financial markets, the fears about the developments in some of the eurozone countries, and the overall condition of the domestic economy. One of the reasons is that some of the long-lasting factors that contributed to the stability of this sector during the period following the global financial crisis in 2008 continue to have a positive effect. In particular, these include high-quality capital, a relatively low dependence on funds from the interbank market, a high share of retail loans secured by real estate lien rights, and only a relatively low amount of foreign currency loans.

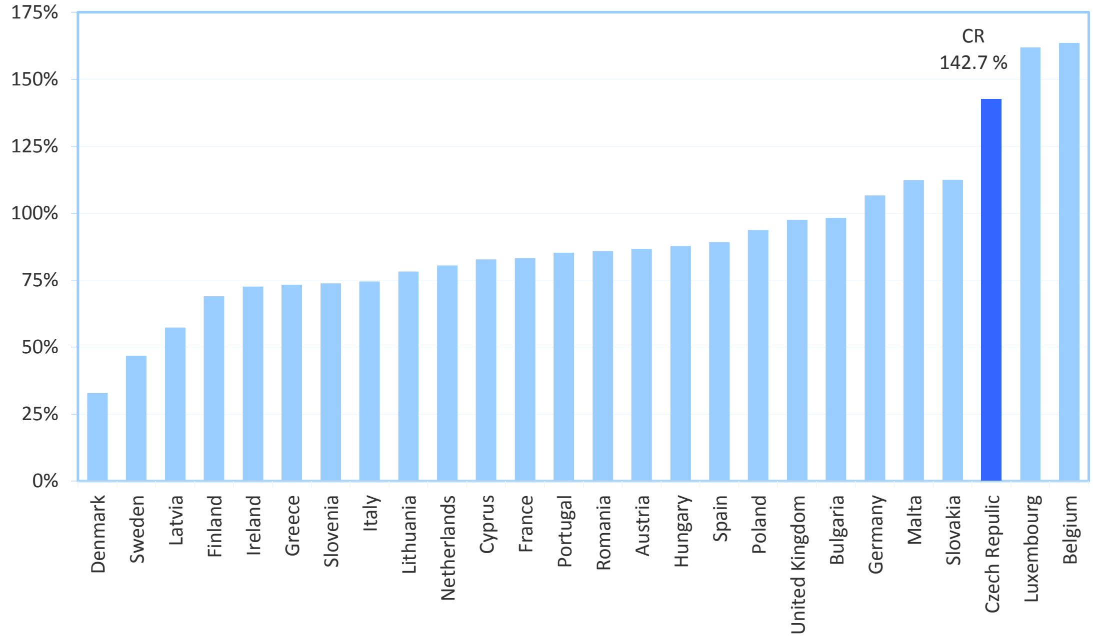
The capital adequacy of the banking sector in the Czech Republic has been increasing over the long-term in spite of the situation on the global markets, where increased uncertainty has been reappearing during certain periods and in certain areas. By the end of 2012 capital adequacy had reached a level of 16.4% (the regulatory minimum is 8%). This reflects a year-on-year increase of 1.2 pp. The development during the monitored period represents a reversal of the slight decrease in capital adequacy that the banking sector reported in 2011 (by 0.3 pp). However, within the context of a longer-term comparison, it is possible to see the significant 4.8 pp increase in this indicator as compared to the status prior to the crisis at the end of 2007. At that time capital adequacy was at a level of 11.6%. On the basis of this development it is possible to state that the banks in the Czech Republic have significantly increased the size of their capital cushion, which they can use to cover any unexpected losses.

The resistance and stability of the banking sector has also been repeatedly confirmed by the stress tests performed by the CNB. According to the results published on 5 December 2012 (which used data from the third quarter of 2012), even in the event of a situation that is more theoretical and less likely, specifically a very negative scenario, the sector's capital adequacy would still remain above the regulatory minimum of 8%. This particular scenario takes into account the possible consequences of a theoretical long-term and permanent decline in Europe's economic activities, the temporary freezing of the interbank market in the Czech Republic, and the partial devaluation of exposures held against European countries with a national debt equal to more than 60% of GDP. Even were this situation to arise, according to the CNB, the capital adequacy of the Czech banking sector would remain at slightly below 10%.

Generally speaking, the sector's relatively lower dependence on funding from the interbank market makes a significant contribution to the stability of its funding sources and overall liquidity. Banks in the Czech Republic have for a long time obtained the majority of their funding through client deposits. At the same time it applies that during periods of acute liquidity, problems have generally first appeared in the interbank market in which financial institutions lend to each other or in other more volatile sources of funding provided by other financial market participants. In contrast, after the outbreak of a liquidity crisis, client deposits are usually a more reliable and stable source of funding.

The monitored ratio of deposits to loans (refer to Chart 5.1) has remained stable in the Czech Republic over the long term and is currently 142.7%. This ratio value shows that the loans granted by banks to clients in the Czech Republic are more than fully covered by client deposits. From this perspective, the banking sector in the Czech Republic is one of the most resilient in all of Europe. Conversely, some of the least favourable values are reported by Ireland and some of the Scandinavian and Baltic economies, which at various times in the past have undergone dynamic credit growth. In terms of year-on-year development, significant increases in the value of this indicator can be observed in, for example, the Czech Republic, Luxembourg and Belgium. Some other countries that have recorded a substantial increase in the value of this indicator include Bulgaria, Latvia, Lithuania, and Hungary.

Graph 5.1: Client bank deposits to loans ratio in 2012



Source: ECB

In general it is difficult to find a universal interpretation and explanation of the development in the deposits to loans indicator across countries. An increase in the value of this indicator is favourably affected by an increase in the volume of deposits as well as by a decrease in the volume of loans. However, the latter may be the result of uncertainty and, in some cases, might have a negative effect on the financing of economic activities and consequently on the economy as a whole. In those cases, the improvement in the indicator could actually be a negative signal. Another issue associated with the interpretation of this indicator is the need to set it within the context of the product structure of the relevant national financial market. If, for example, the majority of retirement savings in a country are administered by the non-bank sector, then the volume of bank deposits would be reduced by the amount of these savings. These funds may find their way onto the banks' balance sheets, however they would get there indirectly in the form of deposits made by pension fund managers or as payment for the purchase of bank securities and they would therefore not be necessarily included in the ratio of primary deposits to loans. In addition, from the perspective of the bank's stability, these sources cannot be equated with the more diversified retail deposits. Institutional deposits are associated with a lower number of subjects and they can therefore be generally more volatile.

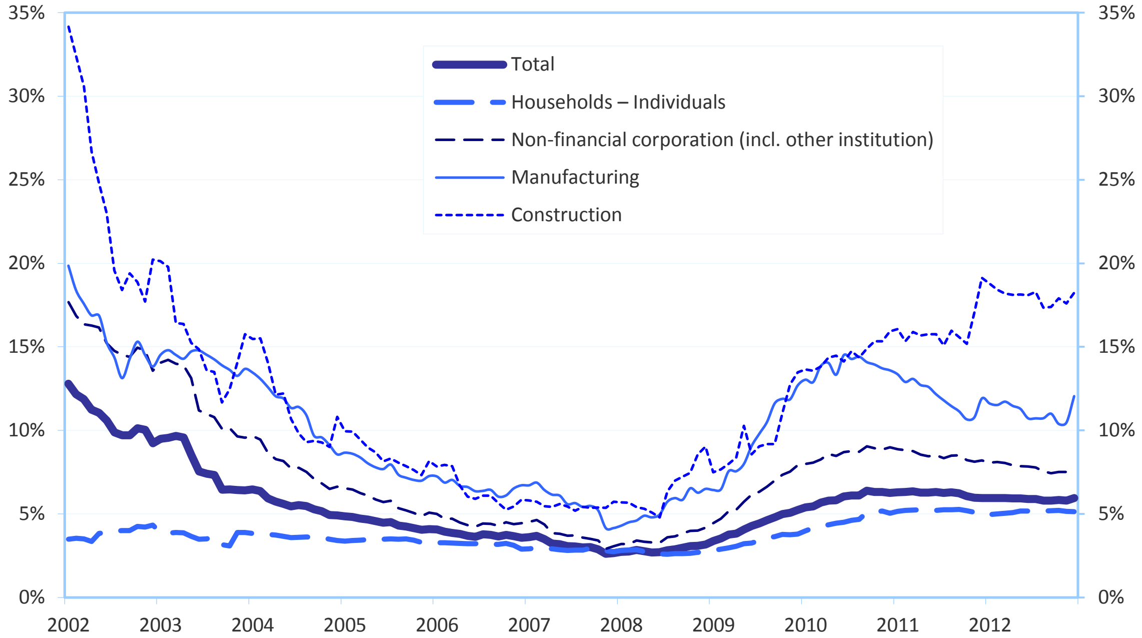
Finally, it should be noted that the deposits to loans ratio discussed above evaluates the banking sector as a whole, which does not exclude the fact that some banks have a significantly lower value for the coverage of loans by primary deposits and are more vulnerable from this particular perspective.

5.2. Banking Sector Assets

At the end of 2012 the total asset volume in the banking sector, including building savings banks, was CZK 4,633 billion. When compared with the development in 2011, a slight slowing down of growth dynamics is apparent. In 2012 the balance sheet total increased by 3.5%. In 2011, however, asset volume grew at a rate that was almost double (6.8%). This slowdown was reflected in the decline in the growth rate of receivables due from clients (an increase of 2.5%, compared to an almost 6.5% increase in 2011). This may indicate that the recovery of credit activity is also slowing down.

As far as the quality of assets is concerned, the banks' balance sheets are in relatively good condition. The quality of the loan portfolios, which are the most important factor given the nature of the domestic banking sector, is illustrated in Graph 5.2 which presents the non-performing loan (NPL) ratio for each category of borrowers.

Graph 5.2: Distribution of non-performing loans



Source: CNB – ARAD

At the end of 2012 the ratio of non-performing loans to total customer loans (granted to residents and non-residents) was at 6.0% and was almost unchanged when compared to the previous year. It thus seems that the deterioration in the quality of loans, which started in 2008 mainly due to the macroeconomic consequences of the global financial crisis, may have stopped in 2011. However, the value of this indicator continued to gradually decline throughout most of 2012 and the turning point did not occur until the last quarter. It is therefore not yet possible to claim that this represents a clear change in the trend, although it is possible to say that the NPL ratio attained a level that is only half compared to the situation in 2002.

The data for the individual segments may better illustrate the different development trends that exist within these segments. While the NPL ratio for loans provided to households (inhabitants) increased by 0.2 pp to 5.1%, in the case of the non-financial business sector it is possible to see development in the opposite direction and the NPL ratio dropped by 0.8 pp to 7.4%. The different form of restructuring applied in various sectors as a response to the economic slowdown following the global financial crisis of 2008 may have contributed to this development. The decline in the NPL ratio in the construction industry by 0.9 pp to 18.2% (although this value remains very high) provides further evidence of this possibility. Conversely, the summary data for the important manufacturing sector reports a slight increase in the NPL ratio of 0.1 pp to 12% after a period of favourable development in 2011.

From the perspective of potential problems caused by external factors, specifically the developments in exchange rates, it is essential to monitor loans denominated in foreign currencies. The share held by these loans in the number of total loans did not change in 2012 as compared to the previous period and remained relatively low. It is however important to keep in mind the positive implications of this long-term status with regard to resilience against the shocks caused by exchange rate fluctuations and subsequently the positive effect it provides for the functioning of the real economy and the stability of the financial sector.

Thanks to the low share of foreign currency loans, any changes in the domestic currency do not have significant direct effect on the overall amount of loan payments, as most payments do not have to be recalculated into the domestic currency in which borrowers often generate their income to repay these loans. With the depreciation of the domestic currency the loan payments for loans denominated in the domestic currency do not increase nor is the ability of borrowers to repay impaired, and there is thus no decrease in the quality of bank assets. In the case of non-financial corporations, over the last few years the share of foreign currency loans has been between 15 and 20%. Mostly, however, the relevant cash flow is offset by export revenues in foreign currencies, thus significantly decreasing the level of currency risk. Household debt in foreign currencies is equal to 0.1% and is therefore essentially negligible. In this respect the situation of the Czech banking sector is different from the situation in many other countries of Central and Eastern Europe, especially Hungary.

5.3. Economic Results of the Banking Sector

For the year 2012, the banking sector's profit before tax is CZK 76.7 billion (refer to Table 5.1). This represents a year-on-year increase of more than 20%. It is necessary to look to the reduction in impairment losses as the main contributor to this improvement, as net interest income and net income from fees and commissions did not grow at a similar rate. The sub-categories of profit – specifically the profit from financial and operating activities – increased less than the profit before tax, specifically by 2.8% to CZK 166.6 billion.

Table 5.1: Selected items from the profit and loss accounts of the banking sector

Item (in billion CZK or %)	2009	2010	2011	2012	Year-on-year change
Profit/loss from financial and operating activities	168.4	157.4	162.1	166.6	2.8%
Net interest income	103.3	105.3	109.9	108.0	-1.9%
Interest income	174.4	167.0	172.3	170.4	-1.1%
Interest expenses	71.2	61.7	62.5	62.6	0.2%
Net fee and commission income	36.4	38.5	39.1	37.3	-4.5%
Fee and commission income	46.8	48.4	50.0	49.2	-1.6%
Fee and commission expenses	10.3	9.9	10.9	11.9	9.0%
Administration costs	60.5	62.4	66.0	66.7	0.9%
Other costs [17]	27.2	29.2	33.0	23.0	-30.3%
Total profit or loss before tax	**70.8**	**65.6**	**63.4**	**76.7**	**20.8%**
Ratio of net interest income to net fee and commission income	2.8	2.7	2.8	2.9	2.8%
Ratio of net interest income to profit/loss from financial and operating activities	61.3%	66.9%	67.8%	64.7%	-4.5%
Ratio of net fee and commission income to profit/loss from financial and operating activities	21.6%	24.5%	24.1%	22.4%	-7.1%

Source: CNB

The net interest margin recorded unfavourable development. Year-on-year, net interest income declined by 1.9% to CZK 108.0 billion. Neither of the components of this item developed favourably. Interest expense increased only slightly (by 0.2% to CZK 62.6 billion). On the other hand, interest income decreased by 1.1% to CZK 170.4 billion, due to, amongst other things, the reduction of monetary policy rates and the gradual manifestation of this development in the interest earned on bank assets such as loans.

Net income from fees and commissions recorded an even more pronounced relative decline, and decreased by 4.5% to CZK 37.3 billion. (Gross) income from fees and commissions fell only slightly (by 1.6%). However, the associated costs recorded a significant year-on-year increase (about 9% to CZK 11.9 billion).

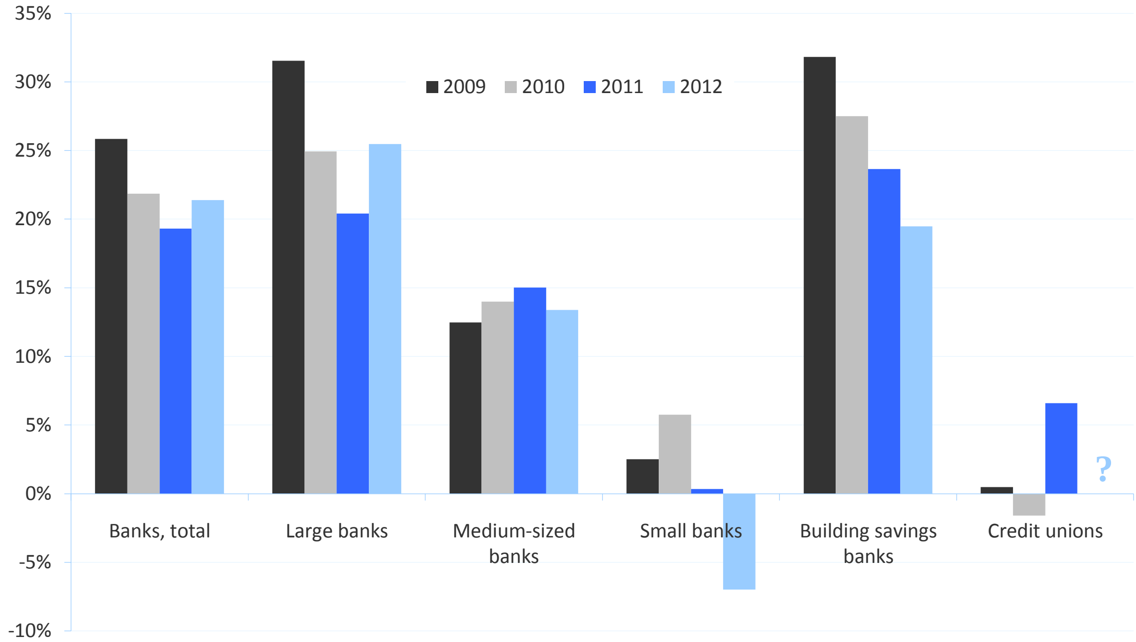
The ratio indicators provided at the bottom of Table 5.1 better illustrate the relative importance of the individual items. Net interest income in 2012 was almost three times the net income from fees and commissions. In addition, this particular ratio indicator once again reported a year-on-year increase (by 2.8%). The dominance of net interest income can also be illustrated with respect to profit from financial and operating

[17] Others costs include depreciation, the creation of reserves, and impairment losses. Together with the items Financial and operating income and expenses and Administrations costs, they are included in the profit before tax.

activities, as it has a 64.7% share. On the other hand, the contribution of net fee and commission income amounted to only 22.4%.

As a whole, the banking sector achieved a relatively high rate of return on Tier 1 capital, which increased slightly by 2.1% to 21.4%. However, significant differences can be seen in the profitability of the individual categories of credit institutions (refer to Graph 5.3, which, for the sake of comparison, also provides information on the profitability of the credit union sector). Despite the individual year-on-year changes, it is not possible to detect any significant tendency of these values to come closer together. Overall, in relative terms, the banking sector performed slightly worse than in previous years. One explanation may be the increase in Tier 1 capital, although the causes for individual entities may differ.

Graph 5.3: Tier 1 capital profitability[18]



Source: CNB

5.4. Interest Rate Development

The development in market interest rates is affected by many factors, but primarily by the setting of interest rates as one of the CNB's monetary policy instruments. In 2012 the central bank decided to cut its key 2W repo rate three times and it gradually went from 0.75% down to 0.05%. Monetary policy rates are (once again) the lowest in the history of the country. A basic overview of the rates at the end of each half of individual years is provided in Table 5.2.

Along with this decline to record low levels, there was a further adjustment made to the spread between the base rate and the other CNB rates. The discount rate, which up to this point was 0.25 pp less than the 2W repo rate (and before that even a full percentage point lower), was left at the same level as the repo rate. The Lombard rate developed similarly. In the past it was 1.0 pp higher than the 2W repo rate. After the repo rate was reduced down to 0.25%, this margin also decreased to 0.2 pp.

A number of other key central banks from around the world are continuing with their loose monetary policy and, in some cases, even intensifying it. It is however necessary to emphasise that those that are intensifying it are using less standard tools, such as asset redemptions. As described in more detail in Chapter 1.1, the Bank of England left its basic interest rate at 0.5% and the U.S. Fed in an interval from 0.0 to 0.25%. Conversely, the European Central Bank decided to reduce its basic rate to 0.75%.

[18] The graph does not include data for the credit unions sector in 2012, because the data were not published by CNB.

Table 5.2: CNB interest rates

(%)	30/6/2010	31/12/2010	30/6/2011	31/12/2011	30/6/2012	31/12/2012
2W repo	0.75	0.75	0.75	0.75	0.50	0.05
Discount	0.25	0.25	0.25	0.25	0.25	0.05
Lombard	1.75	1.75	1.75	1.75	1.50	0.25

Source: CNB

The overview of average client interest rates in the Czech Republic in individual years (refer to Table 5.3) shows a further, albeit slowing, decline in the interest rates paid on deposits. The interest rate paid on the deposits of non-financial businesses is obviously lower than the rate paid on the deposits of households and has been approximately 50% lower for the past three years. Conversely, even as recently as 2008, the deposits of households and small business owners earned interest at lower rates.

The average interest charged for new loans provided to households declined and the interest rates for consumer loans declined even more drastically by almost 3.7 pp to 10.9%. The average interest for new loans provided to non-financial business also dropped, specifically by 0.2 pp to 3.7%. In general, however, the lowest interest is charged on loans provided to larger enterprises.

Table 5.3: Average interest rates

As at 31 Dec (%)		2008	2009	2010	2011	2012
Deposits	households and small business owners	1.5	1.4	1.3	1.2	1.2
	non-financial businesses	1.8	0.9	0.6	0.5	0.6
Loans	to households and small business owners	6.8	7.0	7.0	6.8	6.5
	for consumption	13.4	13.9	14.3	14.6	10.9
	for real estate	5.1	5.2	5.3	5.1	4.8
	to non-financial businesses	5.6	4.6	4.1	3.9	3.7

Source: CNB – ARAD
Note: The data refers to new deposits and loans in CZK.

In the case of loans provided to households, in addition to monitoring interest rate, it is advisable to also monitor the more comprehensive indicator that includes the other costs associated with the loan – the effective annual percentage rate. The EAPR[19] for new consumer loans increased only slightly during 2012 (refer to Table 5.4). In December 2011 it was 15.8% and after an initial increase in 2012 it gradually decreased to 15.9% at the end of the year. This development was very similar to that recorded in 2011. In contrast, the EAPR for the purchase of residential real estate has recorded a much more marked decline – it was 3.7% in December 2012, reflecting a decrease of 0.4 pp. The cost of housing loans is thus approaching the lowest levels in history[20] as a result of how banks are reacting to the way in which the central bank is setting rates. An important role is also played by competition amongst the individual banks.

Table 5.4: APR (Annual Percentage Rate) for CZK loans provided by banks

New loans in 2012 (%)	January	February	March	April	May	June	July	August	September	October	November	December
Consumer credit	16.5	16.3	16.0	16.2	16.1	16.2	16.3	16.3	16.3	16.2	16.5	15.9
For residential real estate	4.1	4.1	4.2	4.2	4.1	4.1	4.1	4.0	4.0	4.0	3.8	3.7

Source: CNB

[19] The EAPR represents the percentage of the amount due that the client must pay over the period of one year in addition to the amortisation of the loan amount, specifically in relation to fees, loan administration, and other costs associated with using the loan. The EAPR referred to is the EAPR on loans in Czech crowns provided by Czech banks (new transactions).
[20] The decline in client interest rates for residential housing (as measured by Hypoindex) continued at the start of the year 2013 and attained a level even lower than the previous historical minimum.

5.5. Deposits and Loans

Bank deposits (see Table 5.5) increased during 2012 at a rate approximately three times faster than loans (7.3% as compared to 2.4%). Looking at Table 5.5 it is evident that this reversed the development trend from 2011, when the volume of loans grew faster than the volume of deposits (6.0% as compared to 4.5%). The reasons for the slower rate in the increase in loans in 2012 can be attributed to a combination of factors, including the increased prudence on the part of both banks as well as potential borrowers, the slow rate of economic growth, and the adverse effect of the developments in the eurozone on the economic activity in the Czech Republic.

Household deposits increased at a rate that is almost fifty percent less than the growth rate for the deposits of non-financial businesses (3.4% as compared to 6.4%). The deposits of financial entities and the government sector increased by approximately one fifth and recorded the largest absolute increase (by CZK 68.4 billion), thus breaking the trend of the past few years, when households made the greatest contribution towards increasing the total deposit volume. Nevertheless, household deposits still continue to represent more than one half of total deposits (CZK 1,770 billion out of CZK 3,128 billion). They are followed by non-financial business with CZK 716 billion in deposits. From the perspective of changes in the structure of deposits according to withdrawal period, in 2012 there was a sharp increase in deposits made to demand deposit accounts (up 11.9%) as compared to term deposit accounts (up 0.8%). At the end of 2012, the deposits held in demand accounts accounted for 61.4% of all deposits.

Households also hold the dominant position amongst borrowers. The volume of bank loans provided to households grew as fast as the volume of household deposits (by 3.4%) and reached CZK 1,132.2 billion, which represents 48% of all bank loans. In contrast, the volume of loans provided to non-financial businesses changed only slightly – by 0.9% to CZK 835.4 billion as compared to the situation in 2011, when loans provided to non-financial businesses grew by 6.4%. The stagnation in the number of loans taken out by companies in terms of demand may be explained by, amongst other things, the ongoing uncertainty with regard to future economic development and the resulting reduced motivation to invest. It may also be affected by the increasing potential of companies to finance their activities from their own resources, especially in the case of more profitable firms and business sectors. The ongoing restructuring of businesses and the tendency to reduce indebtedness in some sectors, primarily those that expanded prior to 2008, may also play a role. As was the case a year ago (although the results for 2012 are slightly weaker), the most dynamic growth was recorded by the category of loans provided to non-residents (an increase of 7.8%).

Table 5.5: Distribution of bank deposits and loans by sector

As at 31 Dec	Bank deposits (CZK bn)				Bank loans (CZK bn)			
	2011	2012	Change	Change (%)	2011	2012	Change	Change (%)
Households	1,711.3	1,770.3	59.0	3.4	1,095.2	1,132.2	37.0	3.4
Non-financial companies (including other institutions)	673.1	716.0	42.9	6.4	828.2	835.4	7.2	0.9
Government institutions	305.1	373.5	68.4	22.4	64.2	61.5	-2.7	-4.2
Financial institutions	116.9	138.2	21.3	18.2	117.0	116.4	-0.6	-0.6
Non-residents	84.9	106.1	21.2	25.0	196.9	212.3	15.4	7.8
Non-profit institutions	22.6	23.4	0.8	3.6	2.9	2.3	-0.6	-21.7
Total	2,914.0	3,127.6	213.6	7.3	2,304.5	2,360.1	55.6	2.4

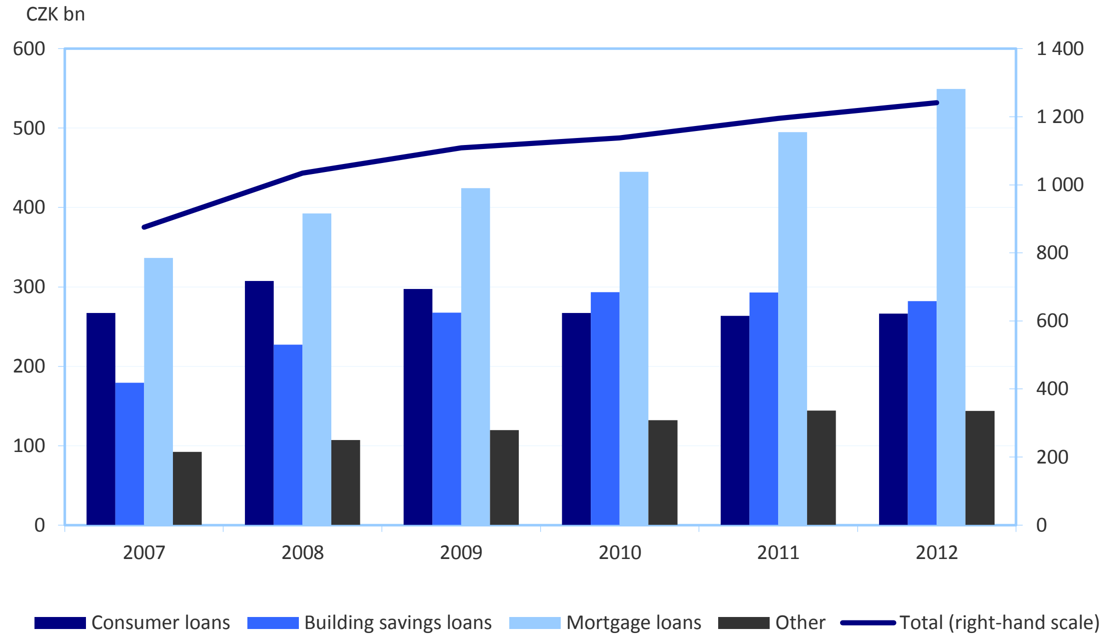
Source: CNB – ARAD
Note: The table shows deposits with banks in Czech crowns and in foreign currencies, which are subsequently converted to billions of CZK. The values are therefore different from table 2.1, which lists only bank deposits in Czech crowns.

5.6. Household Indebtedness

The retail segment, as the dominant client segment, deserves a more detailed analysis that exceeds the scope of the banking sector. Total household indebtedness to banks and non-bank financial institutions reached

CZK 1,241 billion in 2012. This represents an annual increase of 3.4%; however, the growth rate fell by 2.2 pp. As in the past, the development of indebtedness associated with the individual loan products varied. The growth rate for mortgage loans remained basically unchanged and remained at approximately 11%. Conversely, the indebtedness associated with loans provided under building savings schemes fell by 3.7%. In contrast, the level of indebtedness associated with consumer loans decreased slightly (by 0.6%) as compared to the growth in this category in 2011 (+0.8%).

Graph 5.4: Total household indebtedness[21]



Source: CNB – ARAD

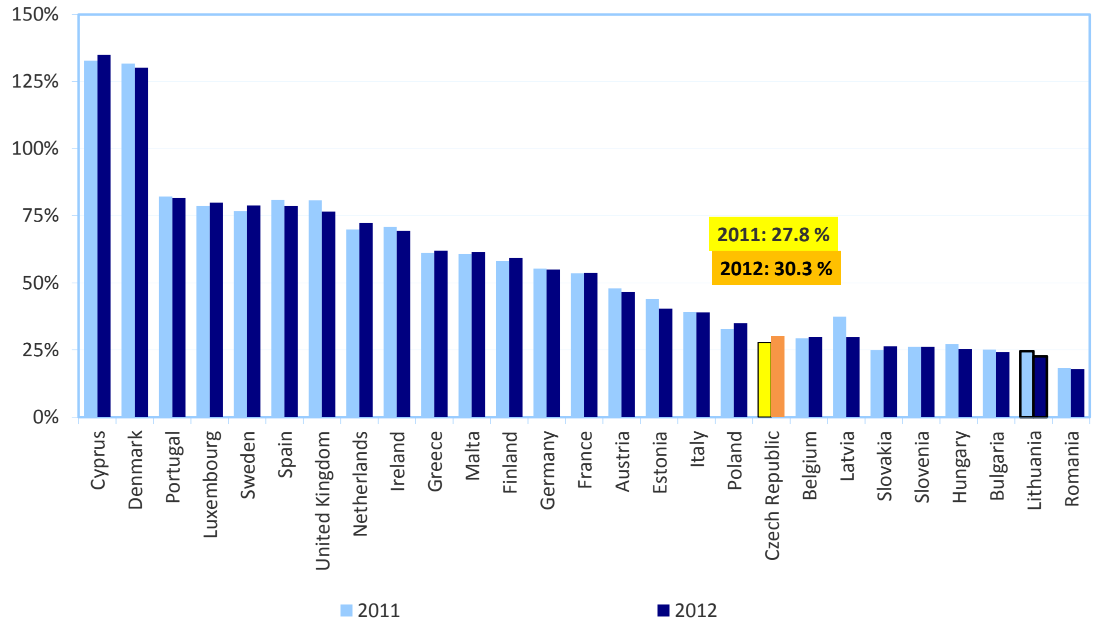
Housing loans recorded an absolute increase of CZK 43.5 billion. Conversely, consumer loans recorded a year-on-year decrease of 1.6 billion. The share of housing loans in relation to total indebtedness thus increased slightly in 2012 (by 1 pp) to a level of 67% by the end of 2012.

Graph 5.5 shows that the level of household indebtedness relative to the size of the domestic economy, which indirectly reflects household income and thus the ability of households to repay their financial obligations, is still relatively low in the Czech Republic as compared to the rest of the EU (about 30.3% of GDP).[22] As before, it therefore applies that the costs associated with the servicing of household liabilities are generally not a factor that might limit private consumption to the same extent as in countries with higher relative levels of indebtedness. As is also apparent from Graph 5.5, the other new member states from Central Europe also report low levels of indebtedness. The reason may be the relatively recent transition of these countries to a market economy, as a result of which they have not yet had sufficient time to accumulate the relative volume of loans as is common in Western Europe. A marked decrease in the relative level of household indebtedness was reported primarily by those economies where there was an increase in indebtedness during the previous stages of the economic and financial cycle and now this level is gradually being reduced (e.g. Great Britain, Denmark, Ireland, and Spain), and by economies that have managed to reduce the value of the relative debt ratio by increasing the value of the denominator for this indicator, i.e. thanks to the renewed growth of the economy (typically the situation in the Baltic states).

[21] The data for loans provided by building savings banks represent the sum of the total value of "bridging" and "standard" loans provided under building saving schemes.

[22] The year-on-year development in this indicator can only be interpreted in a limited manner in the case of economies that have a domestic currency other than the euro, as, in these cases, there exists the risk of year-on-year volatility in the values as a result of fluctuations in the exchange rate of the domestic currency against the euro, which is then used to calculate the commitment of households in the domestic currency in units of the common European currency (the euro).

Graph 5.5: Volume of household indebtedness in the EU in relation to GDP



Source: ECB, Eurostat

Over the long-term, one of the factors that has helped the Czech Republic to maintain the more stable repayment of household debt is the fact that more than 99% of the loans are denominated in Czech crowns. The size of the payments in CZK was thus not affected by the exchange rate volatility as has been the case in some of the other countries of Central and Eastern Europe. Conversely, countries with a higher level of foreign currency debt are now facing negative effects in two areas. Primarily, the higher volatility of payments denominated in the domestic currency is reflected in a fluctuating volume of private consumption, thus destabilizing domestic aggregate demand. In addition, if the consumer spending margin is not sufficient to cover these fluctuations, the volatility of the exchange rate may subsequently be reflected in a decline in the repayment rate for loans and deterioration in the quality of bank assets. With its low level of foreign currency debt, the Czech banking sector has a significant advantage in this area (refer to Chapter 5.1).

However, in addition to the above, it also applies that, due to is comprehensive macroeconomic nature, the ratio indicator of the overall level of indebtedness to aggregate GDP does not sufficiently take into account certain microeconomic facts, such as the different situations that exist within individual income groups and regional differences in indebtedness. Generally speaking, primarily low-income households, which must outlay the greatest proportion of their income in relative terms in order to meet their obligations, face the most serious problems with regard to repaying their debts.

5.7. Mortgage Market

The volume of mortgage loans provided to households reached CZK 700.5 billion by the end of the year (refer to Table 5.6). When compared to 2011, the year-on-year rate of change reports a slight decrease of 2.7 pp to 6.3%.

Table 5.6: Balance of mortgage loans (ML) provided to households

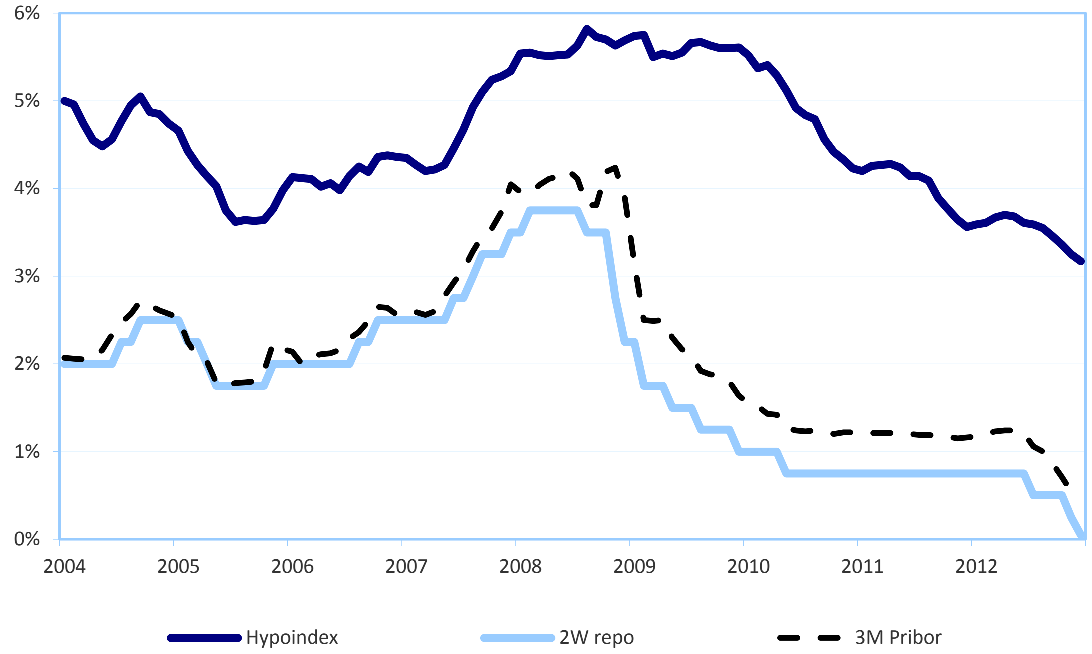
As at 31 Dec	2009	2010	2011	2012	Year-on-year change	
					Abs.	(%)
Number of mortgage loans (000s)	450.8	501.5	572.6	646.2	73.6	12.9
Contractual principal (CZK bn)	663.5	748.3	867.4	989.0	121.6	14.0
Volume of mortgages (CZK bn)	554.4	604.7	659.0	700.5	41.5	6.3

Source: MRD, CNB – ARAD

The positive development of the Czech mortgage market is also partially due to the continuing downward trend in client interest rates as reported by Hypoindex[23], which fell by 0.39 percentage points to 3.17% at the end of the period (refer to Graph 5.6). The dynamics of this trend are however slowing down – in 2011 the decrease was 0.7 pp and in 2010 1.4 pp. Part of the reason for this slowdown is the fact that rates are increasingly approaching minimum values.

Some of the causes of the absolute decline in the Hypoindex rate include the increasing competition amongst lenders, the popularity of variable rate contracts (which are currently priced very low), and of course cheaper sources in the wake of the general monetary policy. The relationship between the development of the client, interbank, and monetary policy rates is worth further analysis.

Graph 5.6: Development of selected interest rates



Source: Fincentrum, CNB

The spread between the Hypoindex rate and the 2W repo rate during 2012 hovered at a level of approximately 3 pp. When compared with the previous year, when the spread was approximately 3.3 percentage points, this represents a slight decrease. In addition, from the perspective of medium-term development, this spread has shown a downward tendency. It reached its maximum value (4.6 pp) at the end of 2009, when the central bank lowered interest rates and lenders responded to this development within the context of the gradually improving situation in the real economy and in the financial markets. With a certain period of delay, Hypoindex is thus reacting to the lowering of CNB's basic interest rate, which began in 2008 in response to the global financial crisis. At the end of 2012 (as was the case in the previous year) the value of the interest spread reached its lowest level since October 2008, although at that time the monetary policy rate was substantially higher.

For the purpose of comparison, Graph 5.6 also specifies the Czech interbank market rate for transactions with a maturity of three months (3M Pribor rate). This rate is also used to calculate the rate of interest for certain types of mortgage loans (e.g. the variable rate loans referred to as "floaters"). At the end of 2012 the spread between the Hypoindex rate and the 3M Pribor rate was 2.62 pp, and between the Hypoindex rate and the 2W repo rate it was approximately 3.07 pp.[24] Looking at this development, the effect of the different time structures of the interest rates is also evident, when the interest on sources from the interbank market with

[23] The FINCENTRUM HYPOINDEX indicator is the weighted average interest rate, which is applied to new mortgage loans provided to individuals within the given calendar month. The development of this interest rate over time is presented in Graph 5.6.

[24] The development of the 3M Pribor rate is strongly correlated to the development in the 2W repo rate, which can be explained by the general ability of the monetary policy carried out by the central banks to influence the market rates.

a maturity of three months often falls faster than the interest on client loans with longer maturities (e.g. mortgages). It should be noted that the interbank 3M Pribor rate has a tendency to fluctuate more due to the associated shorter maturity period.

Table 5.7 provides an overview of mortgage loans according to the main client segments. The total number of mortgage loan contracts increased by almost 75,000, which is about the same as the increase in the previous period. Due to the highest number of contracts and the highest rate of annual change in the individual clients segment, the highest absolute year-on-year increase in the number of contracts was achieved specifically in this segment. In terms of relative change, the number of contracts in the individual clients segment was the highest (12.9%), followed by business entities (7.2%). The slowest growth in the number of contracts was recorded by municipalities (1.7%).

Table 5.7: Mortgage loans (ML) balances by client segment[25,26]

As at 31 Dec		2010	2011	2012	Year-on-year changed	
					abs.	(%)
Individuals	total (000s)	501.5	572.6	646.2	73.6	12.9
	total contractual principal (CZK bn)	748.3	867.4	989.0	121.6	14.0
Business entities	total (000s)	14.1	15.7	16.8	1.1	7.2
	total contractual principal (CZK bn)	265.4	287.4	311.1	23.7	8.2
Municipalities	total (000s)	0.9	0.9	0.9	0.0	1.7
	total contractual principal (CZK bn)	9.2	9.3	9.5	0.2	2.2
Total	total (000s)	516.6	589.3	664.0	74.7	12.7
	total agreed principal (CZK bn)	1,022.9	1,164.1	1,309.6	145.5	12.5
	Loans volume (CZK bn)	765.2	824.9	864.3	39.3	4.8

Source: MRD, CNB – ARAD

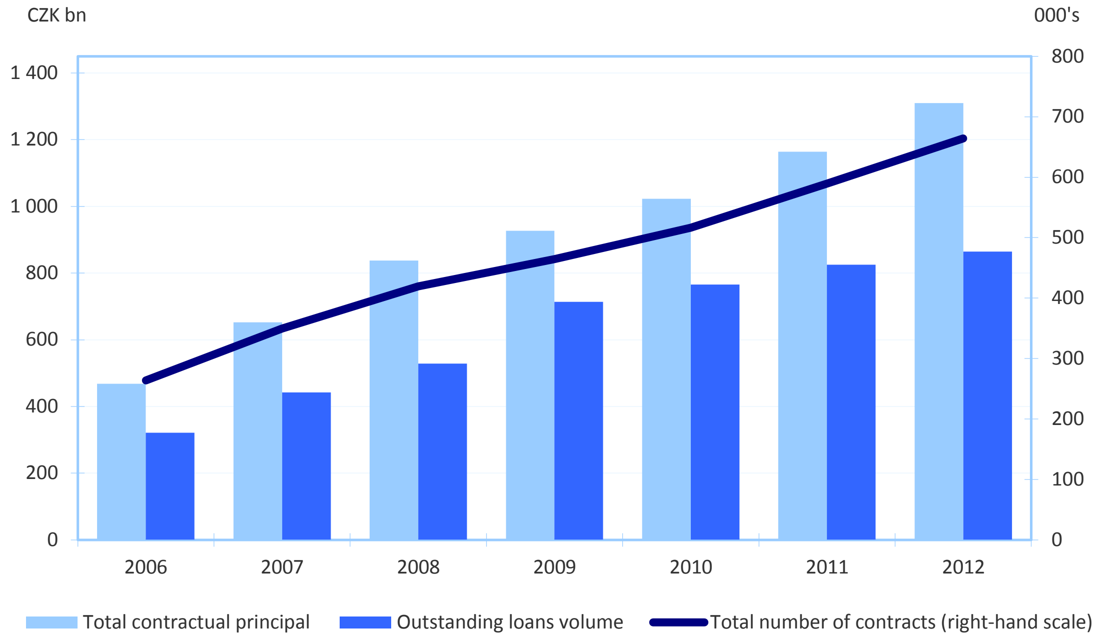
There was an absolute increase of CZK 145.5 billion in contractual principal, of which CZK 121.6 billion (approximately 83% of the total increase) is in the household segment and CZK 23.7 billion is in the business entities segment. The rather marginal municipalities segment recorded an increase of CZK 0.2 billion. As far as dynamics are concerned, the total volume of unpaid principal increased by 12.5%, which is less than the increase reported in 2011 (13.8%). Although the principal component of the loans provided to the household segment (individuals), which holds a dominant share, grew faster (by 14%), it was not enough to compensate for the significantly lower growth in the remaining two client segments.

The last row of Table 5.7 specifies the total reported amount of unpaid principal for mortgage loans, which grew by CZK 39.3 billion (4.8%), which reflects a greater increase than in 2011, when the growth rate was 4.0%.

The development of the overall mortgage market indicators is depicted in Graph 5.7 The data on the total number of contracts and total contractual principal amounts in this chart include not only households, but also businesses and municipalities. The volume of loans includes mortgage loans for residential and commercial real estate. For example, it is not possible to automatically interpret an increase in the indicators as an increase in the volume of lending by banks or even as an increase in their willingness to lend. The increase in value may not be caused only by the provision of new loans, but may also be the result of impairment of the ability of borrowers to repay their obligations (which leads to the amount due not being amortised). Conversely, the improved ability of households to repay the loans itself may not lead to a decline in this indicator, although it may mean a reduction in the volume of outstanding loans, but this effect may be less significant than the recent increase in lending activity.

[25] The definition of the individual groups of beneficiaries is based on the statistics published by the Ministry for Regional Development.
[26] The segment is divided into sectors according to the Ministry for Regional Development methodology.

Graph 5.7: Aggregate mortgage market indicators



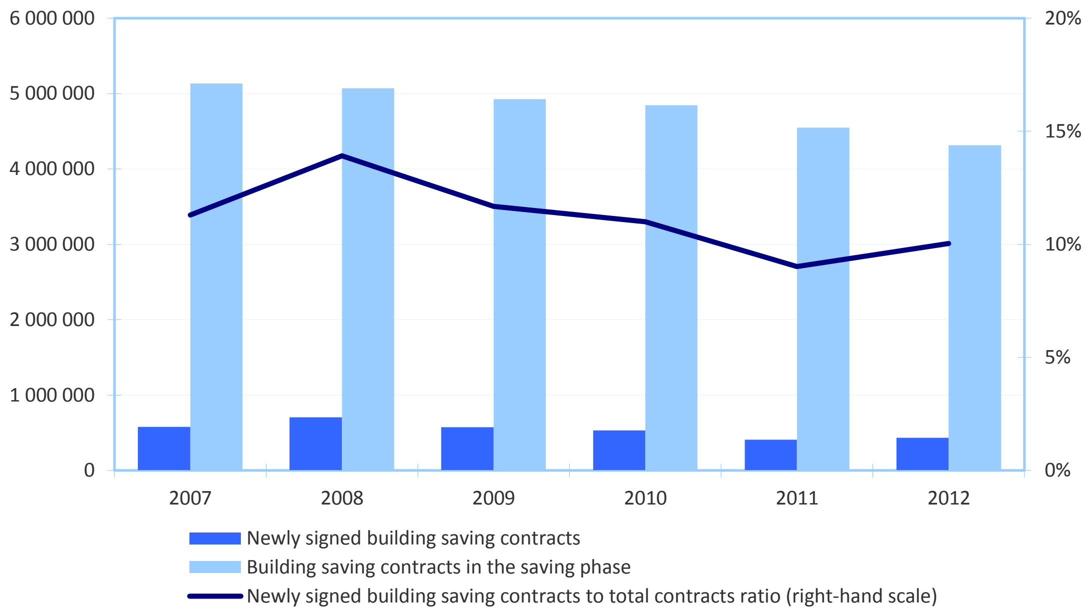
Source: MRD, CNB – ARAD

It is not easy to predict the future development in the volume of mortgage loans provided to individuals. Of course, the composition of the long-term factors that may influence this development does not tend to substantially change in the medium term. In general, it is therefore possible to expect that the continuing relatively low debt ratio of Czech households may, in the long-term, be one of the factors that will allow the further growth of the mortgage market. Without a doubt, the factors that affect the short-term include economic growth, which (again) is primarily related to the demand for loans and the developments in the financial markets. The effect of deferred demand resulting from earlier economic and financial uncertainty or the effect of a change in the intensity of the expected further decline in property prices may also play a temporary role. During the past two years, the falling price of mortgages, which can be monitored by, amongst other things, the Hypoindex rate, has had a positive effect. As in previous years, it of course applies that a rise in interest rates for loans would play a significant role in future development. The development in the demand for mortgage loans may also be influenced by, amongst other things, price expectations. However, the overall outcome remains uncertain, as individual factors may act against each other. In general, the influences that could lead to an increase in demand (e.g. economic recovery) tend to concurrently support a general increase in inflation risk, which could lead to higher mortgage interest rates. Another relevant question concerns the future development of real estate prices, which affect the demand for mortgage loans but are also, to some extent, influenced by the level of interest rates on housing loans. Economic growth and increasing wages may lead to an increase in the demand for real estate, but at the same time inflationary pressures lead to the growth of nominal rates or force the central bank to increase its own interest rates. Subsequently, interest costs increase and the attractiveness of mortgages decreases, which could have a negative impact on the demand for real estate. The refinancing of mortgages, which generates a significant proportion of new loans for housing (but not however a change in the total amount due), combined with the migration of clients from mortgage loans to loans provided by to building savings banks, also introduces a certain level of uncertainty with regard to future development.

5.8. Building Savings Banks

In 2012, 433,000 new contracts were negotiated for building savings schemes, which is about 23,000 more than in the previous year. By the end of 2012 participants in building savings schemes held approximately 4.3 million contracts in the savings phase, which represents a year-on-year decrease of approximately 233,000 (5.1%). Therefore, for the most part, the new contracts were outnumbered by the decreases resulting from contracts that were either terminated or converted into standard building savings loans. This is a continuation of the trend that started in 2004, when the first reduction in the state contribution was implemented (from a maximum of CZK 4,500 to CZK 3,000 per year). Since then there has been a gradual reduction in the number of contracts in the savings phase. However, the annual decrease since 2004 has been at levels below 10% (between 1% and 6%).

Graph 5.8: Number of building savings contracts



Source: MoF

Despite the long-term decrease in the number of contracts, the total amount that participants have saved in building savings banks continues to grow, albeit at a minimal rate. The year 2012 was not an exception and a 0.4% increase in deposits, totalling approximately CZK 435 billion, was recorded. This fact confirms the original prediction made by the MoF, that even after the reduction in the maximum amount of the state contribution, building savings schemes will remain attractive in comparison to comparable products and that there will not be a significant outflow of participants from the system.

Participants continue to view building savings schemes as an important product for long-term savings (refer to Graph 3.1 to see the share of savings held in building savings schemes within the total volume of household savings). Despite the very low market interest rates, building savings banks continue to pay interest of around 2% per annum. The total return on money deposited is further increased by the amount of the state contribution (since 2011, the maximum state contribution has been CZK 2,000). Within the context of the high number of contracts and the saved amounts, it needs be mentioned that some participants still have deposits based on contracts dating back to the time of higher interest rates in the order of 3-4.5% per annum. These deposits represent a relatively high cost to the provider and for this reason three out of five building savings banks started to unilaterally withdraw from these contracts at the end of 2012 and the start of 2013.

In addition, of the main indicators for building savings schemes, the average target amount for individuals has increased to CZK 366,100, which is the highest recorded value since the inception of building savings schemes in the Czech Republic (i.e. since 1993).

The indicators for the loan phase have recorded different development than those for the savings phase. The total number of loans[27] decreased by 62,000 to 894,000, which confirms the reversal of the trend from 2011 and corresponds to the downward trend in the number of contracts in the savings phase. The total

[27] Building savings banks provide loans under building savings schemes as well as bridging loans. The term “loan” includes both types. If the data is associated with only one specific type of loan, this fact is explicitly specified.

volume of loans outstanding also decreased and was CZK 282.2 billion by the end of 2012 (in comparison with a slight increase in the saved amount). For the first time in the history of building savings schemes in the Czech Republic, there was a year-on-year decrease in the volume of loans provided as reported on the building savings banks' balance sheets. The decline on the loan side and the stagnation on the deposit side are of course reflected in the ratio of loans to savings which decreased to 64.9% (i.e. by 2.7 pp). The details are provided in Table 5.8.

Table 5.8: Main indicators for the building savings bank sector

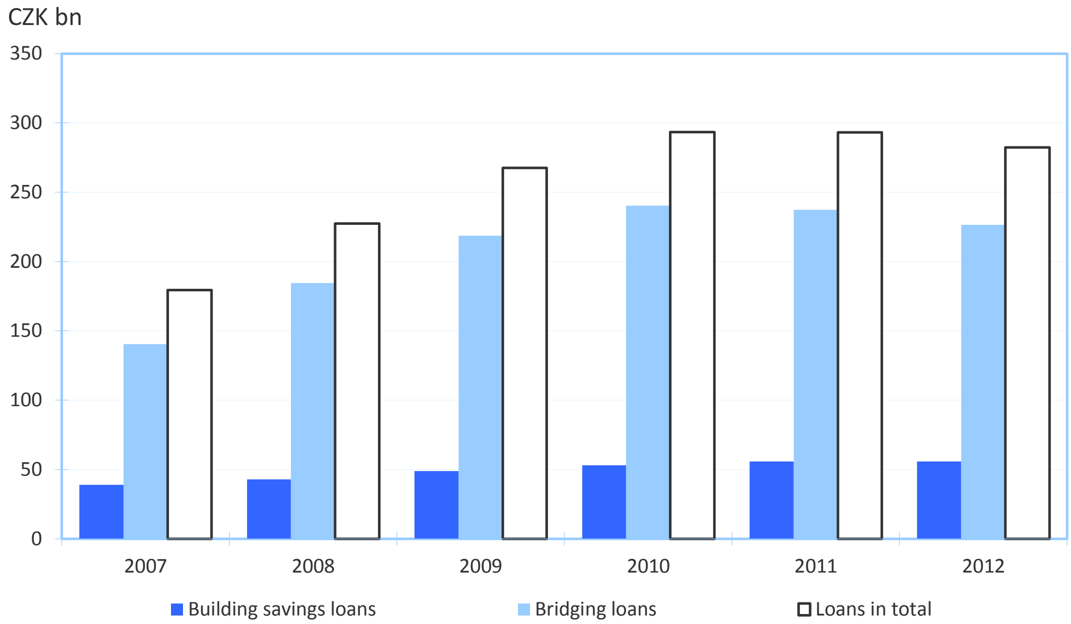
	2007	2008	2009	2010	2011	2012
Total loans (CZK bn)	179.3	227.4	267.5	293.4	293.1	282.2
Saved amount (CZK bn)	384.9	401.1	415.2	430.1	433.4	435.0
Ratio of total loans to saved amount (in %)	46.6	56.7	64.4	68.2	67.6	64.9

Source: MoF

Within the context of a more detailed view of the market (Graphs 5.9 and 5.10) the cause of the decline in the total number of loans provided by building savings banks and in their volume becomes more obvious. This development is the result of a further decline in newly granted bridging loans, specifically a year-on-year decrease of approximately CZK 5 billion (refer to Graph Figure 5.10), combined with the stagnation in the value of new building savings loans. In addition, in 2012 the volume of newly granted[28] loans provided by building savings banks was less than the amount of repayments received for previously provided loans.

The total volume of bridging loans recorded a decline for the second year in a row due to the low mortgage interest rates, which are more responsive to the decline in market interest rates. As a result, traditional commercial banks once again successfully managed to capture a part of the housing loan market. Generally it applies that during period of low interest rates in the economy (in the Czech Republic, between 2011 and 2012) mortgage loans have a lower interest rate than loans provided by building savings banks. The opposite situation occurs during a period of generally high rates, when building savings schemes as a loan product benefit from lower fluctuation in rates.

Graph 5.9: Volume of loans in the building savings banks

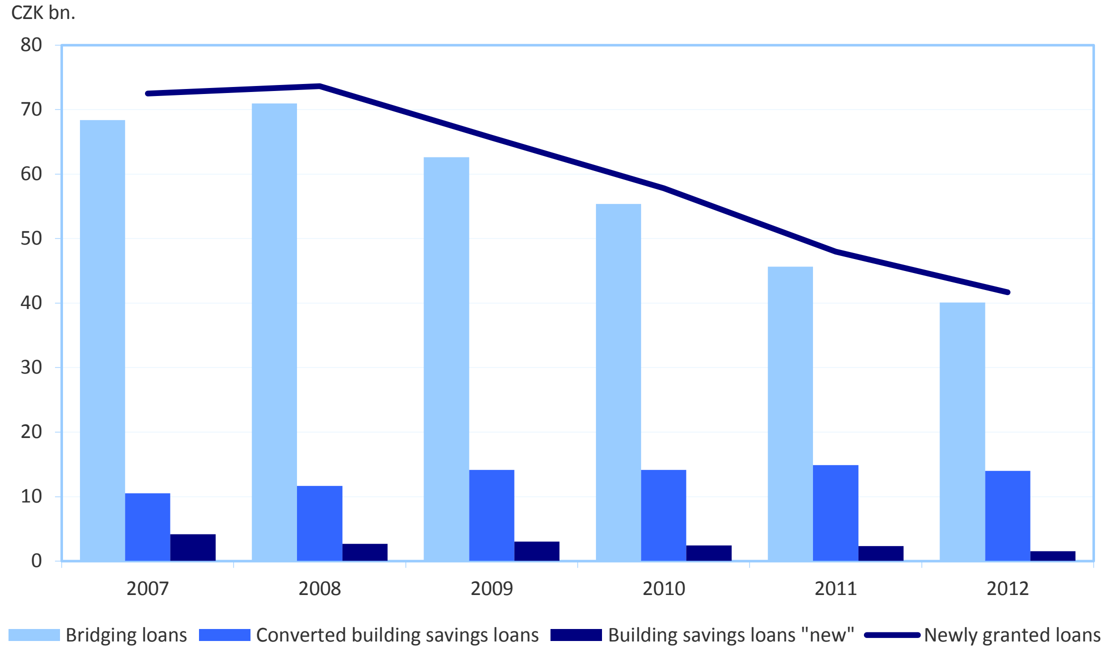


Source: MoF

[28] Newly granted loans are calculated as the sum of newly granted bridging loans (the light blue bar in Graph 5.9) and newly granted building savings loans (the dark blue bar in Graph 5.9). A special category consists of "converted building savings loans" (these are not newly granted loans), which were used by the borrowers as a bridging loan that, after the contractual conditions are met, are converted into standard building savings loans with a new repayment schedule and generally with better interest conditions.

The decrease in the number bridging loans resulted in a change in the structure of building savings loans. Whilst during the previous period, there was a continuing increase in the proportion of bridging loans (from 78% in 2007 to 82% in 2010), during the past two years this has turned into a gradually declining trend. At the end of 2012, the share of bridging loans in relation to total loans was 80% (CZK 226.5 billion).

Graph 5.10: New loans in the building savings banks sector



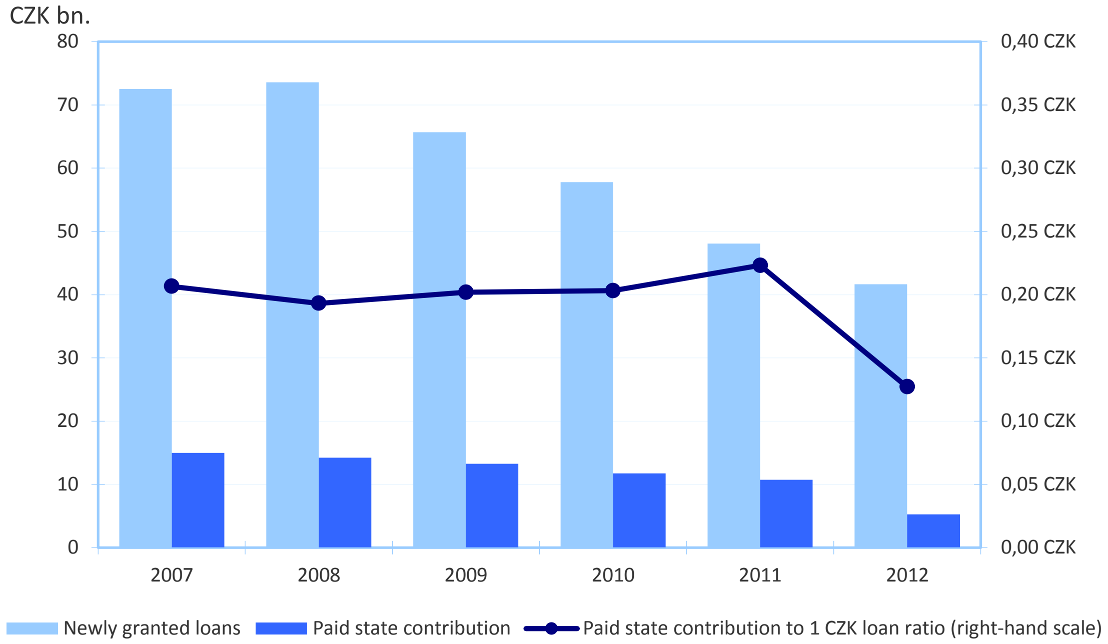
Source: MoF

The structure of the new building savings loans has not changed over the long term from the perspective of how the loans are used. According to the data provided by building savings banks, the majority (86%) of building savings loans are used to repay the bridging loan. An additional 8% were allocated for reconstruction and modernization. Of the new bridging loans, 41% were designated for modernization and reconstruction, 27% for the purchase of a flat or house, and 8% for the construction of a new house or flat.

On the basis of a comparison with the amount of the state contribution disbursed in 2011 (CZK 10.7 billion), in 2012 the burden placed by building savings schemes on the national budget decreased by approximately CZK 5.4 billion less. This significant decrease in 2012 was primarily the result of the amendment to Act No. 96/1993 Coll., on building savings and state support for building savings, which took effect on 1 January 2011 and reduced the state contribution from 15% to 10% of the amount saved in the applicable calendar year, up to a maximum of CZK 20,000 (i.e. the overall ceiling was reduced from CZK 4,500 or, as applicable, CZK 3,000, to CZK 2,000).

Given that the state supports building savings schemes with funds from the national budget and because the use of the funds is reviewed only at the time when a loan is used, the state contribution can be interpreted as a contribution towards financing housing needs calculated on the basis of the amount of the state contribution allocated for each 1 CZK of the expenditure (i.e. loan) generated by the building savings banks sector and earmarked specifically to finance housing needs. Whilst during the 2007 to 2011 timeframe this indicator was around level 20 hellers, as a result of the aforementioned changes in the state contribution, its value dropped to approximately 13 hellers in 2012. It is expected that this coefficient will stabilise in the coming years and that the total amount of the state contribution will be in the range of CZK 5 to 5.5 billion.

Graph 5.11: Paid state contribution



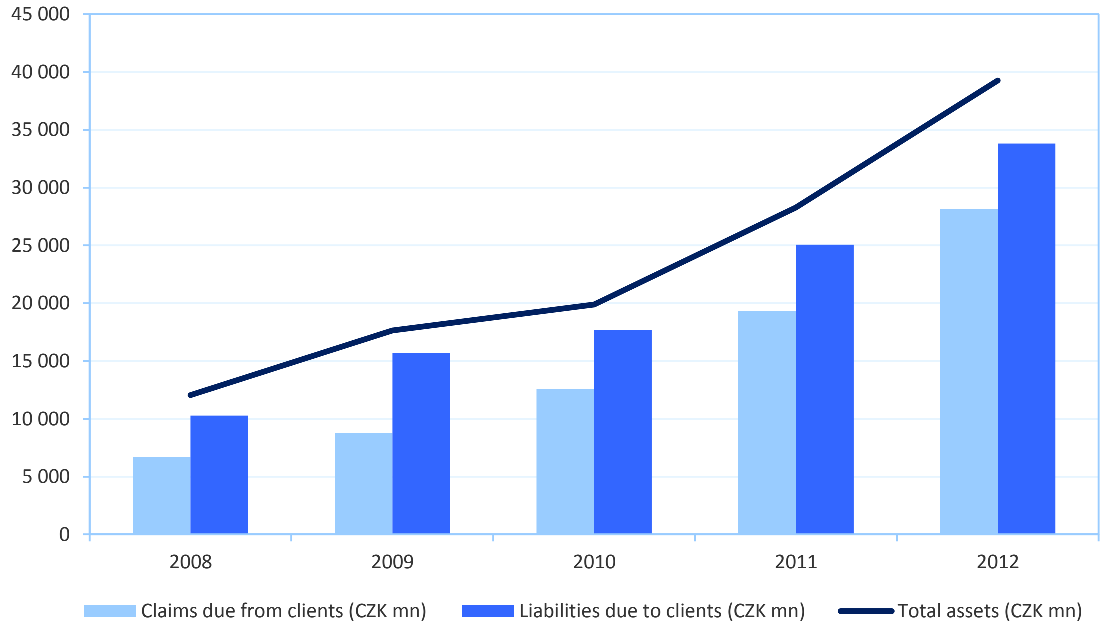
Source: MoF

More detailed information about the building savings banks sector within the framework of the market structure is published quarterly on MoF's website www.mfcr.cz and is available for the years 2007-2012 (refer to Table P2.4 in the appendix).

5.9. Credit Unions

The credit union sector is a fraction of the size of the banking sector. At the end of 2012, the balance sheet total of credit unions was equal to less than 0.9% of the overall balance sheet total for all banks. This sector's importance has, however, almost tripled over the last five years. In 2012 alone the number of credit union members increased by approximately 10,000 to 54,408, representing an annual growth rate of about 22%. The balance sheet total grew even faster – by almost 39% to CZK 39.3 billion. The main reason behind this high increase is the jump in the volume of deposits (up by more than 34% year-on-year). Overall, this result can be attributed primarily to the aggressive interest rate policy sector, which is reflected in the higher interest of depositors, especially within the context of the fact that deposits in credit unions are insured up to the equivalent of EUR 100 000, just like the banks.

Graph 5.12: Main growth indicators for the credit union sector



Source: CNB

In 2012 the volume of loans grew even faster than the volume of deposits, specifically by more than 45% to CZK 28.2 billion. Credit unions generally provide loans at higher interest rates as compared to banks. This plays a significant role in determining the structure of their client portfolio and borrowers are often recruited from the ranks of clients who have been turned down by banks. The end result is that there are problems with the repayment of loans, as can be seen in the increase in the number of loans in default (refer to Table 5.9), the volume of which increased from 6.1% in 2009 to 17.2% in 2011. In addition, the deterioration of the loan portfolios of credit unions during this period was accompanied by a decline in capital adequacy. Another warning sign can be seen in the significant decrease in liquid assets within the credit union sector as compared to the sector's total assets. This decrease may be explained by declining deposits in banks, thus reducing involvement in the interbank market, and the growing level of loan saturation in relation to client deposits, which is illustrated by the decreasing difference in the two columns (refer to Graph 5.12). Although the trend marked by the deterioration of these indicators was interrupted in 2012, this fluctuation does not mean that there is a definite reduction in the risk of the loan portfolios held by credit unions. The decrease in the number of loans in default may, to a certain extent, be explained by a significant increase in new loans combined with the revocation of UNIBON Credit Union's licence.[29] The increase in the capital adequacy ratio was due to an increase in the credit union sector's registered capital, which grew by more than 56% in 2012.

Table 5.9: Credit unions – selected indicators

As at 31 Dec	2009	2010	2011	2012
Number of members in credit unions	47,952	34,003	44,687	54,408
Total assets (CZK mn)	17,649.1	19,890.2	28,274.9	39,278.8
Due from clients (CZK mn)	8,778.2	12,569.3	19,327.0	28,178.1
Owed to clients (CZK mn)	15,673.4	17,668.3	25,060.1	33,816.3
Quick assets to total assets (%)	25.5	17.6	13.1	14.4
Share of loans in default (%)	6.1	11.5	17.2	9.9

Source: CNB

In general, particularly large and medium-sized unions, whose balance sheet totals are higher than CZK 1 billion and are growing very quickly, stand behind the rapid growth in the credit union sector. There are six such large credit unions in the market and they represent more than 95% of the sector's overall balance sheet total. With

[29] The balance sheet total for UNIBON at the end 2011 represented an 8% share of the entire sector, and had a significantly higher than average number of receivable in default combined with a below average capital adequacy ratio.

their size and the range of products they offer, these large credit unions tend to resemble small banks; however, compared to banks the credit unions suffer from certain competitive disadvantages. The International Monetary Fund also reached this conclusion on the basis of an assessment on the stability of credit institutions in the Czech Republic that it performed in 2011. The results from this assessment were published in July 2012.[30]

When compared to the previous period, profit after tax in the credit union sector improved by about CZK 194 million CZK. After profits of CZK 122.8 million in 2011, the sector report CZK 316.6 million of profit, however this figure has not yet been confirmed by an audit.

5.10. Non-Bank Financing Providers

Non-bank financing providers are an alternative to credit institutions. Their balance sheet total amounts to CZK 349.7 billion (refer to Table 5.10). At the moment it is therefore less than 10% of the balance sheet total for the entire banking sector. In addition, during recent years it has been gradually declining (by 1.9% year-on-year and by 22.1% over 4 years). The volume of financing provided is also decreasing (by 3.6% year-on-year and by 28.2% when compared to 2008).

This sector is usually (and also in terms of reporting) split into three segments: Financial leasing companies, other lending companies, and factoring and forfaiting companies. From the perspective of the share of overall balance sheet total, the sector is dominated by financial leasing companies dominated (74.1%), followed by other lending companies (21.2%), and factoring and forfaiting companies (4.7%). During the last three years, the share of the sector's overall assets held by leasing companies has been increasing slightly.

Table 5.10: Main indicators in the non-bank financing providers sector

As at 31 Dec (CZK bn)	2009	2010	2011	2012
Assets	404.2[31]	352.3	356.1	349.7
Loans provided	299.0	260.8	266.3	256.7
Volume of total assets				
Financial leasing companies	282.5	265.2	265.1	259.2
Other lending companies	100.7	67.7	71.3	74.0
Factoring and forfaiting companies	20.9	19.5	19.7	16.6
Relative share of the sector's assets (in %)				
Financial leasing companies	69.9	75.3	74.4	74.1
Other lending companies	24.9	19.2	20.0	21.2
Factoring and forfaiting companies	5.2	5.5	5.5	4.7

Source: CNB – ARAD

The total asset volume of financial leasing companies has not changed in any significant way over the past few years and in 2012 recorded a decline of 2,2% to CZK 259.2 billion. The number of provided loans decreased year-on-year by 3.8% to CZK 188.2 billion. This item thus represents about 72.6% of total assets. The volume of equity is approximately one quarter of the balance sheet total. However, by its very nature this indicator, combined with very specific characteristics of this sector, is not fully interchangeable with capital, or more specifically the capital adequacy of banks.

At the end of 2012 the balance sheet total for factoring and forfaiting companies was CZK 16.6 billion, which represents a year-on-year decrease of 16%. This is an indication of the continuation of the medium-term trend, consisting of the gradual decrease in the balance sheet total for the segment (with variable dynamics) from a maximum of CZK 26.0 billion. Over the past five years it has decreased by more than a third. The lending activity in this segment is dominated by short-term loans granted to residents, which account for about 81.1%

[30] More information on the conclusions and recommendations from the IMF Financial Sector Assessment Programme can be found on the MoF website at http://www.mfcr.cz/cs/aktualne/tiskove-zpravy/2012/2012-02-28-tiskova-zprava-5136-5136

[31] In general it applies that simple sum of the asset volume of the individual sectors showed in the table may not be 100% accurate due to rounding.

of asset volume, which reported a year-on-year decrease of 9.5%. The volume of provided long-term loans dropped from approximately CZK 0.8 billion at the end of 2011 to zero one year later.

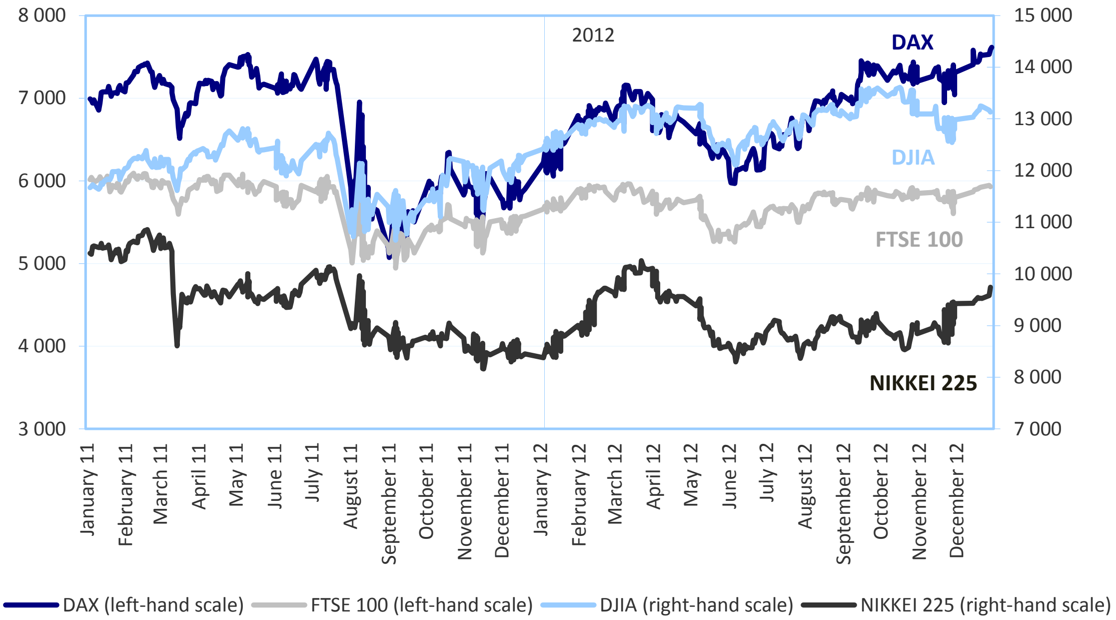
The balance sheet total for other lending companies grew by 3.6%. This growth was mainly thanks to short-term loans, the volume of which increased by 8.9%. Conversely, long-term loans recorded a decline of 6.1%. Taking into account the absolute lower rate of change and the lower number of long-term loans, the total volume of loans recorded a year-on-year increase of 0.2%. The equity to total assets ratio was approximately 42%. Even this other lending companies segment saw a drop in the volume of lending, which led to a decline in its balance sheet total. Over the past four years since the end of 2008 it has decreased by 35.4%. The volume of provided loans has decreased by almost 40% (39.8%).

6. CAPITAL MARKET

During 2012 the events in the capital markets continued to be influenced primarily by the European debt crisis, the efforts of individual institutions to resolve the situation, and, at the end of the year, the threat of a fiscal cliff in the USA.[32] In 2011, the European dept crisis expanded to Italy and Spain and, in mid-2012, the costs associated with servicing the debts of these two countries started to escalate quite rapidly. In Spain, the problem did not involve only public debt, as was the case in Italy, but also private debt, which originated primarily as a result of the mortgage loan bubble that burst and triggered a banking crisis. As a result, in June 2012 Spain submitted a request for financial assistance to recapitalise its banks.

The central banks successfully calmed the unrest on the stock markets with their promise to resolve the situation (refer to Chapter 1.1). This also helped the German DAX to achieve year-on-year growth of approximately 29% during 2012, thanks primarily to the developments during the second half of the year. The Japanese NIKKEI 225 also recorded growth of over 20% and successfully corrected its earlier fluctuations towards the end of the year. The American Dow Jones Industrial Average (DJIA) grew by a mere 7%, primarily due to the uncertainty that arose at the end of the year in relation to the threat of the fiscal cliff. This uncertainty was ultimately reflected in a significant decline in the index. The British FTSE 100 recorded relatively stable growth; however, of the four indexes included in Graph 6.1, it had the lowest level of year-on-year growth.

Graph 6.1: Development of major global indices



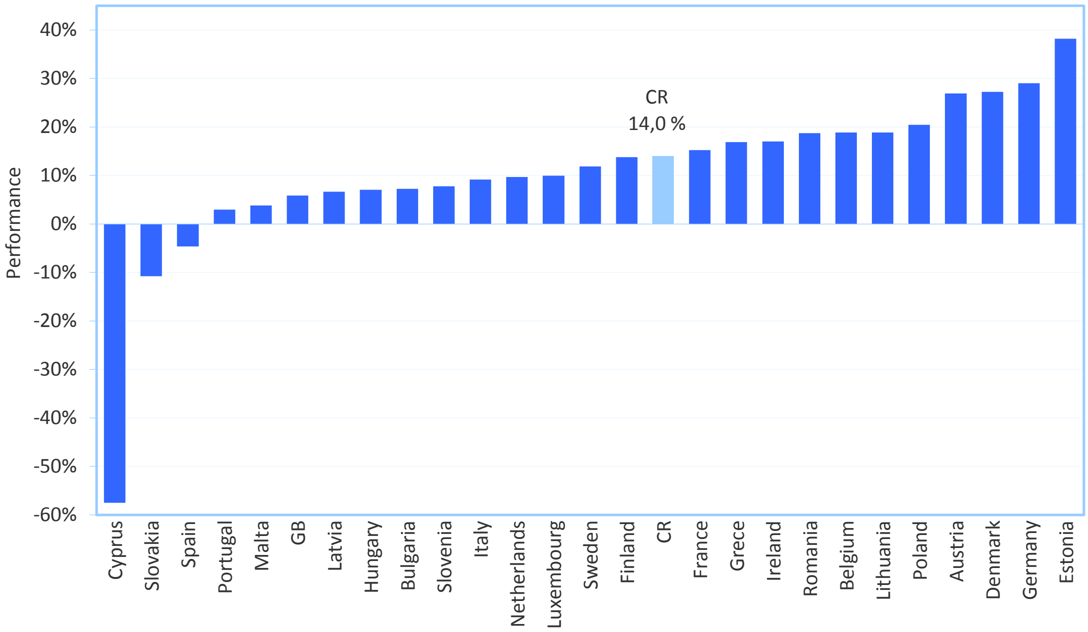
Source: Market organizers

[32] The threat of a fiscal cliff consisted of the simultaneous application of a tax rise and spending cuts after year-end 2012, which could have thrown the USA back into a recession.

When compared to 2011, the majority of the stock market indices in the EU recorded year-on-year growth in 2012. The leader was the Estonian stock market index, which grew by more than 38%. The German, Danish, and Austrian stock indices also fared very well. At the other end of the spectrum, the highest decline was recorded by the Cyprus stock index. It fell by almost 58%, primarily due to the problems faced by its banking sector due to its heavy dependence on developments in Greece, which already led to Cyprus being downgraded to the speculative grade in 2011.

Within the context of the key stock exchanges in the European Union, the PSE's PX index of 14% falls within the more successful half (refer to Graph 6.2). Within the Central and East European region, only the Polish index ranked better with an increase of over 20% while the Hungarian index grew by only 7%. Slovakia's index fell by more than 10% and suffered one of the largest drops in the EU. When compared at the international level, the dividend yield for the PX index is also very positive and achieved an average rate of 6.1% in 2012.[33]

Graph 6.2: Performance of significant stock exchange indexes in the EU Member States in 2011[34]



Source: FESE

6.1. Regulated Stock Market

The main PX index recorded growth of 14% for the full year of 2012. The index fluctuated between 859 to 1,041 points and was thus less volatile than in 2011 (refer to Graph 6.3). In spite of the specific factors behind the development in the PX index, looking at Graphs 6.1 and 6.3 it is possible to see a similar trend in all of the monitored indices during the summer months, or more precisely, the subsequent correction of the drop during the second half of the year. The PX index started the year off with a period of rapid growth, which however adjusted itself downwards due to the uncertainty regarding the developments in the European debt crisis. The PX reached its lowest level in the middle of the year. After that point it started to gradually increase until it reached its peak value in December 2012.

[33] Dividend yield = dividend per share / market price per share

[34] Austria: ATX, Belgium: BEL 20, Bulgaria: SOFIX, Cyprus: FTSE/CySE 20, Czech Republic: PX, Denmark: OMXC 20, Estonia: OMXT, Finland: OMXH 25, France: CAC 40, Germany: DAX, Greece: FTSE/ATHEX 20, Hungary: BUX, Ireland: ISEQ, Italy: FTSE MIB, Latvia: OMXR, Lithuania: OMXV, Luxembourg: LuxX, Malta: MSE, Netherlands: AEX, Poland: WIG 20, Portugal: PSI 20, Romania: BET, Slovakia: SAX, Slovenia: SBI 20, Spain: IBEX-35, Sweden: OMXS 30, United Kingdom: FTSE 100. The graph does not include stocks in Romania and Bulgaria.

Graph 6.3: PX index development

Source: PSE

From Table 6.1 it is obvious that, after its steep decline in 2011, the PX index recorded year-on-year growth and is nearing the same level that it had at the end of 2009.

Table 6.1: PX index values

		2007	2008	2009	2010	2011	2012
PX	as at 31 Dec	1,815.1	858.2	1,117.3	1,224.8	911.1	1,038.7
	Change (%)	14.2	-52.7	30.2	9.6	-25.6	14.0

Source: PSE

From Table 6.2, which presents an overview of the shares listed on the Prague Stock Exchange, it is apparent that the issuers who fared the best are the representatives from the financial sector. Erste Bank recorded the greatest growth with a year-on-year increase of almost 75%, thus making up the losses from the previous year. The support provided by the central banks led to a greater degree of optimism regarding the development in the European financial sector and the consequent increase in the value of VIG shares (+25%) and Komerční banka shares (+20%). The shares issued by AAA Auto also recorded very favourable results and increased by 41% during the year. Conversely, the value of KIT Digital shares declined throughout the year and recorded a year-on-year drop of 97%. The shares issued by the NWR mining company also dropped significantly (-28%) as did the shares issued by the developer Orco (- 27 %). ČEZ lived up to its reputation as the most traded stock on the PSE and its trade volume reached a level of 38% of total shares traded. However, the value of ČEZ decreased by almost 14% year-on-year.

Table 6.2: Share price development for companies included in the PX index

Millions of CZK	Market capitalisation	Trade volume	Annual minimum	Annual maximum	Year-on-year change %
ČEZ	365,833	94,044	622	840	-13.5
ERSTE GROUP BANK	239,503	37,749	313	617	74.9
KOMERČNÍ BANKA	152,420	61,445	3089	4214	20.4
VIG	128,000	1,775	704	1016	25.0
TELEFÓNICA O2 C.R.	104,228	33,724	316	419	-15.5
UNIPETROL	31,734	1,992	166	175	2.3
PHILIP MORRIS CR	20,477	3,140	10,370	12 580	-14.9
NWR	15,892	8,038	72	164	-30.0
CETV	8,487	3,979	90	171	-14.1
ORCO	6,611	549	37	119	-28.2
PEGAS NONWOVENS	4,762	1,673	416	493	7.3
FORTUNA	4,420	800	80	103	-7.4
AAA Auto	1,707	159	17	27	40.9

Source: PSE

The downward trend in trading activity continued in 2012 and the average daily trade volume was only approximately CZK 1 billion, reflecting a year-on-year decline of 32.5% (refer to Table 6.3). When compared to 2008, investor activity has dropped by almost 71%. The share trading volume in 2012 recorded an almost 33% decrease and is approximately 70% less when compared with 2008 values. Derivatives trading came to an almost complete halt on the Prague Stock Exchange. After a period of strong growth in 2011, the volume of bond transactions recorded a decline of more than 5%. Bond trades represent more than 70% of the trading volume on the PSE, although in 2008 share trading held a bigger share and bond trades represented slightly less than 43% of the total trading volume.

Table 6.3: Trade value

Annual (CZK bn)			2009	2010	2011	2012	Year-on-year change (%)
PSE	Shares and investment units		463.9	389.9	371.0	250.6	-32.5
	Bonds		585.7	529.9	628.0	594.2	-5.4
	Derivatives	Futures	0.2	0.2	0.2	0.0	-100.0
		Certificates and warrants	0.3	0.2	1.1	0.0	-100.0
		Total	0.5	0.4	1.3	0.1	-92.2
	Total		1,050.0	920.1	1,000.3	844.9	-15.5
RM-S			10.5	9.2	8.9	6.1	-32.0
Total			1,060.5	929.3	1,009.2	851.0	-15.7

Source: PSE, RM-S

The number of issues traded on the stock exchange recorded a very significant decrease in 2012 (refer to Table 6.4). This drop was primarily to the significant decline in the number of traded derivatives and other products, the volume of which is, however, marginal within the overall context of the stock exchange. Tatra Mountain Resorts (TMR), a company active in the tourism industry, started to be traded on the PSE in October. In December, the shares issued by the technical KIT Digital Company stopped being traded on the stock exchange. During the year the long-term downward trend in the number of registered bond issues was broken.

Table 6.4: Number of registered issues[35]

As at 31 Dec		2008	2009	2010	2011	2012
Shares		28	25	27	26	28
Bonds		121	116	106	95	98
Derivatives and other products	Futures	6	6	6	6	0
	Investment certificates	46	65	42	44	30
	Warrants	2	2	2	24	0
	Total	54	73	50	74	30
Total		203	214	183	195	156

Source: PSE

6.2. Energy Exchange

The trading volume on the Power Exchange Central Europe (PXE), previously known as the Prague Energy Exchange, which is used primarily for the trading of derivative contracts, declined by almost 29% to EUR 944 million. From the perspective of volume, the PXE plays a very minor role within the context of the overall financial market. Once again, futures contracts held the most important position on the PXE and the previously already minimal spot trading volume dropped to absolute zero. Despite the sharp drop in trading volume in 2012, the number of traded products increased.

Table 6.5: Main indicators of trading on the PXE

Indicator	Market	2011	2012	Year-on-year change	
				abs.	(%)
Trading volume (EUR mn)	Futures	1,327.4	943.6	-383.8	-28.9
	Spot	1.7	0.0	-1.7	-100.0
	Total	1,329.1	943.6	-385.5	-29.0
Number of products (at the end of period)	Futures	90	130	40	44.4

Source: PXE

6.3. Securities Dealers

In 2012 the trading volume in the securities dealer sector grew by 6.5% to CZK 50,363 billion. Bank securities dealers significantly strengthened their dominant position and the volume of executed transactions increased by almost 9% thus attaining a 96% share of all trades in the entire sector. Conversely, there was a decline in the volume of closing transactions performed by non-bank securities dealers. Interesting developments were recorded by investment companies, as the number of their clients and consequently the volume of securities trades executed on the basis of asset management contracts significantly increased. In spite of their significant growth, however, this group of entities continues to represent only a marginal segment of the securities dealer sector.

[35] In 2012 the structure of the share and bond trading market changed after the implementation of a new trading system, as a result of which the classification according to main, secondary, and free market ceased to be relevant. For this reason the way Table 6.4 is structured differs from the way the table was presented in the Reports on Financial Market Developments published by the Ministry of Finance in previous years.

Table 6.6: Selected indicators for the securities dealers sector[36]

As at 31 Dec (excl. derivatives, CZK bn)	2012			Year-on-year change %		
	Bank securities dealers	Non-bank securities dealers	Investment companies[37]	Bank securities dealers	Non-bank securities dealers	Investment companies[37]
Total number of licensed entities	25	36	6	-1	4	1
Total value of executed transactions[38]	48,404.6	1,801.8	156.8	8.6	-32.8	255.6
of which: on the basis of asset management contracts	112.6	412.2	156.8	10.8	-41.8	474.4
of which: on the basis of other than asset management contracts	7,615.3	1,052.5	0.0	1.0	-23.2	-100.0
of which: on own-account basis	40,676.6	337.1	0.0	10.2	-44.0	0.0
Value of managed funds	61.4	336.1	207.2	10.8	-18.7	87.9
Value of clients' assets	2,389.6	416.3	205.9	6.0	-10.9	89.8
Number of clients (according to contracts, in thousands)	707.9	167.4	0.7	-4.9	18.5	893.9

Source: CNB

Asset Management

The volume of managed assets increased by 11.6% in 2012 and attained a final total of CZK 885.2 billion. The concentration on the asset management market has recorded a decline for the second year in a row, in spite of the fact that the three largest companies significantly increased the volume of assets that they manage. During the year their market share decreased by 1.5 pp to 59.9%, primarily because in 2012 the three smallest companies recorded an increase of over 30% in their volume of managed assets and one of the smaller firms recorded growth of more than 60% (refer to Table 6.7).

Table 6.7: Financial groups by value of assets under management

As at 31 Dec (CZK bn)	Value of assets under management		
	2011	2012	Change (%)
Generali PPF Asset Management a. s. / ČP Invest	201.3	221.5	10.0
Česká spořitelna, a. s. (group)	148.8	163.8	10.1
ČSOB (group)	137.2	145.2	5.8
ING (group)	100.6	105.3	4.6
Komerční banka (group)	79.6	93.9	18.0
AXA Investiční společnost, a. s.	50.1	54.2	8.1
Conseq Investment Management, a. s.	15.0	24.1	60.5
UniCredit Bank, a.s. and Pioneer investiční společnost, a.s.	16.8	18.4	9.5
AMISTA investiční společnost, a. s.	13.5	17.5	30.2
Raiffeisenbank a.s.	11.2	15.5	38.4
Others	19.2	26.0	35.4
Total	793.3	885.4	11.6

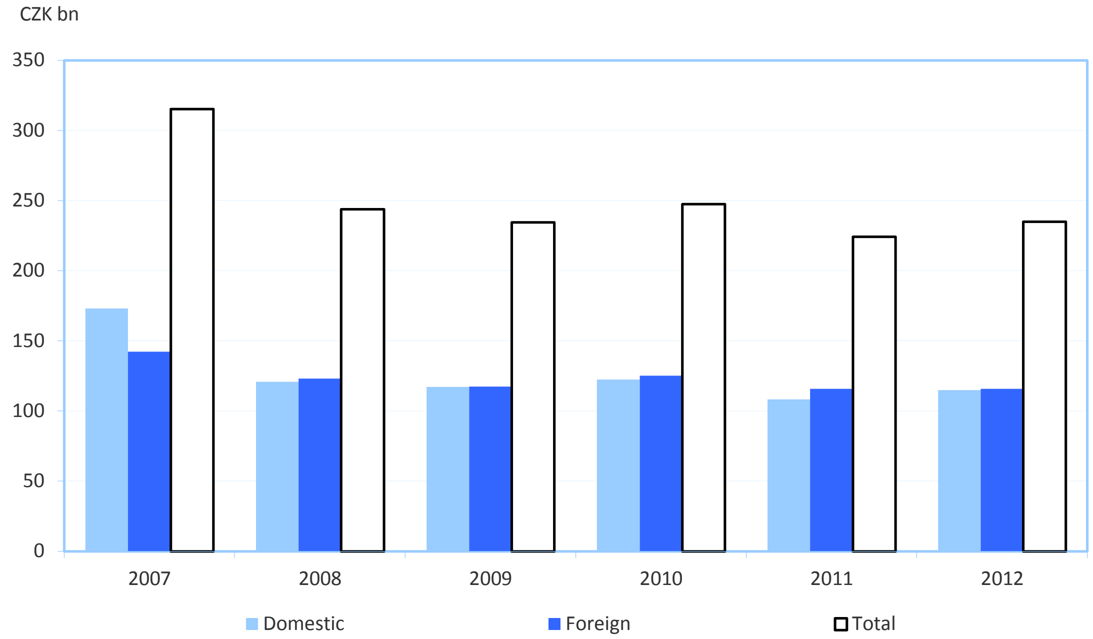
Source: AKAT

[36] As information regarding the value of derivatives contracts is available only in the form of underlying asset value, these contracts are not included in the table.
[37] Investment firms that manage client assets.
[38] The total includes all closed transactions (sales and redemptions) executed on the PSE, RM-S, and foreign markets or as direct trades for shares, participation certificates, and bonds, and performed either on the client's account or on the security trader's account. The total does not include derivative transactions.

6.4. Collective Investment

In 2012 the volume invested in collective investment funds grew by 5% (CZK 11.2 billion) and, at the end of the year, CZK 235.3 billion were invested in this category of funds. At the same time, the trend of foreign funds attracting a higher level of investment than domestic funds, which started in 2008, was broken. The value of assets held in foreign funds increased by CZK 4.0 billion as compared to the CZK 7.2 billion increase recorded by domestic funds. Nevertheless, foreign funds still continue to hold a higher volume (CZK 119.9 billion) than domestic funds (CZK 115.4 billion), as is illustrated by Graph 6.4.

Graph 6.4: Allocation of investments in mutual funds by domicile



Source: AKAT

As can be seen in Table 6.8, investors had the greatest interest in bond funds followed by real estate funds. These were the only types of funds that recorded growth in all four quarters of 2012. Equity funds also fared well during the first and fourth quarters. During the first quarter, equity funds and real estate funds recorded the greatest asset growth. However, investor confidence was subsequently negatively affected by the debt crisis in Italy and in Spain. During the other quarters, bond funds recorded the highest growth. The greatest decline can be found in money market funds and guaranteed funds and their volume of assets decreased throughout the year.

Table 6.8: Assets in individual types of mutual funds by domicile

As at 31 Dec (CZK bn)	2011			2012			Year-on-year change (%)		
Mutual fund type	Domestic	Foreign	Total	Domestic	Foreign	Total	Domestic	Foreign	Total
Bond	39.7	21.6	61.3	50.9	30.9	81.8	28.0	43.3	33.4
Equity	12.7	23.9	36.6	14.3	26.7	41.0	12.9	11.7	12.1
Guaranteed	4.5	45.1	49.6	1.6	37.3	38.9	-64.3	-17.5	-21.7
Mixed	22.9	10.1	32.9	23.8	12.0	35.8	3.9	19.7	8.7
Fund of funds	16.8	0.5	17.3	17.8	0.3	18.1	5.9	-35.9	4.8
Money market	9.7	14.5	24.1	4.8	12.2	17.0	-50.5	-15.6	-29.6
Real estate	2.0	0.2	2.2	2.3	0.4	2.7	14.1	120.2	23.4
Total	108.2	115.8	224.1	115.4	119.9	235.3	6.6	3.5	5.0

Source: AKAT

The change in the volume of managed assets is influenced by two key factors: the increase in value and net sales. Net sales represent the change in fund assets resulting from the purchase and sale of investment units that do not have an effect on fund performance but only on the volume of assets. Looking at Table 6.9 it is obvious that from both the perspective of an increase in value as well as with regard to net sales bond funds recorded the best results in absolute terms followed by equity funds. Conversely, money market funds fared the worst in both categories. The reason for this development is the low interest rate environment and the growing popularity of savings accounts, which can be regarded as a substitute for those collective investment vehicles that have a lower level of associated risk.

Table 6.9: Sales and redemptions of investment units in domestic funds[39]

(CZK bn)	Sales	Redemptions	Net sales	Change in the asset value	Change adjusted for net sales
Bond	15.9	13.0	3.0	11.2	8.2
Equity	3.7	3.4	0.3	1.6	1.3
Guaranteed	-	-	-	-	-
Mixed	6.2	5.6	0.7	0.9	0.2
Funds of funds	5.2	4.9	0.3	1.0	0.7
Money market	4.4	5.3	-0.8	-4.9	-4.1
Real estate	0.8	0.6	0.2	0.3	0.1

Source: AKAT

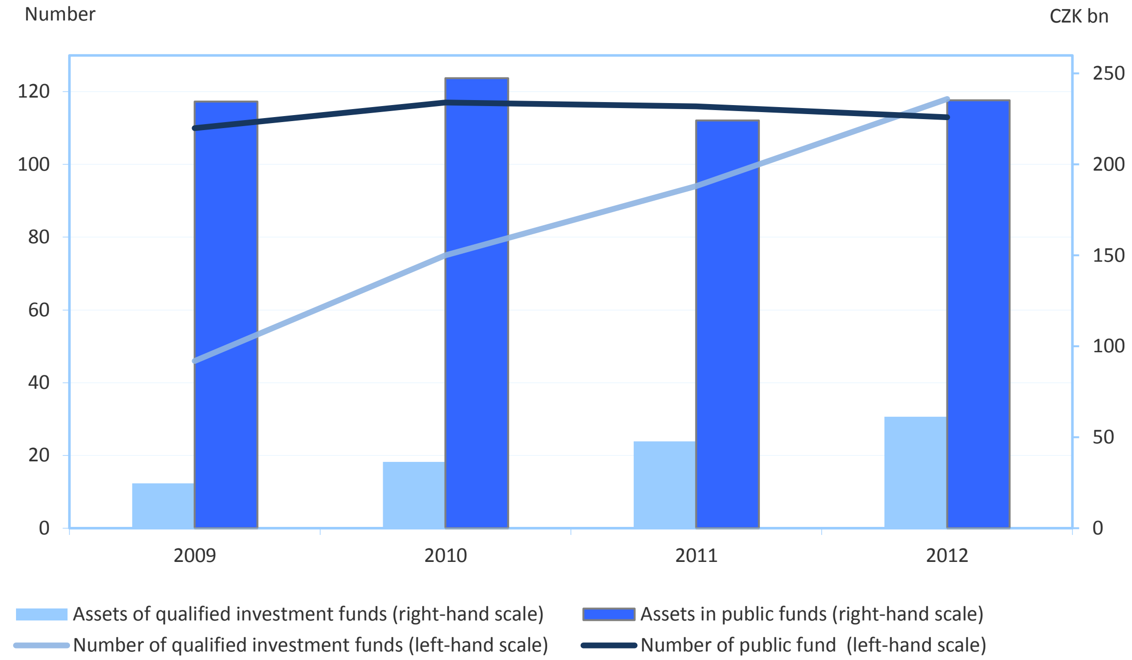
In recent years moderately dynamic growth has been recorded for non-public funds (qualified investment funds). Over the past four years the number of these funds has increased by 257% and in 2012, their number exceeds that of public funds. Nevertheless, the overall volume of the assets managed in qualified investment funds is equal to only 26.1% of the volume held in public funds (i.e. CZK 61.3 billion).

Within the context of a closer analysis of the development of qualified investment funds, it is difficult to differentiate between qualified investment funds established for the purpose of collective investment and funds that have been created for tax optimisation purposes – something that is very common. It is, however, possible to predict that both the number of qualified investment funds as well as the volume of assets managed in these funds will continue to grow, as, at the end of 2012, the government approved a draft bill for the Act on Investment Companies and Investment Funds, which is aimed at promoting the attractiveness

[39] Information on the sale and redemption of guaranteed funds is not included in the AKAT statistics and for this reason Table 6.9 does not include the totals for this category.

of entrepreneurial undertakings on the capital market within the Czech legal environment. More details on this amendment are provided in Chapter 10.4

Graph 6.5: Structure of collective investment funds



Source: AKAT, CNB
Note: Status at the end of period.

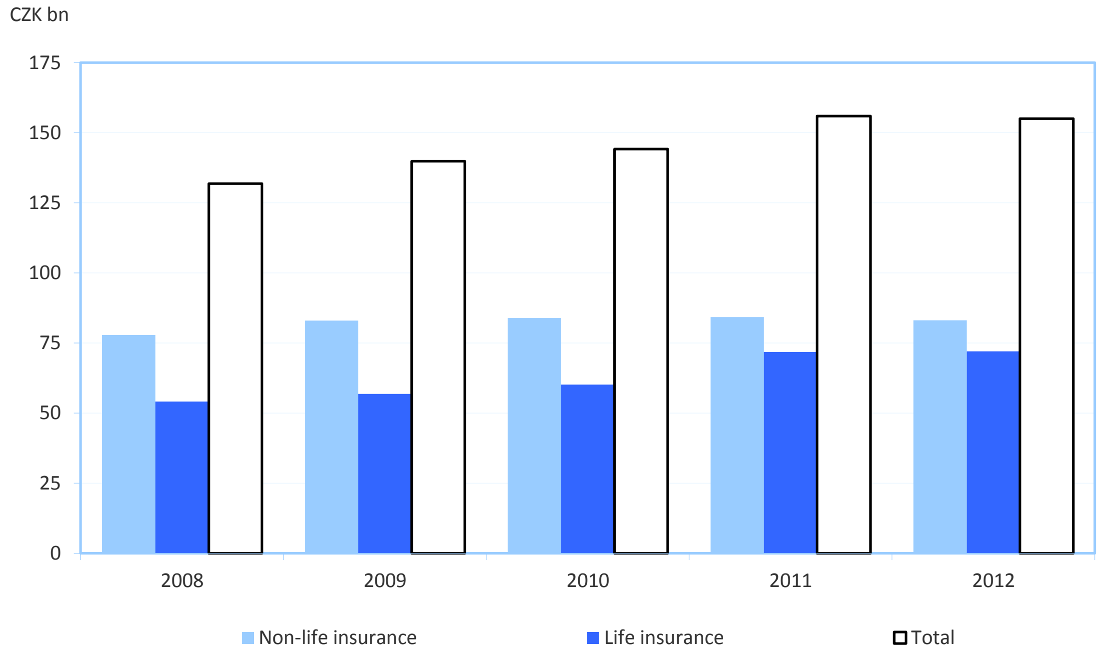
7. INSURANCE COMPANIES

The insurance sector continued to stagnate in 2012, thus, to a certain extent, reflecting the overall status of the Czech economy. Austerity measures – both in households as well as in the business sector – were reflected in the slightly lower level of interest in renewing and updating risk insurance coverage, particularly in the non-life insurance segment. The basic indicator used to monitor the development in this sector, i.e. gross premiums written, slightly decreased by almost 1% to CZK 153.6 billion (refer to Table 7.1). This is the third year in a row in which this sector continues to stagnate. The level of insurance penetration[40] has also been fluctuating at approximately 4% and provides evidence that the potential capacity of the Czech insurance market is still not being fully used, as, in the more advanced European states, this indicator is much higher in many cases.

A certain level of development can be seen in the structure of the insurance market where the proportion of life to non-life insurance changed by 0.5 pp over the course of the year (to a level of 47:53) and came closer to the unwritten “ideal” benchmark for advanced economies (60:40).

[40] Insurance penetration is calculated as the ratio of gross premiums written to GDP.

Graph 7.1: Volume of gross premiums written



Source: CNB

7.1. Development of Life and Non-Life Insurance

Within the life insurance segment, the gross premiums written indicator increased slightly (by 0.1%) to a level slightly above CZK 72 billion (refer to Table 7.1). Unlike previous years, where the main driving force consisted of lump-sum premiums, the trend changed in 2012 and instalment premium captured a greater share. This new tendency makes it possible to assume that the population's approach to life insurance products is gradually changing.

The overall number of life insurance policies grew by 7.9% in 2012. The number of new insurance policies increased by 11.5%, thus exceeding the number of terminated policies.

The growth in the number of life insurance policies was most probably also influenced by the increased interest women had in obtaining a life insurance policy prior to the time new "anti-discriminatory" legislation entered into force. However, a number of insurance companies did not wait until the end of the year to apply the new rules and unified their rates during the second quarter of 2012. This change also received a great level of media attention, which helped to increase women's interest in certain life insurance products (e.g. death coverage) by more than 20%. Based on the new rate tables, in some cases the increase in premiums for risk coverage for women is up to 80% higher than the original rates. In comparison, the reduction in the rates for men is negligible. The new rules had the opposite effect on the rates for men and women in the case of survivor coverage and lifetime coverage; however, neither of these two products enjoys a high level of popularity in the Czech Republic. As opposed to other countries, different rates according to gender are applied to non-life insurance to only a small degree.

In addition to the factors mentioned above, the life insurance segment was also positively affected by the campaign associated with the reform of the pension system, which promoted the population's interest in old age security, including through life insurance products. Together with the other long-term savings products, life insurance with an investment component is sometimes referred to as "Pillar 4 of the pensions system".

Table 7.1: Main indicators for the insurance sector[41]

As at 31 Dec	2010	2011	2012	Year-on-year change	
				Abs.	(%)
Number of policies (in thousands)	27,346	27,909	27,636	-273	-1.0
of which: non-life insurance	18,427	19,233	18,278	-955	-5.0
life insurance	8,919	8,676	9,358	682	7.9
Number of newly concluded policies (in thousands)	10,628	10,780	11,732	952	8.8
of which: non-life insurance	9,190	9,258	10,035	777	8.4
life insurance	1,438	1,522	1,697	175	11.5
Total gross premiums written (CZK bn)	156.0	155.1	153.6	-1.5	-1.0
of which: non-life insurance	84.2	83.1	81.5	-1.5	-1.8
life insurance	71.8	72.0	72.0	0.0	0.1
Total gross claims paid (CZK bn)	83	85	88	3	3.5
of which: non-life insurance	46.1	43.1	41.8	-1.4	-3.1
life insurance	36.5	42.1	46.4	4.3	10.3
Total insurance penetration (%)	4.1	4.1	4.0	-0.1	-

Source: CNB

As far as the non-life insurance segment is concerned, the downward trend in gross premiums written, which started in 2011, continued in 2012. The absolute value for this indicator achieved a value of CZK 81.5 billion, which reflects a year-on-year decline of 1.8%. The key contributors to this result were liability insurance for damage caused while operating a vehicle and accident insurance, personal injury insurance, and personal liability insurance. In the case of liability insurance for damage caused while operating a vehicle and accident insurance it is reasonable to expect that there will be no further decline because, as a result of competitive pressure, the premium rates have already reached the minimum profitability level in this segment. In the coming years it is possible that after this current period of stabilisation there may be a moderate increase in rates, as the collected insurance premiums are already barely enough to cover the incurred damage and associated costs because of the rising cost of repairs and replacement parts as well as the growing price of new cars.

The continuing pressure to decrease premium rates for a number of non-life insurance products, which is supported by the increasing number of online price comparison tools, is leading insurance companies to simplify their insurance products and to reduce insurance premiums to historically low levels. The ongoing price war is beneficial for clients; however, the insurance market is losing its diversity and innovativeness with regard to the qualitative differences between individual products.

The development in the non-life insurance segment also reflects demand behaviour. Given the decreased economic impact of withdrawing from non-life insurance policies, opting out of the insurance coverage provided by these policies is becoming more common than is the case for life insurance, for which the contractual conditions (particularly the provisions governing withdrawal from the contract) set the ground for a longer contractual relationship.

All in all, from the perspective of insurance companies it is possible to evaluate 2012 as being relatively favourable in the non-life insurance segment, thanks primarily to fewer natural catastrophes, with the exception of increased claims for damage resulting from summer storms. According to the data of the Czech Insurers' Bureau, the associated insurance settlements exceeded CZK 1 billion.

7.2. Economic Results of Insurance Companies

The economic results of insurance companies have been stable over the long-term. The balance sheet total increased by 7.7% to almost CZK 470 billion. In 2012 insurance companies reported after-tax profit

[41] The number of life insurance policies does not include policies for supplementary insurance.

of CZK 12.4 billion, which reflects year-on-year growth of approximately 35%. The profit level was affected by cost savings and higher yields from financial placement. The balance in the non-life insurance technical reserves account contributed more to profitability than has been the case in previous years. The future development of the profitability of insurance companies could be negatively affected if the costs associated with settling claims continue to grow faster than gross premiums underwritten over the long-term (refer to Table 7.1).

The increasing value of the insurance technical reserves makes it possible to believe that the fulfilment of future obligations will not be threatened. The volume in the financial placement of these reserves grew by 7% to CZK 407.9 billion. The placement of the technical reserves is conservative in accordance with the applicable regulations: 69% is invested in debt securities and 19% in equity securities (refer to Table P2.7 in Appendix 2). The available solvency margin in the life insurance segment exceeds the required solvency margin by more than threefold and the situation is similar in the non-life insurance segment.

The technical interest rate, which represents the guaranteed share of the yield from financial placement, remained at 2.5% throughout all of 2012. At the start of this year (on 21 January 2013) the CNB, on the basis of developments in the financial market, made a decision to decrease this value to 1.9%, which may be reflected in the future in the decreased attractiveness of traditional life insurance policies as instruments that increase the value of invested funds. On the other hand, this decrease should strengthen the future financial stability of insurance companies as a rate of 2.5% does not correspond to the actual yield that can be attained under the current financial market situation.

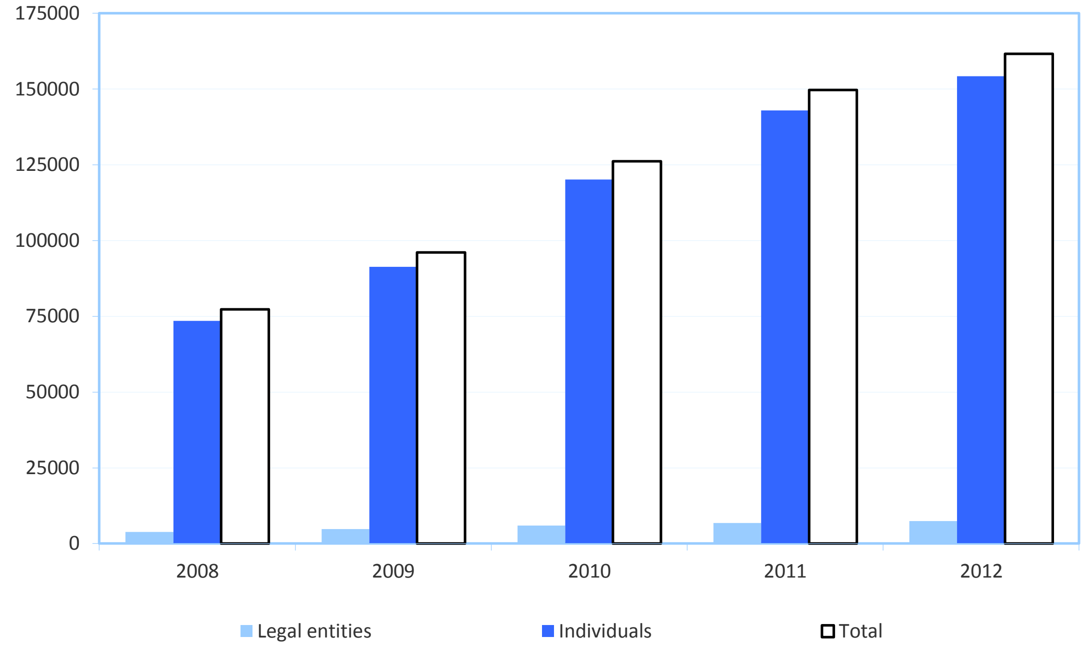
The economic results of insurance companies are also affected by the battle against insurance fraud. According to the statistics maintained by the Czech Insurers Association, in 2012 insurance companies discovered fraud attempts totalling more than CZK 1 billion, which is a 27% year-on-year increase. As in the past, the highest number of proven cases involves liability insurance for damage caused while operating a vehicle and accident insurance. Although this indicator dropped by almost one fifth, the proven value of insurance fraud exceeded CZK 371 million and was 13% higher than in 2011. In the personal insurance segment, the cases of discovered insurance fraud totalled approximately 120 million, which represents an annual increase of 35%.

Thanks to investments in new software as well as detection and analytical systems that help to discover the most serious fraud attempts, insurance companies are able to discover cases with a higher proven value per fraud attempt. Starting in January 2012, nine of the most significant insurance companies have been participating in the Information Exchange System for Suspicious Circumstances, which helps to identify insurance fraud across the entire market, such as multiple claims for the same damage. It is highly likely that additional insurance companies will join in this system

7.3. Insurance Intermediation

The number of insurance intermediaries continued to increase in a manner similar to that in previous years (refer to Graph 7.2). By the end of 2012, the registration process had been completed by 161,600 entities (refer to Table 7.2) with the highest counts registered in the categories of subordinated insurance intermediaries and exclusive insurance agents. The licenses of 13,700 insurance intermediaries were revoked, usually at the intermediary’s request.

Graph 7.2: Number of insurance intermediaries



Source: CNB

A proposed legislative standard, which is aimed primarily at simplifying the entire insurance intermediary system, clarifying the individual categories of intermediaries, and increasing consumer protection has already been approved by the government and will be discussed by the Parliament of the Czech Republic in 2013. It is expected that its adoption will lead to a decrease in the number of entities, primarily those who have a licence but have not actively performed intermediary activities for a number of years.

Table 7.2: Number of insurance intermediaries by category[42]

Entity registered as at 31 Dec	2011			2012			Year-on-year change (%)		
	IN	LE	Total	IN	LE	Total	IN	LE	Total
TIE	13,047	333	13,380	13,462	343	13,805	3.2	3.0	3.2
SII	85,950	2,264	88,214	93,412	2,508	95,920	8.7	10.8	8.7
EIA	36,146	275	36,421	39,322	308	39,630	8.8	12.0	8.8
IA	571	949	1,520	582	1,018	1,600	1.9	7.3	5.3
IB	181	630	811	185	678	863	2.2	7.6	6.4
ILA	71	128	199	88	135	223	23.9	5.5	12.1
FII (EU)	6,988	2,196	9,184	7,170	2,419	9,589	2.6	10.2	4.4
Total	142,954	6,775	149,729	154,221	7,409	161,630*	7.9	9.4	7.9

Source: CNB
*of which the licenses of 13,700 entities have been revoked

8. SUPPLEMENTARY PENSION INSURANCE

The year 2012 marked an important turning point for the supplementary pension insurance sector. It was the last year in which the supplementary pension system functioned in practically unchanged format since its inception in 1994. Within the context of the pension reform, it was decided that the existing pension funds will be closed as of 30 November 2011. Anyone interested in subscribing to voluntary pension savings will be able

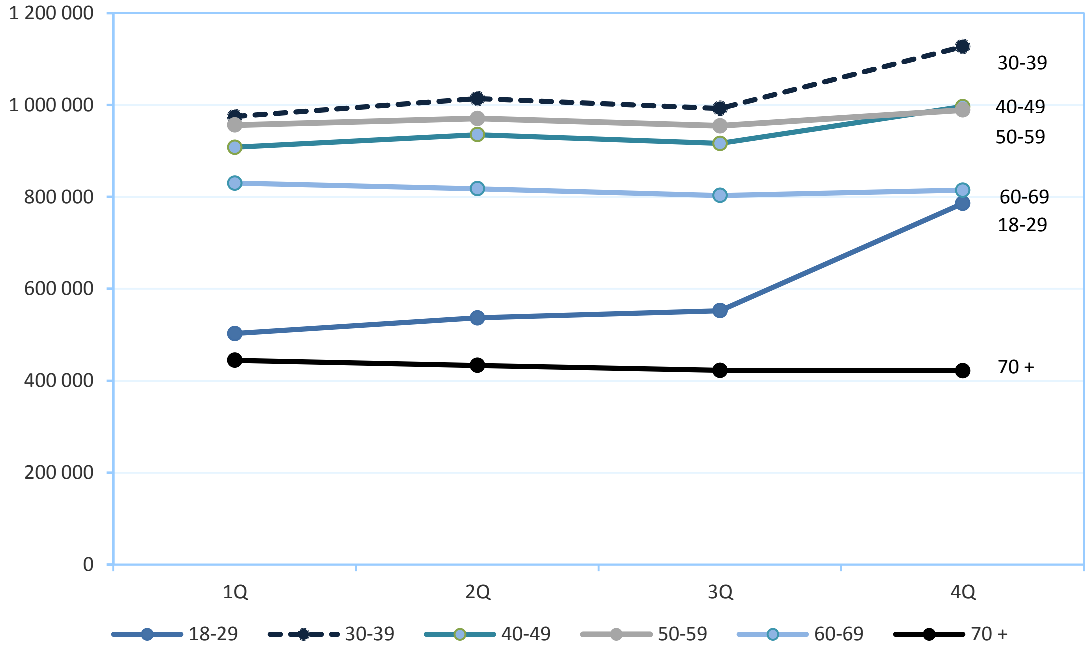
[42] Explanation: TII = tied insurance intermediary, SII = subordinated insurance intermediary, EIA = exclusive insurance agent, IA = insurance agent, IB = insurance broker, ILA = independent loss adjuster, FII (EU)= foreign insurance intermediary, also referred to as the "notified body", IN = individual, and LE = legal entity.

to join only one of the new participatory funds starting at the beginning of 2013. As is explained below, this was already reflected in the figures for 2012, particularly with regard to the number of participants, their age structure, and the average monthly contribution.

The assets managed by the pension funds increased to CZK 246.6 billion, reflecting a year-on-year increase of 6.2%. The growth was not as dynamic as in the previous years even though the annual contributions made by the participants (CZK 25.5 billion) grew at a faster rate than in the last five years (by 8.8%).

In 2012, the number of participants in supplementary pension insurance increased by 569,000, bringing the total number of participants to 5.1 million. This broke the trend of recent years, which displayed certain signs of stagnation as a result of the relative level of market saturation. Looking at Graph 8.1 it is apparent that the majority of the growth took place towards the end of 2012. Of the annual increase in the number of participants (569,000), 493,000 joined in the system during the fourth quarter. This sudden and decisive increase was directly related to the ability to enter into a contract with the original conditions only until the end of November 2012. A number of participants entered unto the old system at the last moment and thus ensured their ability to negotiate an early pension, a no-loss guarantee, and more favourable conditions for withdrawing funds according to the original pension plans. They still retain the right to transfer to the new participatory funds in the future. Whether they take advantage of this option in the future or not will only become apparent in the coming years. Looking at Graph 8.1 it is also possible to see that the individuals who entered into contracts under the original conditions fall primarily into the 18-29 and 30-39 age groups. The number of new participants from the 40-49 age group is slightly lower. Only a few individuals over the age of fifty were involved in the last minute entry into the pension funds.

Graph 8.1: Number of participants by age in the individual quarters of 2012



Source: MoF

Table 8.1 shows the development in the age structure of participants in supplementary pension insurance in more detail than Graph 8.1. In 2012 the highest increase in absolute terms was in the second youngest age group (20-29), although the 18-19 age group had a higher increase in relative terms. In the past these two age groups recorded the absolute lowest increases in the number of new contracts (in 2011 these age groups even recorded a decline). The increase of almost 240,000 in the number of participants under the age of thirty provides evidence that even the younger generation is gradually becoming aware of the responsibility they have with regard to their future once they are past working age. A significant increase can also be seen in the middle age group of 30-49. In the case of the older age groups (50 and above), both the relative as well as the absolute increases are lower, as this segment of the market already has a high level of penetration and the number of as-of-yet undecided potential participants is logically becoming smaller as they near retirement age.

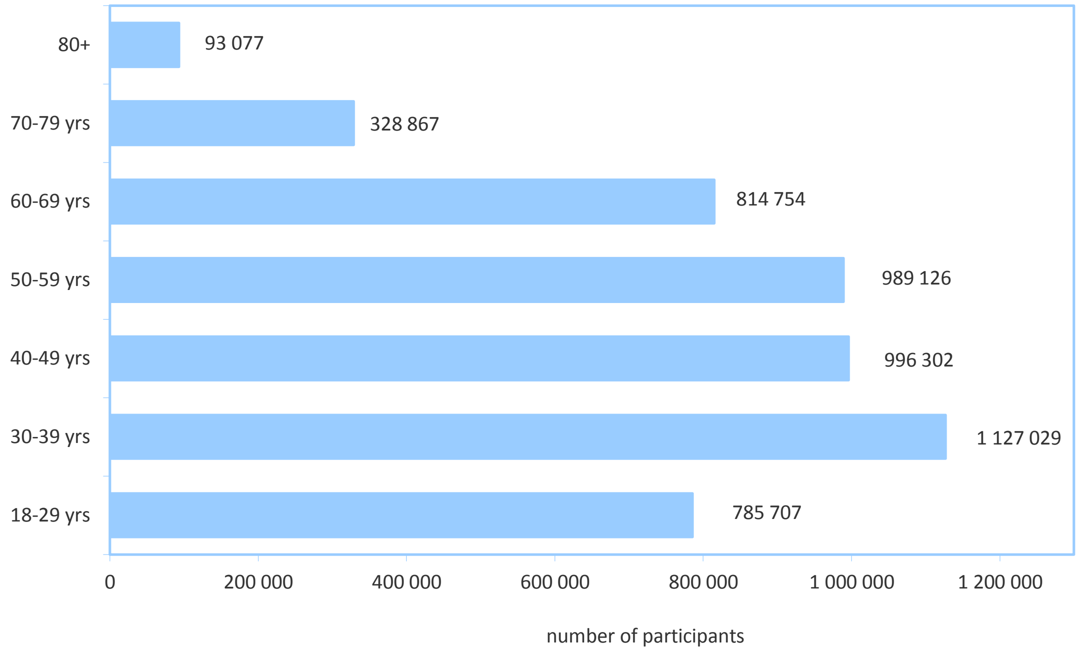
Table,8.1:,Numbers,of,participants,in,supplementary,pension,insurance,by,age

As at 30 Dec	2008	2009	2010	2011	2012	Year-on-year change	
						Abs.	(%)
18-19 yrs	22,526	23,433	22,150	19,569	67,014	47,445	242.4
20-29 yrs	512,496	530,382	537,701	526,835	718,693	191,858	36.4
30-39 yrs	867,574	927,964	965,683	977,023	1,127,029	150,006	15.4
40-49 yrs	807,665	839,614	867,483	885,169	996,302	111,133	12.6
50-59 yrs	1,010,509	1,008,265	998,104	973,152	989,126	15,974	1.6
60-69 yrs	682,601	729,339	765,997	786,776	814,754	27,978	3.6
70-79 yrs	245,558	267,966	292,809	311,402	328,867	17,465	5.6
80+	58,307	67,559	77,847	85,795	93,077	7,282	8.5
Total	4,207,236	4,394,522	4,527,774	4,565,741	5,134,862	569,121	12.5

Source:,MoF

Given the overall high number of participants in supplementary pension insurance (5.1 million), the total described increase at the end of 2012 were not reflected to as high a degree in the final age structure. Looking at Graph 8.2 it is apparent that the dominant position continues to be held by the "middle" generation (the 30-59 age group), i.e. persons of working age with statistically higher and more stable incomes, which provide a better environment to create financial reserves for retirement. The highest number of participants in absolute terms consists of people in their thirties. It is positive to see that almost 800,000 contracts are registered for individuals under the age of thirty.

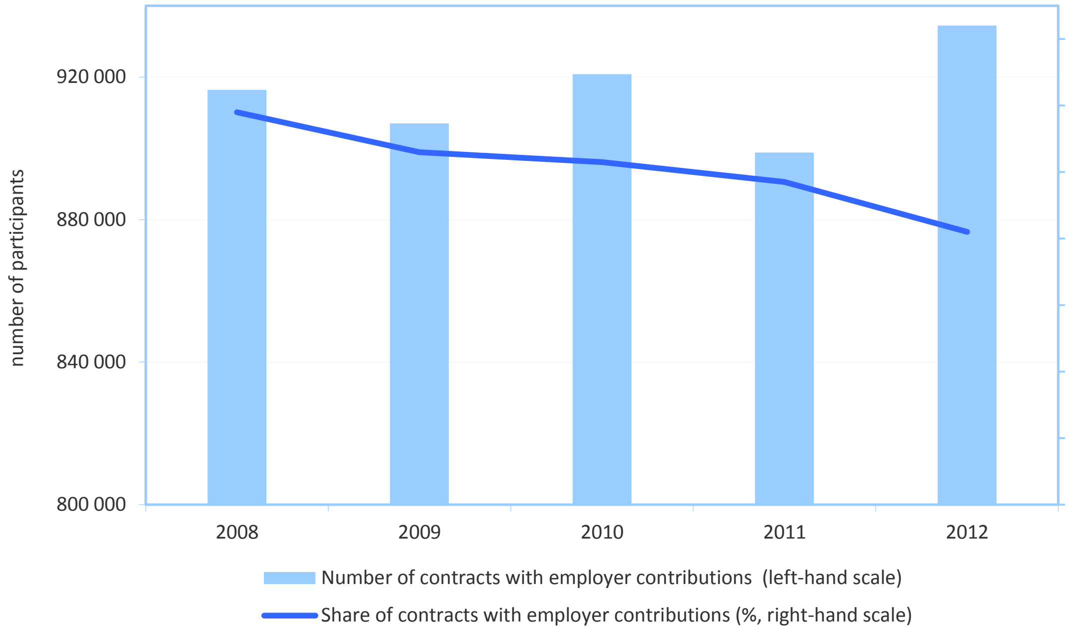
Graph 8.2: Age structure of participants in supplementary pension insurance



Source: MoF

As can be seen in Graph 8.3, the number of participants for whom their employer also makes a contribution towards supplementary pension insurance has been fluctuating over the years. It increased only slightly in 2012 (by 4%) to CZK 934,400. In relative terms this is only a continuation of the downward trend, as the rapidly growing increase in the overall number of contracts was not accompanied by a corresponding response on the part of employers. One of the possible reasons why employers make a supplementary pension insurance contribution for only 18% of the participants might be the various austerity measures that have been implemented in the business sector. Taking into account the fact that the employer's contribution is often used to motivate and stabilise employees, it is most frequently found in the case of participants in the 35-59 age group. Conversely, it is not very common in the case of younger employees (due to higher fluctuation amongst other things).

Graph 8.3: Number of supplementary pension insurance contracts with an employer contribution[43]



Source: MoF

As can be seen from Table 8.2, during the last year of the "old" system the pension funds reduced the deferred expenses attributable to open supplementary pension insurance contracts. Over the past few years the fund managers have been preparing for the expected transformation of the pension funds to pension companies and the associated separation of assets, and have thus been taking specific measures to accelerate the amortization of deferred expenses in order to minimize the burden placed on the financial management of the new pension companies. During the process of separating the assets, the remaining balance of deferred costs was transferred to the balance of the pension companies at the end of 2012 (more information about the separation of assets is provided in Chapter 8.1).

Although the costs associated with the distribution of supplementary pension insurance products recorded a year-on-year increase of approximately 80%, the indicator monitoring the acquisition costs associated with each new contract fell by 27% and returned back to the 2010 level. This reduction in costs was influenced not only by the high increase in the number of new contracts, but also by the relatively high level of publicity and public awareness about the termination of the existing pension scheme, and thus the pension funds did not need to spend as much to acquire a new client as in the past.

Table 8.2: Acquisition costs associated with supplementary pension insurance

CZK / average amount	2009	2010	2011	2012	Year-on-year change	
					Abs.	(%)
Costs incurred in connection with a new policy	3,365	3,184	4,249	3,103	-1,146	-27.0
Deferred expenses in relation to the number of open supplementary pension insurance contracts	883	777	580	457	-123	-21.2

Source: MoF, CNB

[43] Status as at 31 December for each given year.

Average monthly participant contribution in 2012 also increased considerably (by 5.3%) to CZK 465.[44] As shown in Table 8.3, the amount increased throughout the year (refer to the averages for each quarter), but a very significant jump occurred at the end of the year. This can be explained by the aforementioned increase in the number of new participants who entered into contracts in October and November under the "old" conditions. Since there was only very little time remaining until the end of the year, many of the new participants apparently set up their monthly contribution amount to match the new requirements for receiving the state contribution that took effect in January 2013 (refer to Chapter 8.1). For example, the number of participants who contribute CZK 1,000 to 1,099 increased by 45% at the end of 2012 and those who contribute CZK 2,000 or more increased even more by an astounding 217.3%.

As a result of the higher average participant contribution in 2012 and the growing number of participants, the state contribution that was disbursed per participant also increased (refer to Table 8.3).

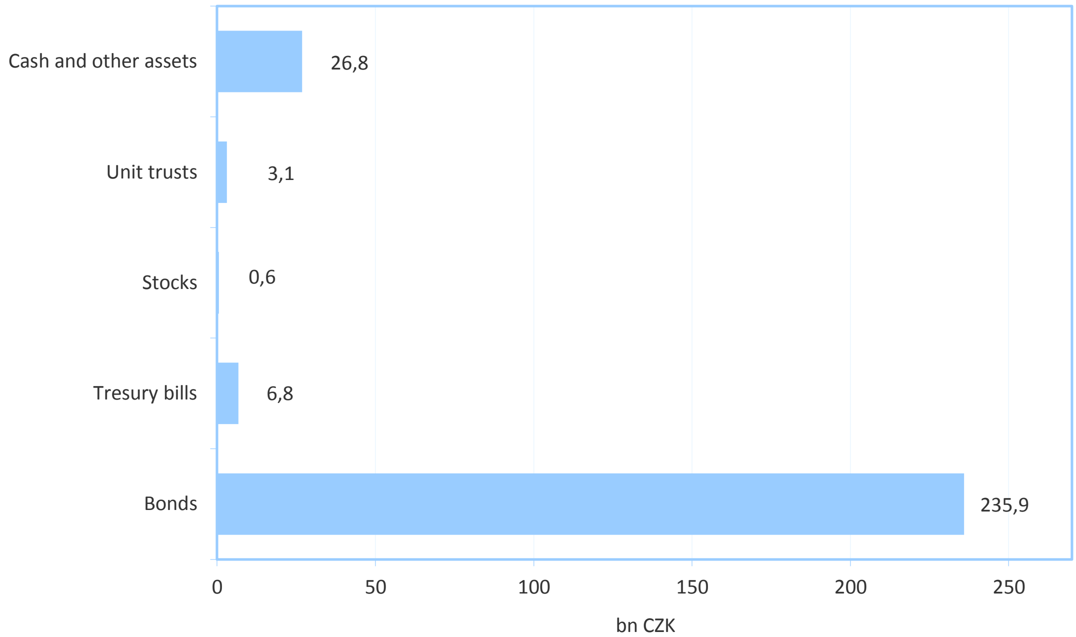
Table 8.3: Breakdown of the average monthly contribution amount

Average, CZK/month	2008	2009	2010	2011	2012	2012				Year-on-year change	
						1Q	2Q	3Q	4Q	Abs.	(%)
Participant's contribution	450.5	443.9	439.6	441.7	465.0	434.0	447.9	466.7	511.3	23.3	5.3
State contribution	104.9	105.2	105.0	105.4	108.0	105.5	106.9	109.3	110.4	2.6	2.5

Source: MoF

The investment portfolios of the pension funds (refer to Graph 8.4) continues to remain conservative as a result of the regulatory framework. At the same time, this conservatism is one of the main reasons why the funds invested by the participants have a low yield. Bonds make up 84% of the portfolio and stocks do not have even a 1% share. Almost 11% is kept in cash and other assets. The remaining items are only minimal.

Graph 8.4: Allocation of pension fund assets as at 31 December 2012



Source: APF CR

[44] This is the average for the entire calendar year 2012 and thus it is lower than the average for the fourth quarter of 2012 as specified in Table 8.3.

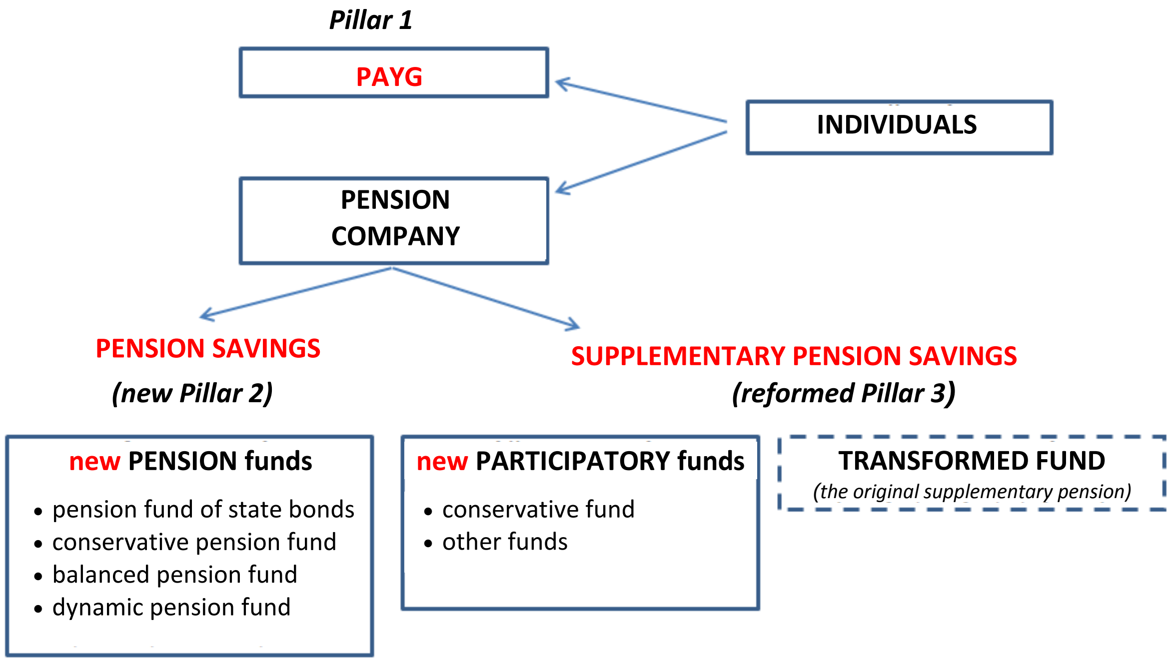
Other indicators monitoring the development of the supplementary pension insurance segment, which exceed the scope of the graphs and tables included in this Chapter, as well as the time series going back to 2002 are included in Appendix 2 without any further commentary (refer to Table P2.6).

8.1. Pension System Reform

The Czech Republic has been discussing the need to reform its pension system since the 1990s, primarily due to the long-term unfavourable demographic development of the country's population and the consequent unsustainable nature of the existing pay-as-you-go (PAYG) pension system. Given the Czech population's great dependence on the pensions disbursed by the state (Pillar 1) and the inadequate diversification of income for retirement, simply changing the parameters of the existing PAYG system (the "minor pension reform") was not sufficient and it was necessary to propose a modification that would expand the system as a whole (a "major pension reform"). This includes a reform of the existing supplementary pension insurance system, which has represented a supplementary source of retirement income for almost two decades. However, due to the low monthly contribution amounts (refer to Table 8.3), the average savings amounts are very low (an average of CZK 48,000 per participant at the end of 2012). In many cases, the achieved level of appreciation did not even equal the inflation rate thus resulting in the actual devaluation of the savings.

The objective of the pension reform are as follows: to ensure the sustainable development of public finances; to distribute risk by lowering the level of dependence on Pillar 1; to enforce the "achievement principle" and individual responsibility; and to strengthen intergenerational ties within families. In order to realise these objectives, the existing pension system was expanded to include a new Pillar 2 and has thus been a three-pillar system since the start of 2013 (refer to Figure 9.1). Changes were made in Pillar 3 with the aim of attaining a higher potential for increasing the value of invested funds (the abolition of the no-risk guarantee, the separation of the pension fund's assets from the savings of its clients, and the implementation of a regulatory framework for the remuneration paid to pension companies for managing the clients' assets). The changes are also aimed at ensuring higher monthly contributions through a modification in the parameters for the state contribution.

Figure 9.1: New structure of the pension system starting in 2013



Source: MoF

Pillar 1 represents the standard pension system, i.e. the mandatory system financed by the state. The basic underlying principle for this pillar is its regular financing, when the pensions disbursed to current retirees are paid from the state budget. The role of this pillar is to ensure that the individuals who have paid pension insurance for the majority of their life receive an adequate pension. The parameters of Pillar 1 were modified by the minor pension reform.[45]

Pillar 2, the pension savings pillar, represents the new option for pension savings in the form of funds (referred to as the "opt-out option"). The basic underlying principle for this pillar consists of lifelong saving for retirement with a selected pension company at a level equal to 5% of gross salary for every given month (paid by the employee). Simply stated, this savings plan consists of transferring 3% of the employee's gross salary that is currently deducted for pension insurance to a private individual account under the condition that the employee pays an additional 2% of the base used to calculate the pension insurance deduction.[46] Participation in this pillar is voluntary; however, it is not possible to withdraw from the system once the contract for pension savings has been registered. The inability to reverse this step provides a guarantee that the purpose of Pillar 2 will be met, i.e. lifelong saving in order to ensure sufficient funds to supplement the pension received from the state. The funds in Pillar 2 cannot be the subject of a collection order during the entire saving phase. In the event of the participant's death during the saving phase, the funds that have been saved are included in the inheritance. Individuals up to the age of thirty-five may join this pillar at any time. Individuals of thirty-five and over must decide if they want to participate in this pillar by 1 July 2013.

At the time the contract with the pension company is concluded, the participant will select an investment strategy based on his/her own risk profile. This risk profile should be defined at the time the contract is being drawn up on the basis of an interview with the potential participant and the completion and evaluation of a relevant questionnaire. The legislation assigns to the pension companies the obligation to offer participants four types of pension funds: dynamic, balanced, conservative, and a state bond fund. The legislation establishes limits for each type of pension fund. The participant has the ability to either elect his/her own investment strategy for allocating his/her funds amongst the individual funds managed by a single pension company or to opt for the "lifecycle strategy", within which the allocation of the participant's contributions is automatically changed according to a predefined plan. If the participant selects the dynamic fund, in order to eliminate the negative impact of fluctuations in the financial market, towards the end of the saving phase the law assigns to the pension company the obligation to automatically move the resources into a more conservative pension fund. The changing allocation of funds amongst the individual pension funds according to the participant's ages is referred to as the "autopilot" method.

One of the objectives of Pillar 2 of the pension system is to ensure a low level of associated costs. For this reason, the law has specified the maximum remuneration to be paid for managing the assets and the maximum fees that can be charged in return for increasing the value of the assets held in the pension funds. The management fees for the pension funds should therefore be significantly lower than for comparable collective investment funds. The law also limits some of the expenses a pension companies may incur, such as the remuneration for offering and intermediating a contract is limited to a maximum of 3.5% of the average wage, which is currently approximately CZK 840. The law also defines limits for the expenses outlaid for promotion, advertising, and sales support.

Significant emphasis is placed on the security of the funds invested by clients. The funds in each of the individual pension funds are managed by pension companies, the majority of whom were created through the transformation of the original pension funds that have been successfully operating in the Czech Republic's financial market for eighteen years (refer to the second column of Table 8.4). Therefore, these are entities with a sufficiently long history. The pension companies and life insurance companies involved in the payout phase are subject to regulation by the MoF and supervision by the CNB. Additional measures that help to protect the safety of the funds include the separation of client assets from shareholder (fund manager) assets. This rule is in effect since the start of 2013 and also applies to the function of Pillar 3. This means that

[45] The minor pension reform was adopted in 2011 in response to the Constitutional Court decision that reinforced the solidarity of the existing pension system. The aim of this reform was to reinforce the principle of achievement for high-earning employees. The lowest paid groups of employees were not affected. The reform also adjusted the retirement age parameters upwards according to updated life expectancy tables.

[46] In practice, 30% of the gross salary earned by a participant in Pillar 2 is deducted. This deduction is separated into two amounts, with 25% of the gross salary paid into the state budget and 5% of the gross salary transferred to the participant's individual account maintained with a pension company.

the fund manager, i.e. the pension company, does not handle the clients' assets directly. All operations are performed by the depositary on the basis of the pension company's instructions. The depositary must confirm that all transactions comply with the law and is liable with its assets for performing an effective verification. There are therefore several levels of checks of the pension companies. If a pension company terminates its activities, the management of the pension funds will be transferred to another manager on the basis of a CNB decision.

The participant is entitled to withdraw the funds saved under Pillar 2 no sooner than on the date that he/she has the right to receive his/her pension from Pillar 1. The payout phase will be administered and performed by the life insurance companies that are authorised to perform this activity. A participant in a pension savings scheme will be able to choose one of three ways in which to withdraw his/her savings as follow:

- A lifetime pension ending upon the participant's death;
- A lifetime pension with a negotiated survivor's pension for a period of three years; and
- An annuity for a period of twenty years.

As can be seen in Table 8.4, there are eleven pension companies active in Pillar 2.[47] Whilst all of them manage assets under Pillar 3 (see below), only six of them applied for and were granted a licence to perform activities including the management of the pension funds under Pillar 2 (refer to column 2 of Table 8.4).

Table 8.4: List of licensed entities in Pillar 2 and Pillar 3

Pension Company	Pillar 2	Pillar 3
AEGON Penzijní společnost, a.s.	no	yes
Allianz penzijní společnost, a.s.	yes	yes
AXA penzijní společnost a.s.	no	yes
Conseq penzijní společnost, a.s.	no	yes
Česká spořitelna – penzijní společnost, a.s.	yes	yes
ČSOB Penzijní společnost, a.s., a member of the ČSOB Group	yes	yes
Generali penzijní společnost a.s.	no	yes
ING Penzijní společnost, a.s.	no	yes
KB Penzijní společnost, a.s.	yes	yes
Penzijní společnost České pojišťovny, a.s.	yes	yes
Raiffeisen penzijní společnost a.s.	yes	yes

Source: CNB

Pillar three, or supplementary pension savings, consists of the voluntary saving of funds for retirement, which the state supports in the form of a state contribution and tax relief. Up to the end of 2012, this function existed in the form of supplementary pension insurance. At the start it was converted to supplementary pension savings, which now offers the ability to enter into one of the participatory funds. As with the pension funds under Pillar 2, the participants bear the investment risk, however, this is in return for a potential higher yield. The conditions of the original supplementary pension insurance scheme continue to apply to those who were participants in the original system.

Pension companies are obliged by law to offer one conservative participatory fund with specific investment limits that are defined in the legislation. They may however offer an unlimited spectrum of additional participatory funds with various portfolio structures (within the limits defined in the law). During the first months of 2013, the pension companies started offering their products, generally consisting of three to five participatory funds, ranging from a conservative fund that includes assets with the lowest associated level of risk (e.g. state bonds, treasury bills, money market instruments, etc.) up to dynamic (stock) funds with a significantly higher associated level of risk but with the possibility of higher returns. Some of the pension companies have also included strategic and/or lifecycle funds, for which the investment strategy is adjusted according to the participant's age. As the participant grows older, the strategy shifts from dynamic to conservative.

[47] The Generali Pension Company does not however offer the new participatory funds and only manages the funds of the participants in the original supplementary pension insurance system that are in the transformed fund.

The autopilot method mentioned above is also available under the supplementary pension savings pillar to help protect the participant against any possible losses immediately prior to the payout phase due to sudden fluctuations in the financial market. Under this method the pension company will transfer all of the participant's funds to a mandatory conservative fund no more than five years prior to the time that the participant acquires the right to receive a pension.

The funds of the participants in the original supplementary pension insurance system were transferred into transformed funds, which are still governed by the original contractual conditions, i.e. the no-loss guarantee (referred to as the "positive zero", where the participant does not bear any investment risk), the ability to receive an early pension, and condition that make it possible to terminate the contract and receive payments.

As both the new participatory funds as well as the transformed funds are administered by pension companies, the same measures to protect the participants' savings that are described for Pillar 2 are in place for Pillar 3.

The amount of the state contribution changed in January 2013 for all participants regardless of whether their funds are allocated in the transformed funds or in the new participatory funds. A comparison of the old and new amounts of the direct state support is provided in Table 8.5.

Table 8.5: Overview of disbursed state contribution according to the participant's contribution

Participant's Contribution (in CZK)	100	200	300	400	500	600	700	800	900	1000 +
State contribution to 31/12/2012	50	90	120	140	150	150	150	150	150	150
Current state contribution	0	0	90	110	130	150	170	190	210	230

Source: MoF

The separation of assets, which was mentioned in the previous sections, introduced the regulation of remuneration for the management of the assets. The law defines upper limits for Pillar 3, but the limit is more relaxed than that in place for Pillar 2. These changes, combined with the removal of a guaranteed annual yield, should lead to higher returns for the new participatory funds and increases the security of the participants' savings.

For the new participants in Pillar 3, including those participants of the original supplementary pension insurance system who choose to transfer their savings from the transformed fund to one of the new participatory funds, the conditions for the payout phase of the supplementary pension savings have also changed. Five years prior to the time they become eligible to receive a pension[48] the participants are able to choose from the following options: a retirement pension for a predefined period of time, the payment of a one-time premium in order to set up a lifetime annuity, or fixed amount annuity payments for a specific period of time. The ability to select a lump-sum distribution is conditional on reaching pension eligibility age.

One of the new features available starting in 2013 is the ability to use the funds from Pillar 3 in the form of a pre-retirement pension. This solution is appropriate for participants who are nearing retirement age and are having a difficult time finding a job and who have already saved enough within the supplementary pension savings system. Up to now, the only option these individuals had was to apply for an early retirement pension. This, however, led to a permanent reduction of the pension they receive. By taking advantage of the ability to draw a pre-retirement pension, the individual falls into the category of individuals for whom the state pays health insurance and also retains the right to a higher retirement pension as he/she does not begin drawing an early retirement pension. However, certain conditions must be met. It is not possible to start drawing a pre-retirement pension more than five years prior to the time the individual reaches retirement age[49] and the pre-retirement pension must be drawn for at least two years. In addition, the amount of the pre-retirement pension must be equal to at least 30% of the average wage in the Czech Republic. At the start of 2013 this meant that at least CZK 90,000 must have been saved in the supplementary pension savings system for each year of the pre-retirement period. The amount of the pre-retirement pension must be paid out as a fixed amount on a monthly basis. Once the pre-retirement pension starts being drawn it is not possible to interrupt or terminate the process.

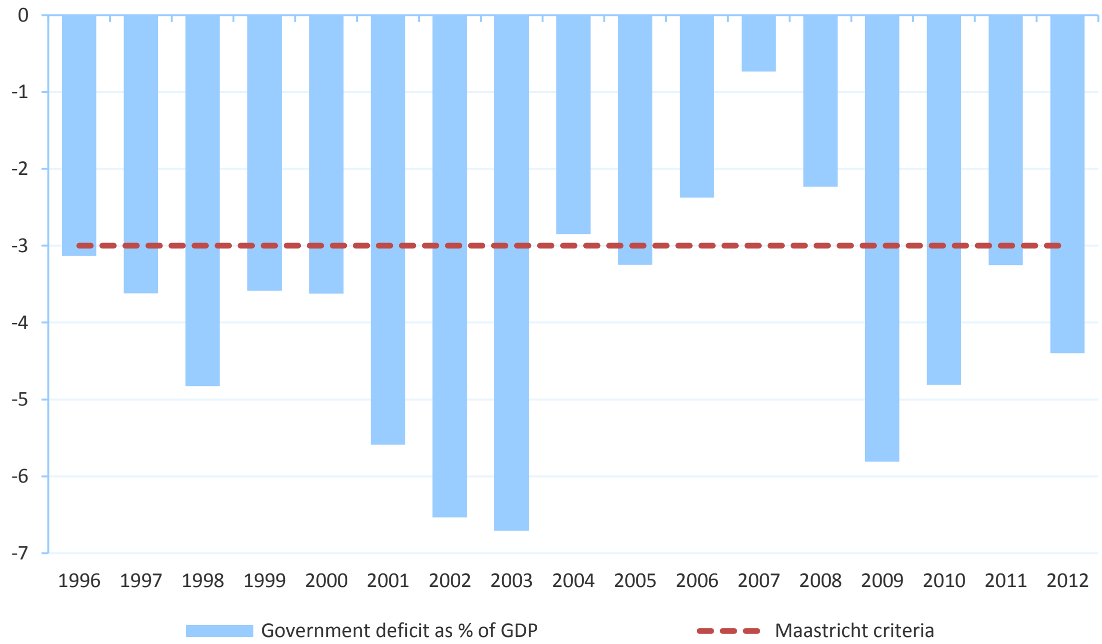
[48] The retirement age for men and women is the same according to their date of birth.

9. GOVERNMENT SECTOR

9.1. Economic Results of the Government Sector

According to preliminary CSO statistics, the economic results in the government sector, calculated using the ESA95 methodology, recorded a deficit equal to 4.4% of GDP in 2012. When compared to the previous year, there was significant deterioration at a level of 1.15 pp. This result can however be attributed to the inclusion of the capital transfer of CZK 59 billion that was performed on the basis of the approved law on the property settlement with churches and religious communities and the inclusion of the capital transfer of approximately CZK 12 billion made as a result of the flat-rate correction for ineligible European expenditure[49] in 2012. If we adjust the capital expenditure item to remove the CZK 71 billion effect of these transfers, the deficit in 2012 was equal to 2.5% of GDP, and, as compared to 2011, there was a significant 0.8 pp improvement in the general government sector. A comparison of the development over a longer time series is provided in Graph 9.1. The decline in the general government deficit since 2010 can be explained by the consolidation measures implemented by the government, which in 2013 are expected to bring the deficit below the Maastricht criterion that specifies a maximum deficit equal to 3% of GDP.

Graph 9.1: Development of the government deficit as a percentage of GDP since 1996



Source: MoF

When compared with 2011, **total revenue** increased by nearly 1%, primarily due to the dynamics of the changes in tax income and social security contributions. Income from value added tax recorded the greatest growth, specifically at a level of almost 3%, which, in the light of the 4 pp increase to the reduced VAT rate that took effect in 2012, reflects only very moderate growth due to the decline in household consumption.

Conversely, thanks to their very low elasticity in relation to fluctuations in household consumption, excise taxes increased by 1.3% in 2012 despite the drop in household consumption. From the perspective of discretionary measures, excise taxes were increased only for tobacco and this had a very slight impact of slightly over CZK 2 billion. As far as other forms of excise tax are concerned, in 2012 a tax was introduced for winnings from

[49] This concerns funds that the government sector disbursed to the final beneficiaries. EU funds should not, however, influence the deficit as calculated using the ESA95 methodology and therefore, if the final beneficiary is an entity outside of the government sector, the associated income and expenditure are subtracted from the balance. As this expenditure will not be reimbursed by the EU, it becomes necessary to add a capital transfer that reflects the situation.

lotteries, betting, and other games of chance, which resulted in a discretionary effect of CZK 8.2 billion. However, in this particular case, it is necessary to take into account the negative impact of the change in the fees associated with gaming machines. The overall positive effect on the government deficit is therefore only approximately CZK 7 billion.

The revenue from personal income tax increased by 1.1% in 2012. This growth was, however, considerably slowed due to the discretionary measures that had an overall effect of approximately CZK 8 billion (this involved primarily the increased allowable annual tax deduction of CZK 1,800 per child and the termination of the temporary decrease in the basic taxpayer deduction).

As far as corporate income tax is concerned, revenue from this tax declined by 0.4%. There were no discretionary measures implemented in this area that had a significant fiscal effect. At the moment, primarily in the case of corporate income tax, it is possible to present only a preliminary estimate which will be specified in more detail in the Notification of Government Deficit and Tax, which will be published in October on the basis of the tax returns that are submitted. Social security contributions increased by 1.3%; however this increase can be considered as fully autonomous development.

There was a sharp decline of 26.1% in capital transfers as compared to 2011. The main reason for this is the more than CZK 12 billion year-on-year decrease in investment subsidies, resulting primarily from the reduction in investment subsidies received from the EU, which are generally used to finance investments where the financial beneficiary is an entity from the government sector.

Total expenditure in the government sector increased by 3.4% in 2012 as the result of the two capital transfers specified above (the property settlement with churches and the flat-rate correction for subsidies), which totalled CZK 71 billion. If these transfers were not taken into account, there would be an almost 1% year-on-year decrease in expenditure.

In 2012, government consumption grew by only 0.4%, thus underlining the efforts made towards an austerity policy over the course of the year. The most quickly growing significant component of government consumption consisted of social benefits (expenditure associated primarily with healthcare), which increased by 2.4% without any government intervention (i.e. as result of autonomous development). Although several discretionary measures were approved for 2012, such as increased patient co-payments amounts and other changes in the healthcare system (e.g. categories of hospital care, outpatient surgery, and payments for medicines), any positive effects were basically offset by the increase in the reduced VAT rate.

The development in intermediate consumption reflected a certain degree of cost-effectiveness and declined by 1.8% in comparison with 2011. This decrease was evenly distributed between central government and local government. Employee compensation increased by only 0.6% due to several wage adjustments (consisting primarily of wage increases for employees in the educational field). There was a decline primarily on the local level.

On the expenditure side, the most significant decrease (more than 15%) was recorded for gross capital creation. The most sizable drop was in central government (by approximately CZK 10 billion). This decline is an indication of the connection with the aforementioned decrease in the income from revenue investment subsidies received from the EU.[50] At the central level, there was therefore most likely a decrease in the number of investments co-financed from European funds. The final result is that savings in the government sector may only take the co-financing amounts into account and this will probably be less than a billion crowns. There was also an approximately CZK 3 billion improvement in relation to the operations with used fixed assets. The acquisition cost for new tangible fixed assets for local government declined by CZK 6 billion although the investment subsidy for this sector decreased only minimally (by approximately CZK 1 billion). It is very likely that this reflects a decline primarily in investments made using national sources and mainly in the case of local government entities.

[50] The reduction in the accrued subsidy amount consists of the expenditure designated as European expenditure when the final recipient is an entity from the government sector.

Capital transfers are another item on the expenditure side that decreased in a relatively significant manner, however only after they are adjusted by the two aforementioned one-off capital transfer operations. A decrease of approximately CZK 6.5 billion was recorded, of which the predominant portion (CZK 5.5 billion) is a result of the decreases in the capital transfers performed under the General Treasury Chapter in connection with the discretionary measures reducing the state contribution for building savings schemes. The majority of other expenditure items developed autonomously. Nevertheless, their lower than average dynamics are to a certain degree a reflection of the efforts to implement an austerity policy. Thanks to this there was a significant across-the-board level of budgetary saving, focused specifically on savings in investments, capital transfers, and discretionary tax measures.

9.2. Economic Outlook for the Government Sector for 2013-2016

We expect that the deficit will attain a level equal to 2.8% of GDP in 2013, which would be an improvement of 1.6 pp as compared to 2012 (after adjusting the results of 2012 to not include the property settlement with churches and the flat-rate correction for European subsidies there was only a year-on-year decline of 0.3 pp). However, this is still 0.1 pp below the target that is currently in place for 2013.

From the perspective of revenue, several discretionary changes have been prepared for 2013. The total measures on the revenue side (consisting primarily of changes to taxes and social security contributions) are expected to have a financial impact of more than CZK 20 billion. The most important of these changes are the change in the VAT rates, which is expected to bring in approximately CZK 15 billion and modifications to personal income tax provisions (such as the termination of the tax relief for working pensioners, limiting the flat-rate expense deductions, and the 7% “solidarity tax”), which is expected to bring in almost CZK 7 billion. Conversely, the pension reform will have a negative impact on the government sector’s revenue, as it is expected that this will lead to a decrease of approximately CZK 6 billion in 2013. In the area of excise taxes, there will be another increase in the excise tax for tobacco products.

On the expenditure side, the most important discretionary measures include the change in the indexation formula for pensions, which is expected to have a financial impact of CZK 9.5 billion; improvements in the effectiveness of the public procurement system; and a decrease in the expenditure chapter according to the commitments made last year (by almost CZK 13 billion).

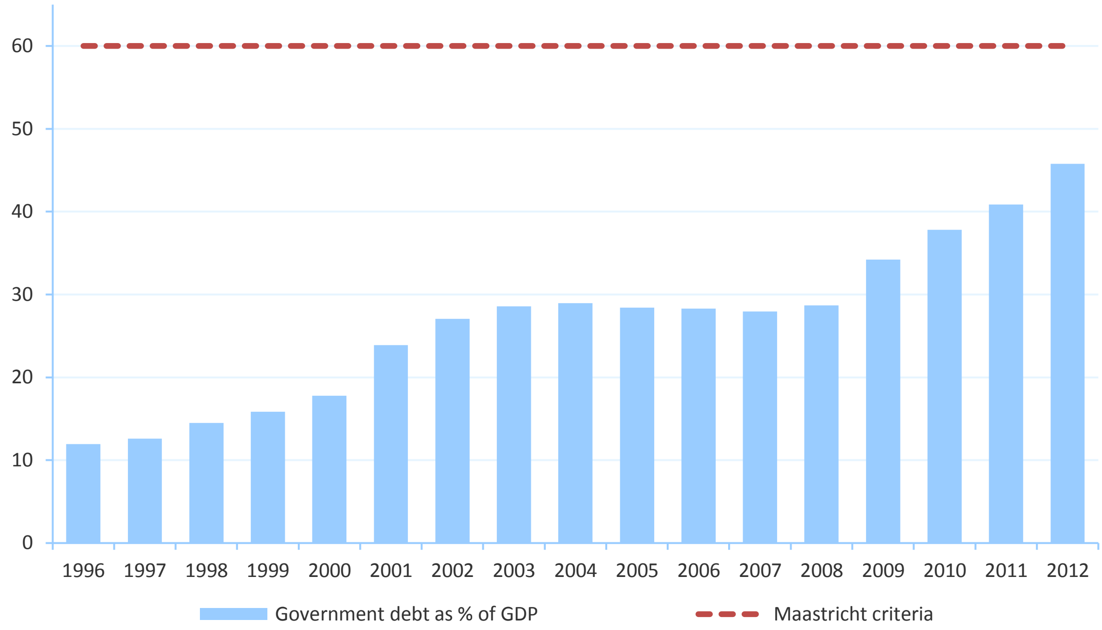
The medium-term prediction for the budget during the 2014-2016 period anticipates a stable ratio of the government deficit to GDP ranging between 2.8% and 2.9% of GDP. The MoF predicts that this result will be achieved even in spite of the very negative production gap, equal to approximately 3% of potential production, which is expected in 2013 and 2014. This is at a level comparable to the average value of this indicator in 2009, when the government deficit was at almost 6%.

9.3. Government Sector Debt with an Emphasis on National Debt

Total government debt was equal to 45.8% of GDP at the end of 2012. The most recent predictions expect continued growth in the nominal value of the debt over the medium term. Taking into account the slowdown in the speed at which consolidation measures are being achieved and slower GDP growth, the MoF also predicts an increase in the debt ratio over the entire timeframe in question. In relative terms, the debt to GDP ratio should increase from 48.5% in 2013 to 51.9% in 2016.

Graph 9.2 illustrates the development in government debt since 1996. There has been a noticeable increase in debt since the outbreak of the global financial crisis in 2008, which can be explained primarily by the increase in cyclical deficit or, more specifically, the declining phase of the economic cycle, during which there is less income flowing into the state budget. In spite of this steep growth, the government debt remains significantly below the 60% of GDP limit defined in the Maastricht criteria. Looking at the distribution of government debt amongst the various levels of government, it is obvious that a decisive share is held by the central government subsector. This share was equal to 94% of the total debt at the end of 2012 and it is expected that it will continue to increase at a moderate pace for the entire period of the prediction. Primarily the debt associated with the national budget (national debt) has the most significant impact on the debt ratio.

Graph 9.2: Development of government debt as a percentage of GDP since 1996

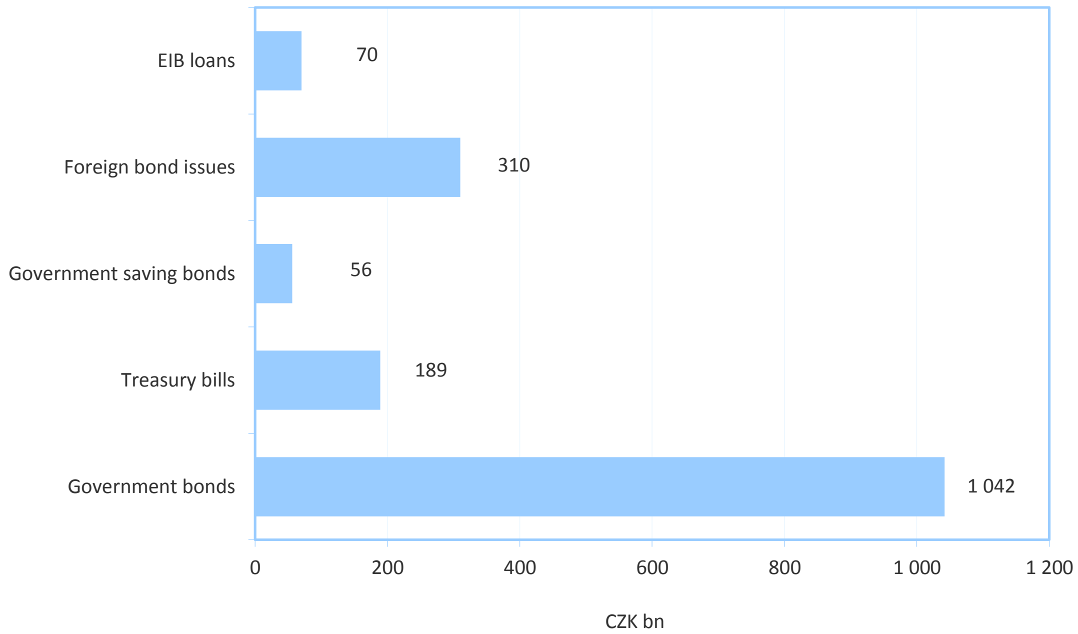


Source: MoF

When preparing the state's medium-term debt strategy, primary attention is focused on refinancing risk and market risk, which are the two key sources of uncertainty in funding. The stabilization of these two areas appears to be crucial particularly during periods of above-average volatility in the international financial markets and increased uncertainty on the part of investors. We have seen this situation in the past and in the present, and it is very likely that it will be the same in the future. A key indicator for assessing refinancing risk is the ratio of short-term national debt to total national debt, which ranged from 17.9% to 21.4% during 2012 and was 17.9% at the end of the year. It is predicted that the short-term national debt ratio will not exceed 20% during the 2013 to 2016 timeframe, which leaves a sufficient margin in relation to the established limit that has been set at 25% since 2012. Medium-term debt (i.e. debt maturing within five year) is also actively managed. The maximum limit for the ratio of medium-term national debt to total national debt has been set at a level of 70% since 2012.[51] As a result of this, the management of refinancing risk is distributed between short-term and medium-term national debt.

[51] The ratio of medium-term national debt in relation to total state debt was 52.7% at the end of 2012.

Graph 9.3: National debt by type of instrument at the end of 2012



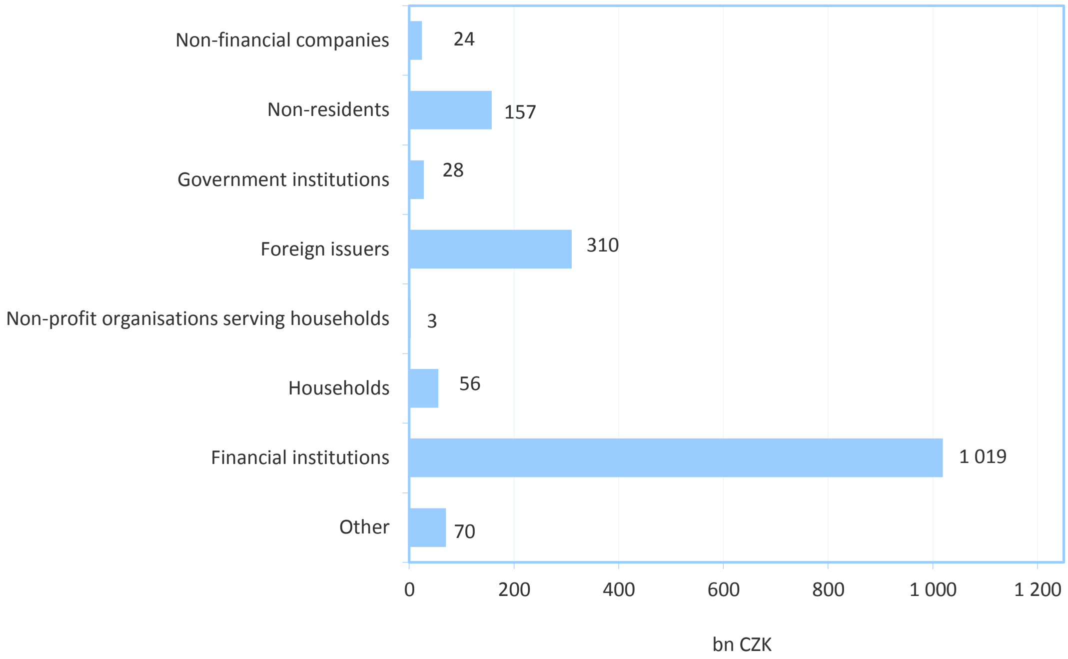
Source: MoF

The average maturity of national debt in recent years has ranged between six and seven years. However, during the past three years the target range for this indicator has been repeatedly shifted downwards. At the end of 2012 the average maturity of national debt was 5.7 years. The target range for 2013 has been left at a level of five to six years.

Interest rate risk is the most important risk from the perspective of managing national debt. Since 2006 a strategic target value has been defined on an annual basis for the share of the debt portfolio that has an interest fixation period of up to one year. This is the portion of debt for which the interest rate will be adjusted within one year and which is therefore highly sensitive to fluctuation in the interest rates on the financial market in the coming year. At the end of 2012 this indicator was equal to 37.5%. The target range for 2013 has been left at 30-40% and it is expected that the indicator's actual value will be someplace towards the upper-half of this range.

From the perspective of debt structure, the ratio of variable interest national debt to total national debt was 14.9% at the end of 2012. This ratio should not exceed a value of 17% during the 2013 to 2016 timeframe. The effect of derivative operations on interest rate exposure is associated with operations hedging the currency risk for foreign issues. Another market risk to which the national debt portfolio is exposed is currency risk, which has been actively managed since 2011. The rule that has been defined states that the ratio of foreign currency national debt to total national debt cannot exceed the long-term target value, which has been set at 15% (with an allowable short-term tolerance of 2 pp). At the end of 2012, the ratio of foreign debt to total debt was 10% and it this value is not expected to significantly change in the long-term. Graph 9.4 shows the distribution of national debt according to individual categories of creditors.

Graph 9.4: National debt by creditor at the end of 2012



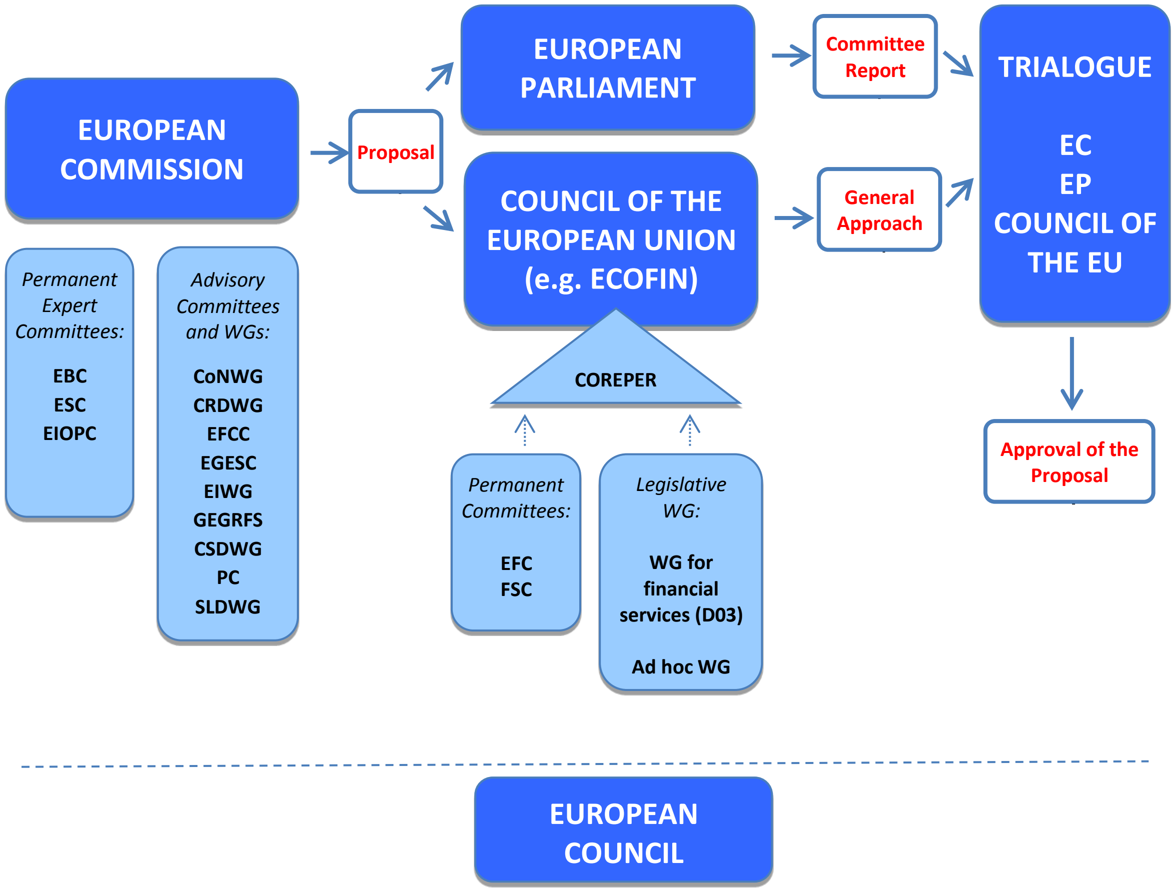
Source: MoF

10. FINANCIAL MARKET ACTIVITIES OF THE MOF AND FINANCIAL MARKET LEGISLATION

10.1. Ministry of Finance's Activities on the European Level

The MoF's activities on the European level are associated with the legislative process for discussing and approving the directives and regulations governing the financial market. Figure 10.1 provides a basic description of this process. The preparation of proposed legislative acts falls within the competence of the European Commission, which holds a "legislative monopoly" within this particular area. In a number of cases, the Commission discusses its plans, and the text of its proposals, at an expert level with representatives from the member states using the platforms provided by the permanent expert committees (referred to as Level 2 Committees), expert advisory committees, and working groups. The Commission's proposals are subsequently finalised, published on the Commission's website, and forwarded for parallel discussion by the European Parliament and the Council of the European Union. At the level of the European Parliament, the proposals are discussed by the appropriate committee (proposals affecting the financial market are discussed by the ECON Committee). The output from the discussions is compiled into an approved Committee Report and includes revisions to the original proposal submitted by the Commission. As far as the Council is concerned, the proposals are discussed by the representatives of the member states within the applicable working group, which, in the case of financial services, is the D03 working party, and various ad hoc working groups that are established as required. The result from the meetings consists of a revised version that is submitted for approval in the form of a General Approach document, first to the Permanent Representatives Committee (COREPER), and then to the Council in its ECOFIN configuration. The General Approach document and the Report prepared by the appropriate committee of the European Parliament are the input materials for a "trialogue" – a tripartite meeting during which a compromise version of the directive or regulation is negotiated by three parties, specifically the Commission, the Council, and the European Parliament. The final version is then formally approved by the Council and the European Parliament and subsequently published in the Official Journal of the European Union.

Figure 10.1: Basic structure of the European institutions within the context of the legislative process



Source: Prepared internally

The following sections of Chapter 10.1 provide information about the topics discussed by the various structures of the Commission and the Council. More details about the individual proposals for directives and regulations are provided in Chapter 10.3.

European Commission

The European Commission is one of the EU's supranational organs, which acts independently of the member states and protects the Union's interests. The term "Commission" is used in two different ways: either in the sense of the College of Commissioners or to also include the full administrative body. The Commission participates at almost all levels of the decision-making process and, of all of the EU's organs, has the largest administrative and expert body at its disposal. Most importantly, the Commission is the "guardian of the treaties", which means that it ensures compliance with the basic treaties establishing the European Union and one of the Commission's official obligations is to lodge complaints if any breach of these treaties is discovered. Another key competence of the Commission consists of its participation in creating the Union's legislation. In this respect, it holds an "initiative monopoly" – only the Commission has the right to submit legislative proposals. Other powers entrusted to the Commission include the publishing of recommendations and opinions, the exercise of delegated power (delegated legislative power), and representing the EU externally, including maintaining diplomatic relations and negotiating international treaties. The Commission is also responsible for managing a majority part of the EU budget.

Various working groups and committees function within the Commission as its advisory bodies. Their meetings are held with the participation of representatives from the member states. As far as financial services are concerned, these are usually representatives from the ministries and, in some situations, also from the central banks. In some cases representatives from the ECB, Level 3 bodies (EIOPA, EBA, and ESMA), EFTA and EEA member states, and the candidate states to the European Union participate as observers.

European Banking Committee (EBC)

The EBC acts as the Commission's advisory body during the preparation of EU legislative acts in the banking sector. In 2012, the committee met only once at the start of the year. The main topics discussed at this meeting included the issue of the timely implementation of the legislative proposals for a capital requirements directive and a capital requirements regulation, referred to as the CRD IV package, which, on the basis of a recommendation made by the Basel Committee on Banking Supervision (adopted in December 2010 and referred to as Basel III) will be transposed into European legislation. Another point that was discussed concerned the issues associated with microcredit, and focused specifically on the prudential rules for the provision of microcredit resulting from the Capital Requirements Directive. The aim of the debate was to prepare the foundation for a discussion by the EBC members with regard to the regulation of the microcredit segment.

European Securities Committee (ESC)

This committee convened one meeting in 2012, the subject of which consisted of the Commission's implementing measures for the Alternative Investment Fund Managers Directive (AIFMD), specifically the Commission Implementing Regulation for Directive 2011/61/EU with regard to selecting the regulatory regime applicable to the alternative investment fund managers falling under the scope of Directive 2011/61/EU, and the Commission Implementing Regulation for Directive 2011/61/EU with regard to the process for determining the member state of reference for a non-EU alternative investment fund manager.

European Insurance and Occupational Pensions Committee (EIOPC)

This committee convened one meeting in 2012, the subject of which consisted of the Commission's implementing measures for the Alternative Investment Fund Managers Directive (AIFMD), specifically the Commission Implementing Regulation for Directive 2011/61/EU with regard to selecting the regulatory regime applicable to the alternative investment fund managers falling under the scope of Directive 2011/61/EU, and the Commission Implementing Regulation for Directive 2011/61/EU with regard to the process for determining the member state of reference for a non-EU alternative investment fund manager.

European Insurance and Occupational Pensions Committee (EIOPC)

The EIOPC addresses not only expert issues associated with insurance, including pension funds, but also related political issues. EIOPC meetings are held with member states' and the Commission's representatives as well as with representatives of the supervisory authority EIOPA (European Insurance and Occupational Pensions Authority) and the EEA states as observers. The Committee's mission is to assess all issues associated with the application of the EU legislation in the insurance sector and in the sphere of occupational pensions.

In 2012, the EIOPC discussed the long-term guarantees impact assessment as regards the risk-free interest rate term structure settings in the proposal of Omnibus II Directive[52]; the trialogue participants made a decision about the assessment in summer 2012. The EIOPC also discussed the text of the Terms of Reference containing the basic framework and rules for this impact study. The Terms of Reference also define technical specifications for the scenarios of the assessment, which the EIOPA is responsible for organising together with national supervisory authorities. In relation to the course of the discussions regarding the Omnibus II Directive, the Committee also debated the overall postponement of the final deadline for the implementation and application of the Solvency II Directive as well as the implementation process in member states.

Other topics covered by the EIOPC included the impact of a risk-based solvency capital requirements implementation under the Solvency II regime to long-term investments and an equivalence of supervisory regimes applied in non-EU countries (primarily the USA) to the Solvency II regime. The Committee also addressed the scheduled publication of guidelines by the EIOPA, which will be aimed primarily at ensuring that the preparations of insurance and reinsurance undertakings, and national supervisory authorities are harmonised and in line with the Solvency II requirements, particularly with regard to the system of governance,

[52] Proposal for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (Omnibus II). Without the changes incorporated by the proposed Omnibus II Directive, the Solvency II Directive (2008/138/EC) cannot be applied. As a result, the new supervisory regime for the insurance sector cannot be launched without a valid and effective Omnibus II directive.

reporting, forward looking assessment of the undertaking's own risks, and the pre-application for internal models for calculating the solvency capital requirement.[53]

Other selected European Commission platforms

Close-out Netting Working Group (CoNWG)
The CoNWG is the working group focused on the unification of material law with regard to close-out netting. The Commission's draft proposal in this area has not yet been published, although this was expected to occur by the end of 2011.

In March 2013 the final discussions on close-out netting were held under the auspices of the UNIDROIT organisation, which is involved in the unification of private law. During this meeting the participating member states, including the Czech Republic, agreed on the principles to be used as an example for the legal provisions for close-out netting, particularly in developing states.

Capital Requirement Directive Working Group (CRDWG)
The CRDWG is involved in the preparation of prudential rules for the banking sector, or more specifically, the regulatory framework for credit institutions and certain types of investment firms. The aim of this group's work is primarily to take over the recommendations of the Basel Committee on Banking Supervision and to incorporate them into European legislation with the understanding that they will be revised in order to take into account the specifics of the European banking market. This working group did not meet at all in 2012, however, it is safe to assume that it will start addressing issues associated with the revision of the trading book and securitisation activities in the near future.

European Financial Conglomerates Committee (EFCC)
The EFCC resolves expert issues associated with financial conglomerates. The Committee's meetings are attended by observers from Level 3 bodies - the EIOPA, EBA, and ESMA.

During the three meetings that were convened in 2012, the Committee continued its discussions regarding the focus and contents of the so called fundamental revision to the Financial Conglomerates Directive (Directive 2002/87/EC, referred to as FICOD). An important point on the agenda was the proposal for the Commission's Report on its review of FICOD, which primarily addresses the current functioning of the financial conglomerates' supplementary supervision. The main topics that were discussed covered the inclusion of as-of-yet unregulated entities, particularly special purpose vehicles, within the scope of the Directive; the need to revise the definition of a financial conglomerate in response to the increasing size and complexity of groups through the implementation of risk-based threshold conditions; and the appropriateness of adapting the definition as an answer to the disappearing borderlines between sectors. It also appears to be desirable to expand the supervision to the non-financial parent company in the group and to define its responsibility for meeting obligations ensuing from the supplementary supervision. According to the EFCC, the next revision of FICOD should not address the issues of systemically important financial institutions (SIFIs). A more specific proposal of the Directive will however be published only after the rules contained in particular sectoral directives (primarily Solvency II and CRD IV) have been stabilised and the functioning of the Banking Union has been clarified in order to ensure mutual compliance.

Expert Group of the European Securities Committee (EGESC)
This expert group met twice in 2012 (in March and in September). These meetings were focused on the revision of Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS V) and the Commission's delegated acts with regard to Directive 2011/61/EU (AIFMD) and the Prospectus Directive (2003/71/EC).

Early Intervention Working Group (EIWG)
The EIWG provides an expert forum for discussing proposals related to crisis management in the banking sector. Over the course of 2012, the member states had the opportunity to present their view of the individual

[53] The Solvency II Directive will however most likely not yet have taken effect at the time when the general guidelines are expected to be published (autumn 2013 and applicable at the start of 2014).

aspects of the crisis management framework that was being prepared. After the submission in June 2012 of the proposal for the directive establishing a framework for the recovery and resolution of credit institutions and investment firms, the discussion regarding this topic shifted to the level of the Council's Working Party on Financial Services (D03).

Government Expert Group on Retail Financial Services (GEGRFS)
GEGFRS is the EC's expert group that deals with the issues associated with retail financial services. Its tasks are primarily based on the Green Paper on Retail Financial Services in the Single Market published in May 2007. The EC's legislative and non-legislative proposals are presented during the group's meetings as well as various topics that are at the discussion stage. In 2012 the group formally met in March to discuss the current developments in the Commission's individual financial services agendas. Particular focus was placed on the issues associated with the basic payment account, transparency, the comparability of bank charges, the regulation of Packaged Retail Investment Products (PRIPs), the amended directive on insurance mediation, and others. The Commission also presented the conclusions and findings from some of its studies, specifically the public opinion surveys on retail services (Eurobarometer, and Internet Sweep on consumer credit).

Market Infrastructure Working Group – Central Securities Depositories (CSDWG)
The CSDWG focuses on preparing the regulatory framework for central securities depositories. On the one hand the aim of the regulation should be to improve the level of certainty associated with the services provided by the central securities depositories. On the other, it should create a framework that ensures improved cross-border operations. The Commission's proposal was published in March 2012 and is currently under discussion at the Council's expert level.

Payments Committee (PC)
The PC is the Commission's permanent advisory committee for issues associated with payment services legislation and generally meets twice a year. The committee's meetings are held with the participation of the representatives from the member states. Representatives from the ECB, the EFTA and EEA states, and the candidate states to the European Union participate in the role of observers. The committee's agenda currently includes issues associated with Directive 2007/64/EC on payment services in the internal market, Directive 2009/110/EC on electronic money, Regulation (EC) No 924/2009 on cross-border payments in euros, and Regulation No 260/2012 establishing technical and business requirements for credit transfers and direct debits in euros.

Securities Law Directive Working Group (SLDWG)
The SLDWG is involved in the preparation of a proposal for a directive that will unify the law on indirectly held securities. The proposal was inspired by the work of the Legal Certainty Group (one of the Commission's advisory groups). The proposal aims to harmonise material law with regard to the provisions for indirectly held securities, which will lead to common rules and consequently increased legal certainty on the part of investors, cheaper cross-border operations, and decreased transaction costs. As of the end of 2012 the Commission's legislative proposal had not yet been published, even though it was expected prior to the end of 2011. The most recent information indicates that the Commission's proposal may be published either in June 2013 or this autumn.

Council of the European Union / ECOFIN

The Council of the European Union (informally referred to as the Council of the EU) brings together the ministers from the EU member states, who meet and adopt legislative acts and co-ordinate the functioning of individual policies. The key tasks performed by the Council of the EU include approving the EU's legislation, co-ordinating the main direction of the economic policies of the member states, signing agreements between the EU and other countries, approving the annual budget, developing the EU's foreign and defence policies, and co-ordinating the co-operation between the judicial organs and the police authorities in the member states.

The Council does not have any permanent members. Each of the member states sends its representative (minister) responsible for a particular area of policy to each of the Council's meetings. The Council thus meets in various compositions (there are ten in total) according to the area to which the discussed materials belong.

The ECOFIN Council is the Council of the EU configuration consisting of the economics and finance ministers from the EU member states (if budget issues are on the agenda to be discussed, the budget ministers also attend the meetings). The competencies of the Council include the adoption of measures in areas such as the coordination and supervision of economic policies; the monitoring of budgetary policy and the state of public finances in the member states; the euro as the single currency; taxes; the financial markets; the free movement of capital; and economic cooperation with third countries. In addition, every year the ECOFIN council works in conjunction with the European Parliament to prepare and approve the EU budget. The presidency of the ECOFIN Council rotates every six months according to a pre-approved sequence (the Czech Republic held the presidency during the first half of 2009). As a rule, the ECOFIN Council meets once a month. In addition, the economics and finance ministers meet informally in the presiding country once during its term. The governors of the central banks also participate in these informal meetings.

There are a number of expert committees as well as permanent and ad hoc working groups within the structure of the Council of the EU, who lead active discussions regarding legislative proposals. In the case of financial services, these comprise the Economic and Financial Committee, the Financial Services Committee, and the Working Party on Financial Services (referred to as D03).

In 2012 the activities of the ECOFIN configuration of the Council of the EU consisted of approving the General Approach documents for the Commission's proposals that were discussed by the Working Party on Financial Services as well as discussing the developments in the agendas for which discussions are still underway. The proposals for implementing a single supervisory mechanism, the proposals for amending the EU rules for the capital requirements of banks and investments firms, and various issues associated with the financial transaction tax became the priority topics during the course of the year.

During the ECOFIN Council meetings held in 2012, ECOFIN:

- updated its position on the proposed regulation on over-the-counter (OTC) derivatives, in order to make it possible to conclude the negotiations with the European Parliament during the first reading. The ECOFIN Council also took into consideration the working programme for economic and financial affairs presented by the Danish presidency, which specifies the strengthening of financial regulation and supervision as one key objective. (24 January 2012)
- adopted the regulation on short selling and certain aspects of credit default swaps, which implements common requirements for transparency at the EU level and unifies the powers that regulators may exercise in extraordinary situations when there is a serious threat to financial stability. Information was received about the results of the trialogue that took place with the European parliament and with the Commission on 9 February 2012 and at which an agreement was reached with regard to the regulation on OTC derivative transactions, central counterparties and trade repositories. At this meeting ECOFIN also evaluated the preparations for the proposal on deposit guarantee schemes after the European Parliament adopted its position on 16 February 2012 in the first reading. (21 February 2012)
- received information from the presidency about the preparations that are underway for a directive that aims to implement a financial transaction tax at the EU level and about the plans in place for developing this directive further. (13 March 2012)
- discussed the proposals for amending the EU's rules with regard to the capital requirements for banks and investment firms (CRD IV) in order to make it possible to launch discussions with the European Parliament with the aim of adopting the acts in question during the first reading. (2 May 2012)
- reached an agreement on the General Approach to two proposals to amend the EU's rules with regard to the capital requirements for banks and investment firms (CRD IV); approved the conclusions regarding the TARGET 2 Securities (T2S) project; discussed the progress attained within the Eurosystem and with regard to the appropriate involved parties; and confirmed its political support for the T2S system as a significant contribution towards the implementation of a single securities market. (15 May 2012)
- organised a political debate on the proposed directive aimed at implementing a financial transaction tax throughout the EU. ECOFIN also took into consideration the progress that has been made with regard to the proposed regulation and proposed directive for changing the EU's rules for capital

requirements for banks and investment firms (CRD IV); the proposed regulation and proposed directive regarding credit rating agencies (CRA 3); the proposed directive on credit agreements relating to residential property; and the proposal for a directive on the transparency requirements for companies listed on stock exchanges. (22 June 2012)

- received information from the presidency about the progress attained thus far during the discussion with the European Parliament regarding the proposed regulation and proposed directive for changing the EU's rules for capital requirements for banks and investment firms (CRD IV). ECOFIN also took into consideration the Commission's presentation about its proposal for a directive establishing the framework for the recovery and resolution of credit institutions and investment firms as well as the working programme for economic and financial affairs presented by the Cypriot presidency. (10 July 2012);
- confirmed the goal of attaining a political agreement with regard to the capital requirements for banks and investment firms (CRD IV) by the end of the year. ECOFIN also received information that eleven member states have either already submitted to the Commission a request for a proposal implementing a financial transaction tax through the enhanced cooperation procedure or are planning to do so. The former category consists of Germany, Greece, France, Austria, Belgium, Portugal, and Slovenia whilst the latter category includes Spain, Italy, Estonia and Slovakia. It remains up to the Commission to consider submitting the proposal for the Council's decision, which would allow this enhanced cooperation. (9 October 2012)
- discussed proposals for implementing a single supervisory mechanism for credit institutions in the eurozone and the other EU member states that choose to participate in this system. ECOFIN also evaluated the developments with regard to the implementation of a financial transaction tax in a number of member states that want to participate in enhanced cooperation and discussed how to proceed further in this matter. The Commission submitted a proposed Decision in which it allows enhanced cooperation in this area. The ECOFIN presidency provided information about the progress attained in the discussions with the European Parliament with regard to amending the EU rules for capital requirements for banks and investment firms (CRD IV). (13 November 2012)
- discussed proposals associated with the single supervisory mechanism, which is a key part of the more general plan to establish a banking union. ECOFIN agreed to convene an extraordinary meeting prior to the December's European Council meeting in order to reach an agreement that will make it possible to launch discussions with the European Parliament with the object of adopting a suitable version by the end of the year. ECOFIN was informed by its presidency about the political agreement reached with the European Parliament with regard to the proposals to amend the EU rules for credit rating agencies. It also received information from the presidency about the progress attained in the discussions with the European Parliament with regard to the capital requirements for banks and investment firms (CRD IV) and confirmed its commitment to reach an agreement with the Parliament by the end of the year. ECOFIN also discussed the most recent development in the situation to implement a financial transaction tax in some of the member states through the enhanced cooperation procedure. (4 December 2012)
- reached an agreement on the General Approach to the proposals aiming to implement a single supervisory mechanism for credit institutions. (12 December 2012)

At its meetings the ECOFIN Council also addressed the preparations for the European Council meeting and the preparations for a common ground for the G20 summit.

In addition, there were also two informal meetings of the finance ministers and the governors of the central banks. The first meeting took place in April 2012 under the Danish presidency and the discussions that took place primarily concerned the issues associated with crisis management, credit rating agencies, and the financial transaction tax. The second meeting took place in September of 2012 during the time when Cyprus held the ECOFIN presidency. The topics discussed included the banking union, shadow banking, and banking sector reforms (the "Liikanen Report").

At the start of 2013 the ECOFIN Council focused primarily on the revision of the directive on capital requirements (CRD IV) and addressed the current situation regarding the discussions about some legislative proposals (SSM, BRRD, MAD/MAR, and MiFID2/MiFIR).

Financial Services Committee (FSC) and Economic and Financial Committee

The Financial Services Committee (FSC) and the Economic and Financial Committee (EFC) are two of the ECOFIN Council's permanent committees.

The FSC provides a forum for the preliminary expert level discussion of issues associated with financial services and, together with the EFC, takes part in the preparations for the individual ECOFIN Council meetings. Representatives from the ministries of finance of the EU member states, the Commission, the ECB and the European supervisory authorities (EBA, ESMA, and EIOPA) participate in the activities of the FSC.

The EFC's activities primarily consist of monitoring the economic and financial situation in the member states, the eurozone, and the EU as a whole; submitting reports to the ECOFIN Council and to the Commission and participating in the preparation of the Council's activities in the economic and financial sector. The range of topics covered by the EFC is thus significantly broader than in the case of the FSC. The committee's meetings are held with the participation of representatives from the ministries of finance of the EU member states, the Commission, the ECB, and the national central banks.

During 2012 the financial market topics discussed by the EFC included, amongst others, bank recapitalisation; financial market development; the banking union and the implementation of a single supervisory mechanism; shadow banking; banking sector reforms (the "Liikanen Report"); regulatory dialogues with third countries; the Target 2 Securities Project; the preparation of selected legislative proposals (e.g. MiFID, MAD, the Transparency Directive, and ICSD); issues associated with the functioning of the European supervisory authorities and the European Systemic Risk Board; international accounting standards; the implementation of a single Legal Entity Identifier (LEI); financing for small and medium-sized enterprises; improved consumer protection in the financial markets; credit rating agencies; and the implementation of the Volcker Rule. The committee also participated in the preparation of a common ground for the G20 Summit regarding the issues discussed by the Financial Stability Board (FSB).

In 2013 the committees are continuing their discussions regarding issues associated with the implementation of a single supervisory mechanism, developments on the financial markets, a single Legal Entity Identifier, and banking sector reforms.

Working Party on Financial Services (D03)

The Working Party on Financial Services is one of the Council of the EU's preparatory bodies, which discusses the relevant Commission proposals for financial market legislation prior to the time they are submitted to the ECOFIN Council. The Working Party thus covers a wide range of topics which vary according to the current stage of negotiations regarding a particular legislative proposal and if any new proposals were published. The meetings of this working party include the participation of experts from the individual EU member states, who are led by the expert from the presiding EU state. In most cases, the member states are represented by their financial attachés only during later phases of the discussion on the proposals.

The Council's Working Party on Financial Services discussed the following topics in 2012:

- the proposal for a new directive on deposit guarantee schemes (the DGS Directive); trialogues covering this topic took place in 2012;
- the proposal for an amendment of directive on investor compensation schemes (ICSD); trialogues covering this topic took place in 2012;
- the proposal for directive and for a regulation on capital requirements (referred to as CRD IV and CRR respectively); the General Approach was approved in May 2012 and trialogues were subsequently launched;
- the proposal for a directive on credit agreements relating to residential property (the CARRP Directive); the General Approach was approved in May 2012 and trialogues were subsequently launched;
- the proposals for a regulation on European Venture Capital Funds (EuVECA) and a regulation on European social entrepreneurship funds (EuSEF); trialogues were launched in June 2012;
- the proposed amendment of the Transparency Directive; trialogues were launched in June 2012;
- the proposed amendment of the regulation on credit rating agencies (NORA3); trialogues were launched in June 2012;

- the proposal for a directive amending the Prospectus Directive and the Solvency II Directive with regard to the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (ESMA) – referred to as Omnibus II. Trialogues were held in 2012; however they were not successfully completed by the end of the year. In 2012 the parties to the trialogue decided to perform an impact study on the topic of "Long-Term Guarantees" scheduled to start in January 2013. Once the impact study is completed, the trialogues concerning the proposed directive will be resumed;
- the proposal for a regulation on market abuse (MAR); the General Approach was approved in December 2012 and trialogues were subsequently launched; and
- the proposal for a single supervisory mechanism for credit institutions; the General Approach was approved in December 2012 and trialogues were subsequently launched; on 18 April 2013 COREPER approved the final compromise versions of both proposals as agreed by the Council of the EU and the European Parliament.

The Council's Working Party on Financial Services also discussed proposals for establishing a recovery and resolution framework for credit institutions and investment firms; the directive on markets in financial instruments (MiFID2); the regulation on markets in financial instruments (MiFIR); the proposed amendments to the UCITS IV directive (referred to as UCITS 5); the proposed amendment to the directive on insurance mediation (IMD2); the proposal for a Regulation on key information document for investment products (PRIPs); and the proposal for a regulation on central securities depositories (CSDs). By the end of 2012 the discussions on these topics had not yet reached the General Approach approval phase. More information on the individual proposals that were discussed is provided in Chapter 10.3.

European Council

The European Council is the European Union's most important political body and comprises the highest representatives from the member states (heads of state and prime ministers) and the President of the Commission. The European Council meets at least four times a year and defines the general political directions for the EU. The European Council does not perform any legislative functions. After each of its meetings it is obliged to submit a report on its meeting to the European Parliament. The EP also receives an annual written report prepared by the European Council regarding the progress achieved by the Union.

The topics addressed by the European Council during its meetings in 2012 included, amongst other things, the issues associated with the discussions about some of the legislative proposals for implementing a single supervisory mechanism, capital requirements for banks, and crisis management.

10.2. Ministry of Finance's Activities on an International Level

OECD

The Organisation for Economic Co-operation and Development is an intergovernmental organisation of the worlds' thirty-four most developed countries, which have all adopted the principles of democracy and a market economy. The OECD was established in 1961 through the transformation of the Organisation for European Economic Co-operation (OEEC). The OEEC was originally established in 1948 to help administer the post-war Marshall Plan. The OECD coordinates the cooperation of its members in the sphere of economic and social policy, negotiates new investments, and promotes the liberalisation of international trade. The OECD's objectives are to facilitate further economic development; to suppress unemployment; and to stabilise and develop the international financial markets. The most important bodies within the OECD structure include the Council comprising the ambassadors from the OECD member states, the Executive Committee, the Secretariat led by the Secretary- General, and several expert committees.

Some of the OECD's activities transcend the national boundaries of its member states. The International Network on Financial Education (INFE) is only one example.

<u>OECD Committee for Financial Markets (OECD CMF)</u>

The CMF is the OECD's main body involved in financial market issues. It provides a platform for discussing the development trends in financial markets and the relevant measures for improving their functioning both in individual countries as well as at the broader supranational level. The members of the CMFS consist of representatives from the ministries of finance, central banks, and other regulatory and supervisory authorities. Representatives from international financial institutions, such as the International Monetary Fund, the World Bank, and the Bank for International Settlements in Basel, also participate in the committee's meetings, as well as representatives from associate countries with rapidly developing economies. The OECD CMF therefore provides a geographically broader platform for debate and the exchange of experience than is provided by other mechanisms, such as discussions between the member states of the European Union.

A very specific characteristic of the committee's activities consists of the regular meetings with representatives from the private financial sector, at which important topics of common interest to both the public as well as the private sectors are discussed, particularly development trends in the global financial market. The main topics discussed in 2012 included issues associated with current market development around the world; experience in implementing financial sector reforms leading to stabilisation; the regulatory systems used by important institutions; and government guarantees towards the financial sector. In 2013 the CMF will, amongst other things, return to the topic of financing for long-term investments and will continue to discuss the steps taken by the world's most important central banks in their efforts to stabilise the financial markets and renew economic growth.

<u>OECD Insurance and Private Pensions Committee (OECD IPPC)</u>
The IPPC is the main OECD body that addresses insurance market issues, the supervision of the insurance sector, and private pension issues (i.e. non-public pension security schemes). Within the IPPC, the Working Party for Private Pensions (WPPP) deals specifically with private pensions issues. The IPPC strives to attain international cooperation, coordination, and a higher level of compatibility with regard to the supervision of the aforementioned sectors of the financial market. The Committee comprises representatives from the ministries of finance and those state administration authorities who are responsible for the insurance sector and private pensions. Representatives from the supervisory authorities of the OECD member states also participate in the IPPC meetings. In the case of open meetings, insurance market and trade union representatives may also attend.

The main topics that the IPPC focused on in 2012 consist of the global development of the insurance market; annuity issues (pension insurance); longevity risk (i.e. the risk of higher than expected growth in the average life expectancy); the relationships between institutional investors and long-term investments, or, more specifically, the effect that the insurance sector has on long-term growth and stability, including the issue of "green investments" in infrastructure. In addition, the IPPC addressed the topic of insurance against catastrophic risks and its financing; consumer protection; and an assessment of the development of the regulatory framework in Chile after that country's accession to the OECD. The negotiations regarding Russia's accession to the OECD also continued.

The Working Party for Private Pensions (WPPP) focused primarily on the following topics: the OECD's Global Pensions Statistics; the international comparability of statistics; optimal data collection methods; the classification of pension plans and the related methodology; longevity risk and the associated issue of retirement savings adequacy; long-term investments project and the impact of solvency regulations (including research focusing on large pension funds); and a revision of the Core Principles of Occupational Pension Regulation.

G20

The G20 brings together the finance ministers and the central bank governors from nineteen countries[54] *and the EU (which is represented by the presiding member state and the ECB). The G20 was established in 1999 as a forum in which the leading world economies are able to exchange their opinions regarding key issues related to the global economy. The Czech Republic is not a member of the G20 but is de facto represented by the representative for the European Union.*

Mexico was the G20's presiding country in 2012. At the June summit in Los Cabos, Mexico, the leaders:

[54] The member states of the G20 are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States of America.

- confirmed their commitment to ensuring that all standardised over-the-counter (OTC) derivative contracts are traded on stock exchanges or electronic trading platforms and cleared through central counterparties by the end of 2012. OTC derivative contracts should be reported to the Trade Repositories and any contracts that are not centrally cleared should be subject to higher capital requirements.
- welcomed the progress that has been attained with the implementation of Basel II, Basel 2.5, and Basel III and requested all of the jurisdictions to implement the standards according to the agreed schedule.
- confirmed their commitment to ensuring that the national crisis resolution systems will be consistent with the principles recommended by the FSB and that no bank or other financial institution can be designated as too big to fail;
- welcomed the progress made with developing the principles for identifying domestic systemically important bank.
- voiced their support for further activities towards strengthening the supervision and regulation of shadow banking;
- called upon the competent authorities to move forward with the process of ending mechanical reliance on ratings and supporting measures that will lead to increased transparency and competition between the credit rating agencies; and
- approved the FSB's recommendations for a framework for developing a Global Legal Entity Identifier.

10.3. European Financial Market Legislation

Single Supervisory Mechanism (SSM) for Credit Institutions

In September 2012, the Commission submitted proposals[55] for establishing a single supervisory mechanism for credit institutions in the eurozone, thus also transferring the supervisory powers from the national supervisory authorities to the ECB. Although the ECB will formally supervise all of the banks in the eurozone, as far as less significant banks (whether financially, economically, or from the perspective of prudential importance) and banks which neither requested nor receive financial aid from the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM) are concerned, the ECB will delegate its powers to the national supervisory authorities. The member states outside of the eurozone will have the possibility to enter into close cooperation with the ECB and thus subject even their banks to ECB supervision. The proposals were discussed by an ad hoc working group established by the Council. From the perspective of the Czech Republic, the key issues include the way in which the voting procedure for the European Banking Authority (EBA) is defined; the transformation of subsidiaries into branches; and the position of the member states who enter into a close cooperation with ECB. On 12 December 2012 the ECOFIN Council approved the General Approach and trialogues with the European Parliament were subsequently launched during which the regulation on the ECB was only consulted with the EP. On 18 April 2013 COREPER approved the final compromise versions of both proposals as they had been agreed by the Council of the EU and European Parliament. The next step consists of the formal approval of the proposals by the European Parliament and by the Council of the EU. The single supervisory mechanism should become functional twelve months after the legislation is published in the Official Journal of the European Union, which should be in approximately mid-2014.

Crisis Management (BRRD)

In June 2012 the Commission submitted its proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms. This directive aims to ensure the avoidance and resolution of crises in the case of selected entities in the financial market, specifically credit institutions and investment firms, and to thus ensure that the stability of the financial markets and public finances are protected (the costs associated with the measures should be borne primarily through the bail-in of shareholders and creditors). The proposal is divided into three basic sections, which include the powers of the supervisory authority with regard to preventative measures, the powers associated with early

[55] A proposal for a regulation amending Regulation 1093/2010 establishing a European Supervisory Authority (European Banking Authority), and a proposal for a regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

intervention, and the crisis resolution tools and powers. The subject of the proposed legislation is to resolve difficulties of specific entity or group through newly established authorities (resolution authorities) with the use of certain mechanisms, such as a bail-in tool (the write down, or conversion, of shareholder assets and the claims held by creditors as a part of the resolution) or the transfer and sale of the healthy part of the entity to the state or a third party. The Council's D03 Working Party began discussions on the proposal during the second half of 2012 and these discussions are continuing in 2013. From the perspective of the Czech Republic, the key concerns include the balanced division of competencies between the host and home supervisory authorities, as well as the issue of financing. It is expected that the General Approach will be approved during the first half of 2013.

Guarantee Schemes (DGS and ICSD)
The proposal for a new directive on deposit guarantee schemes (DGS) primarily aims to unify the functioning of national guarantee schemes in the banking sector and to provide better protection for depositors. On 17 June 2011 the General Approach was approved at the COREPER meeting and the trialogues with the European Parliament were launched; they continued through the first half of 2012. Within the negotiations, the Czech Republic considers the key issues to be the reduced payout period, the cross-border sharing of resources, and the use of resources from the deposit guarantee fund for the purposes of crisis management. As a result of the submission of the proposal for the crisis management directive in June 2012 and its close links to the directive on deposit guarantee schemes, which will have to be taken into account, the negotiations for the directive on deposit guarantee schemes was suspended until the time that the finalised version of the crisis management directive is approved.

According to the Commission, the proposed amendment to the directive on investor compensation schemes (ICSD) is a response to the developments and changes in the conditions on the capital market since the publication of the original text of the directive in 1997. There is also a need to remove the gaps in investor protection that have been discovered in practice. The General Approach for the directive was approved at the COREPER meeting on 23 November 2011. There has however been no significant progress made in negotiations since that time. As is the case with the DGS Directive, the process has been suspended until the finalised version of the crisis management directive is available. The key concerns that the Czech Republic has consist primarily of the financing method for the ICS, the obligatory mutual borrowing between the national investor compensation schemes, and the compensation limit.

Capital Requirements (CRD IV and CRR)
Activities associated with the revision of the capital requirements directives (2006/48/EC and 2006/49/EC) continued at the level of the Council of the EU during 2012. These two directives will be replaced with one directive and one regulation (referred to as CRD IV and CRR respectively). Meetings were held within the framework of the Council of the EU's Working Party with the active involvement of representatives from the MoF acting in cooperation with the CNB.

The discussions on the full scope of the proposals for the directive and for the regulation as submitted by the Commission were completed during the first half of the year. The subsequent discussions have been limited to those sections of the proposals which the member states consider to be the most problematic. The disputed areas include issues such as the maximum harmonisation requirement or, more specifically, the flexibility of the interventions of the supervisory authorities in the case of unfavourable development; liquidity issues (i.e. liquidity standards and supervision of the liquidity of branches); the leverage ratio; the definition of capital; cooperation between the host and home country supervisory authorities; the provisions regarding sanctions; and corporate governance. From the Czech Republic's point of view the most critical areas of interest consist of liquidity issues and the cooperation between the host and home country supervisory authorities, including the distribution of their powers and issues associated with the competencies of the European Banking Authority (EBA). The MoF and the CNB worked intensively on preparing statements to present at the Council meetings, including written comments responding primarily to the issues that are of key importance for the Czech Republic.

On 6 January 2012 the Danish presidency submitted the first compromise proposal. The General Approach was submitted to the finance ministers for their approval at the ECOFIN Council meeting on 15 May 2012.

During the second half of the year the negotiations were launched with the European Parliament in the form of trialogues. The discussions were focused on selected parts of the directive and the regulation, e.g. on liquidity, the maximum harmonisation requirement, corporate governance, sanctions, capital, remuneration, the powers of the EBA, crisis management, and the treatment of investment firms. In addition, the meetings of the Council of the EU's working party continued at the level of the financial attachés, for which the MoF prepared further opinions and proposals in conjunction with the CNB with the aim of ensuring that the legislative proposals for the directive and for the regulation do not significantly stray from their versions in the approved General Approach, which contains the desired balance in the areas that of key importance for the Czech Republic, i.e. the issues associated with the relationship between the host and home country supervisory authorities, liquidity, and the non-strengthened powers of the EBA.

The target effective date for the proposed legislation (1 January 2013), which was based on the Basel III reforms and the EU's commitment as a G20 member, was not met as the meetings regarding the submitted legislative proposals were still continuing at an intensive level during the second half of 2012. It is possible to expect that the anticipated date for the legislation to take effect will be set as 1 January 2014.

Basic Payment Account

A public consultation on the Commission's materials entitled "Consultation on Bank Accounts" took place from 20 March 2012 to 12 June 2012. The topics were divided into the following three sections: the transparency and comparability of bank account fees; bank account switching; and access to a basic payment account (the account would provide every legal resident of the EU with at least the basic services associated with opening, maintaining, and closing a payment account; and deposits, withdrawals, and transfers, including debit card transfers and direct debits, either free of charge or for a reasonable fee). This consultation was a follow-up to the Commission Recommendation 2011/442/EU from 18 July 2011 on access to a basic payment account. The Commission determined that the situation in the majority of the member states is unsatisfactory and is preparing to submit a legislative proposal during the first half of 2013. Given the situation in the Czech Republic the Ministry of Finance does not consider another legislative solution on access to a basic payment account to be necessary. There is already an offer of payment accounts in the Czech Republic that meet the requirements for a basic payment account as defined in the aforementioned recommendation. The main reason why payment accounts are not opened is because sufficient proof of identity is not presented or other conditions required by anti-money laundering legislation are not met.

Alternative Dispute Resolution (ADR)

On 22 April 2013 the Council of the EU formally approved the compromise solution for the legislative proposals submitted in December 2012 for a directive on alternative dispute resolution (ADR) and a regulation for online dispute resolution (ODR). Both of the European legislative acts shall be published in the Official Journal of the EU at the end of May 2013. The ADR directive must be transposed into national law within two years of the date it is published in the Official Journal. The ODR regulation will enter into effect six months after this date.

Consumers will be able to submit a dispute that arises between a consumer and a trader in connection with the sale of goods or the provision of services to an ADR entity. The use of the ADR process is not compulsory for either the consumer or the trader. The ADR entities will have to be able to accept online submissions (due to the implementation of the associated ODR regulation). The directive does not provide detailed provisions for the process that the ADR entities should follow. It does however establish that any procedural rules that are applied may in no way make the consumer's access to ADR more difficult. The proposal defines certain minimal qualitative requirements for ADR entities, specifically with regard to impartiality, transparency, effectiveness, and fairness. The ADR process should be provided to the consumer either free of charge or costs should not exceed a nominal fee.

As the issue involves general consumer provisions, the responsible governmental authority of the ADR and ODR legislation is the Ministry of Industry and Trade. As the provisions also affect financial services, the MoF provided its comments for both proposals, particularly with respect to the adequate obligation of traders to provide information about ADR entities and that ADR should strengthen the consumer´s position as the weaker contractual party and traders should not be able to initiate a dispute through an ADR entity. The MoF successfully promoted its recommendations in the vast majority of cases.

Consumer Credit Directive (CCD)
On 8 May 2012 the Commission published the Guidelines on the Application of Directive 2008/48/EC in relation to costs and the Annual Percentage Rate of Charge (APRC). After the public consultation on the Commission's website[56], the EC also published a new version of the simulator for calculating the APRC for consumer credit, which also takes into account Directive 2011/90/EU. This tool makes it possible to input model parameters and monitor the relevant indicators for individual types of consumer credit in accordance with the applicable European and national legal provisions. The simulator is also available in Czech.

Mortgage Loans
During the first half of 2012 the Danish presidency intensified the discussion regarding the proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property (COM(2011)142), which aims to unify and support the internal mortgage loan market. On 16 May 2012 a qualified majority vote made it possible to submit the proposed directive to COREPER II, which approved the General Approach on 30 May 2012. In June 2012 the European Parliament presented its report on the Commission's legislative proposal, which contained numerous recommendations for changes that far exceed the scope of the proposal for the directive. For the most part, these changes consist of many exemptions from the jurisdiction of the directive aimed at certain products offered on the mortgage loan market, particularly in the UK; and modifications to the following areas: the legislatively mandated obligation of the state to ensure the financial education of consumers; packages / combined products and unfair business practices; real estate valuation; loans made in foreign currencies and the right of the consumer to convert a mortgage loan into a different currency; the transferability of loans (to another pledged real estate, even in another country); the procedure associated with implementing a lien; and supervision of the credit registers. Technical trialogues took place starting in June 2012 to clarify the main disputes, which subsequently became the subject of political trialogues.

Further meetings of the Council of the EU's working group were held concurrently with the trialogues. Although the majority of the member states did not agree with the recommendations made by the European Parliament, during the trialogues, which were completed in April 2013, the Irish presidency yielded to the European Parliament in many respects. The proposed directive in the version agreed with the European Parliament was approved at the level of COREPER II on 8 May 2013.

Markets in Financial Instrument (MiFIR II and MiFID II)
On 20 October 2011 the Commission published its proposed amendment to the directive on markets in financial instruments (MiFID 2) and its proposal for a regulation on markets in financial instruments (MiFIR). Both MiFID 2 and MiFIR represent a comprehensive amendment and replace the current directive on markets in financial instruments. Amongst other things, these legislative proposals aim to expand the regulatory framework to include a new organised trading facility (OTF); to implement rules for pre- and post-trade transparency for the bond and derivative markets; to increase the supervision of commodity derivative markets; and to implement a notification requirement for investment positions. At the more general level, stricter requirements will be instituted with regard to managing a client's assets, investment consultancy, and the offering of comprehensive financial products.

The MoF still has serious doubts, particularly with regard to the defined regulatory framework for the bond and derivative market, as the Commission would de facto define all of the exemptions from the obligation to provide information about offers (pre-trade transparency) and information about closed deals (post-trade transparency) for all shares, bonds, and derivatives. In addition, this method of using delegated acts to define exemptions is very unpromising as it does not make it possible to regularly (at least on a monthly basis) recalibrate the entire system of exemptions according to fluctuating market liquidity (liquidity fluctuates primarily in the case of bonds). In addition, the entire regulatory framework can function without any negative effects only in the case of highly liquid financial instruments. In the case of less-developed markets and less liquid financial instruments, including state bonds, there might be a significant departure of investors, which would consequently lead to the liquidation of these small markets. At the moment the MoF is trying to obtain a more flexible regulatory framework for less liquid state bonds.

[56] http://ec.europa.eu/consumers/rights/fin_serv_en.htm#credit

Meetings of the Council of the EU's working party are still underway at the level of the financial attachés and a consensus has not yet been reached with regard to some very political issues. The question as to when the General Approach will be approved and the trialogues with the European Parliament will be launched still remains unanswered.

Market Abuse (MAD, MAR)
On 20 October 2011 the Commission published a proposal for a regulation on insider dealing and market manipulation (market abuse), referred to as MAR, which will replace the current directive on insider dealing and market manipulation (market abuse), referred to as MAD. At the same time it published a proposal for a directive on criminal sanctions for insider dealing and market manipulation, referred to as CSMAD. Amongst other objectives, these legislative proposals will expand the regulatory framework to include two new types of trading facilities (MTF and OTF); strengthen the supervision of the commodity and emission permit markets; and establish a single framework for imposing sanctions. During the course of the discussions, the Czech Republic voiced its doubts about the inclusion of emission permits and commodities under the supervision of the financial market supervisory authorities. In addition, the Czech Republic promoted the retention of national discretion with regard to the automatic submission of list of inside traders. The approval of MAR and the date when it takes effect are dependent upon the approval and effectiveness of MiFID 2, even though it is expected that the discussions regarding MAR will finish first.

Transparency Directive (TD)
On 26 October 2011 the Commission published a proposal for a revised transparency directive, which aims to increase the level of investor confidence thanks to equal transparency requirements for security issuers and investors throughout the entire EU. According to the submitted proposal, the key changes in the revised transparency directive include the repeal of the requirement to publish interim management reports; a greater level of harmonisation with regard to reporting the share of voting rights; more precise rules for selecting the domicile state in the case of issuers from third countries; the implementation of a new requirement for country-by-country reporting; and establishing a new framework for imposing sanctions. The trialogues for this directive were launched in June 2012. Further discussions were subsequently suspended due to the links between the transparency directive and a directive on accounting, which provides a general solution for the country-by-country reporting that is specified in the revised TD. After the accounting directive was approved, the discussions on the revised transparency directive were resumed at the level of the financial attachés. Trialogues took place in the first half of 2013, during which the European Parliament voiced its intent to vote on the proposal in mid-June 2013.

Credit Rating Agencies (CRA 3)
On 15 November 2011 the Commission presented a proposal for the amendment of the regulation on credit rating agencies and a proposal for a directive amending directive 2003/41/EC, 2009/65/EC, and 2011/61/EU in respect of the excessive reliance on credit ratings.

One of the key elements of the regulation on credit rating agencies that is currently still in force is a single authorization and supervisory regime for credit rating agencies and the publication of ratings, which are used in those cases when the EU requires an assessment of the quality of a certain financial instrument on the basis of ratings. With its new proposal, the Commission aims to reduce the excessive reliance of financial institutions on external ratings; to increase the transparency of credit rating agencies; to institute a rule for the obligatory rotation of credit rating agency in the case of publishing ratings as a result of resecuritisation; and to implement civil law liability rules for credit rating agencies.

In the case of the proposal for the directive, the primary aim is to reduce the level of dependence on ratings by assigning to the fund managers the task of implementing measures that will ensure that they will not exclusively or mechanically rely on external ratings when assessing the quality of the asset values included in Undertakings of Collective Investments in Transferable Securities (UCITS) and alternative investment funds (AIF). It is expected that both the regulation and the directive will be published in the Official Journal of the EU at the end of May 2013.

European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF)

On 7 December 2011 the Commission published a proposal for a regulation on European venture capital funds and a proposal for a regulation on European social entrepreneurship funds. These legislative proposals institute a "European passport" for funds managers who do not fall within the scope of the AIFMD ("below-threshold fund managers). These regulations assign to the funds the obligation to invest at least 70% of their assets in small and medium-sized enterprises, which, according to the Commission, should have a positive effect on the access these enterprises have to financing. The Czech Republic has supported both of the proposals since the very start. The trialogues for these legislative proposals started in June 2012. However, due to the issues associated with third countries (particularly tax havens), they did not finish until December 2012. Both regulations were published in the Official Journal of the EU in April 2013 and will take effect on 22 July 2013.

Revision of the UCITS IV Directive (UCITS V)

On 3 July 2012 the Commission published a proposal for an amendment to the directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with respect to the activities of depositories, the rules for remuneration, and sanctions (referred to as UCITS V). This legislative proposal brings the UCITS provisions into line with the AIFMD with regard to the depository regime and remuneration, and also onto compliance with other legislative proposals for harmonising sanctions. The Czech Republic supports the maximum possible level of unification for the depository regime according to the AIFMD and the UCITS Directive. It also agrees with the proposal to establish general requirements for the remuneration of individuals; however it is against defining rules at a very high level of detail. As far as the provisions for sanctions are concerned, the Czech Republic believes that it will be very difficult to reach a consensus. It is expected that the proposal will be approved some time during 2013.

Supervision of Financial Conglomerates (FICOD 1)

On 10 June 2013 the deadline expires for the implementation into national law of Directive 2011/89/EU of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate (referred to as FICOD 1). The aim of this amendment is to improve the effectiveness of the supplementary supervision prior to the Commission's full review of Directive 2002/87/EC of 16 December 2002 on the on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC (referred to as FICOD). The analysis of the fundamental revision of Directive 2002/87/EC and the conclusions from this analysis were summarised in a Commission's Report published in December 2012. The Commission also employed answers to the call for advice submitted by the Financial Conglomerates Sub-committee within the Joint Committee of European Supervisory Authorities. Based on this report, it appears that the Commission does not intend to publish the proposal for a new directive until the rules in the sectoral directives for banking and the insurance sector are finalised. Taking into account the size of domestic financial institutions and considering that the majority of them are controlled by foreign parent companies, the Czech Republic does not consider the need for a fundamental revision of the Directive to be acute and the MoF voiced its support for holding back legislative proposals until the provisions for the individual sectors have been stabilised.

Insurance Regulation (Solvency II and Omnibus II)

Within the insurance legislation, the existing set of directives, cumulatively referred to as Solvency I, is being replaced by a new regulatory regime as defined in Directive 2009/138/EC of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (referred to as Solvency II). The objective is to thoroughly harmonise the rules for supervision and to unify the requirements for solvency, the calculations of technical provisions, valuation, management and reporting on the basis of an economic risk based approach.

The Solvency II directive has already been amended by Directive 2011/89/EU (referred to as FICOD1), specifically in relation to the revision of Directive 2002/87/EC on the supplementary supervision of financial entities in a financial conglomerate. In addition, revisions were made by Directive 2012/23/EU in the form of a “quick fix” with the aim of preventing the Solvency II directive from taking effect on 1 November 2012 as stated in the original text and postponing this date until 1 January 2014.

The implementation of the Solvency II directive is practically impossible without the changes to it that are defined by the proposal of the directive amending Directives 2003/71/EC and 2009/138/EC with respect to the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (referred to as Omnibus II). The purpose of the Omnibus II is to adapt Solvency II within the context of the Lisbon Treaty and to reflect the establishment of the European Supervisory Authorities (particularly the European Insurance and Occupational Pensions Authority – EIOPA). The Omnibus II proposal also provides a solution to certain aspects exceeding the scope of changes associated with the Lisbon Treaty and the creation of the EIOPA (namely the provisions for risk-free interest rate term structure in relation to the long-term guarantees and other factors, such as equivalency of regulatory and supervisory regimes of third countries and reporting). The discussions at the trialogue level stopped at the topic of long-term guarantees, specifically with regard to the provisions that help to alleviate the effects of the artificial volatility of the financial position of insurance undertakings that offer products with long-term guarantees, resulting from fluctuations in values of assets and liabilities when valuation is performed under the Solvency II regime. For this reason, in July 2012 the parties of the trialogue decided to commission an impact study concerning the provisions that address long-term guarantees. The study will be performed by insurance undertakings, reinsurance undertakings, the supervisory authorities, and EIOPA starting in January 2013. The results will be compiled in a Commission’s Report and should be available in June 2013. At that point it will be possible to renew the trialogue discussions (which are expected to end without any problems, however, taking into account the developments up to now, it is not possible to exclude the possibility that complications might arise). It will also be possible to start preparing the measures at Levels 2 and 3 of the Lamfalussy Process.

The Czech Republic supports the speedy completion of the discussion on the Omnibus II directive’s proposal, however it does not believe that the quality of the final proposal, and consequently the proper and stable functioning of the Czech insurance market, should be sacrificed. During all of the discussions that have taken place to this time, the Czech Republic has placed emphasis on the cautious definition of the rules for adjustments of the risk-free interest rate term structure as regards long-term guarantees and for the reporting rules. The final version of these provisions will be negotiated during the continuing trialogue. The Czech Republic has taken a critical stance concerning the expansion of the binding mediation activities led by EIOPA during the resolution of cross-border disputes between the national supervisory authorities. During the trialogues the Czech Republic will continue to strive for a balanced approach for assessing the equivalence of the supervisory regimes in place in third countries.

Another quick fix to the Solvency II directive deferring the effectiveness of the Solvency II directive cannot be avoided. It is expected that the effective date for the Solvency II directeve (as amended by Directive 2011/89/EU and the Omnibus II directive) will be postponed until 1 January 2016. This appears to be advantageous, particularly with regard to the additional time that will be provided for the preparation of delegated acts at Level 2 of the Lamfalussy Process and for the preparation of the regulatory and implementing technical standards at Level 3, the proposals for which are being prepared by the EIOPA. Just as importantly it also allows sufficient time to implement the Solvency II regime into national legislation and to prepare the insurance sector for the implementation of this regime in practice.

Insurance Mediation (IMD2)

In June 2012 the Commission published a proposed amendment to the Directive on insurance mediation (IMD2). This legislative initiative reflects the need to resolve certain problems that arose during the transposition of the original Insurance Mediation Directive from 2002 into the national legislation for this particular sector of the financial market. The Commission had already promised to perform a revision at the start of 2010. However, as a result of the links between the amendment and the Solvency II Directive, the revision to the Markets in Financial Instruments Directive (MiFID), the prepared UCITS V Directive, and the prepared Regulation for packaged retail investment products (PRIPs), the proposal for IMD2 was not published until mid-2012. Based on the results from the Commission’s review of the Directive, it became apparent that there is a need to limit the existing level of variations that exist in the national provisions for insurance mediation, to strengthen consumer protection, to ensure the internally consistent and mutually neutral (with regard to products and distribution) regulation of financial services as a whole, to unify the approach towards supervision and administrative sanctions; and to simplify and clarify the regime for cross-border activities in the EU's internal market.

During 2012 the IMD2 proposal was discussed at the level of the Council's working parties. As a result of the numerous issues for which Member states could not reach the required consensus these negotiations will continue in 2013. On the basis of its own national legislative objectives, the Czech Republic fully supports the idea of revising the regulatory framework for insurance distribution as well as the main pillars of the new Directive. During the discussions of the Council's working groups, the Czech Republic drew attention particularly to the need to clarify the characteristics of the individual types of insurance distributors in the amendment as well as the associated issues of an appropriate registration and supervisory regime. The Czech Republic also supports the intended expansion of the scope of the Directive to also include the insurance products directly offered by insurance undertakings.

Key Information Documents for Investment Products (PRIPs)

In 2007 the ECOFIN Council called upon the Commission to review the internal consistency of the regulations in place for the information providing obligations associated with investment products offered to clients within the individual sectors of the financial market. The results of this review were published in 2009 in the Commission's Communication on Packaged Retail Investment Products (PRIPs). This Communication was the first time a mention was made of common community provisions that would most importantly unify the rules for the actions of investment product distributors and also define the obligations they have with regard to providing information to consumers. The regulation of these two areas associated with distribution should have been addressed separately and by means of a different legislative process. The Commission's proposals for the rules of behaviour in relation to clients negotiating the purchase of PRIPs were implemented in the applicable sectoral directives. The relatively uniform and universal foundation of the intended regulation (i.e. key information for investors), which applies to products across all sectors, makes it possible to create horizontal provisions in the form of a directly applied regulation. The Commission published its proposal for this Regulation in June 2012. The selection of this legislative tool also supports the monitored objective, specifically to ensure maximum comparability of the investment products offered on the internal market. The key elements and characteristics of the proposal consist of its application for a relatively broad range of investment products or, more specifically stated, products that have an associated investment element; its multi-level (Lamfalussy) regulatory structure; and the idea of Key Investor Information Documents (KIID) inspired by the UCITS Directive.

During 2012 the proposal for the Regulation was discussed at the level of the Council's working parties. However, the negotiations were not successfully completed by the end of 2012 and thus the member states will continue in their efforts to reach a consensus for the General Approach in 2013. Taking into account its own national conceptual objectives for regulating the distribution of financial services, the Czech Republic is a long-time supporter of the EC's legislative initiative for PRIPs. Within the context of the consultations regarding the Commission's emerging proposal and also at the level of the individual working parties of the Council, the Czech Republic has, in particular, been promoting that the broadest possible range of products be included within the scope of the Regulation. On the other hand, the Czech Republic has requested that the provisions that are ultimately chosen take into consideration the needs of the individual Member states with regard to the specifics of their markets, i.e. the Regulation should not interfere in the national pension systems and in the out-of-court dispute resolution procedures in place.

Financial Transaction Tax (FTT)

In September 2011 the Commission submitted a proposal for a directive on a common system of financial transaction tax. The legal basis for this proposal is Article 113 of the Treaty on European Union, which assumes the principle of uniformity. The aim of the proposal is to harmonise the conditions for taxation on the EU's financial market and to limit certain types of high-risk transactions (high-frequency trading). In addition, according to another proposal submitted by the Commission, the Financial Transaction Tax will become a new source of internal resources for the EU budget.

The proposal was discussed numerous times at all level of the Council. On 26 June 2012 the European Council reached the conclusions that a unanimous consensus on the proposal cannot be reached in the foreseeable future, as the opinions of the member states with regard to the existence and functioning of this type of tax reflect diametric differences. On 22 January 2013 the ECOFIN Council adopted a decision that allows eleven member states (Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia, and Slovakia) to continue working on a financial transaction tax system within the scope of enhanced cooperation in accordance with Article 326 et seq. of the Treaty on European Union. The decision was adopted by a qualified majority vote. The Czech Republic, together with Luxembourg, Malta, and the United Kingdom abstained from voting. The Czech Republic does not consider the reasons for implementing a financial transaction tax to be relevant. In the absence of an agreement at the global level, the implementation of this type of tax only in the countries of the EU would have a negative effect on the European market's competitive position at the global level and could lead to a relocation of trading from the EU – something the Czech Republic does not consider to be desirable.

Single Euro Payments Area (SEPA)
The main objective of Regulation 260/2012 of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009, is to set end-dates for replacing of current national euro credit transfer and direct debit schemes by SEPA payment instruments, and to define the requisite technical requirements. The SEPA regulation has defined 1 February 2014 as the date on which the existing national schemes for credit transfers and direct debits in euros will cease to exist and will be fully replaced by SEPA instruments, specifically the SEPA Credit Transfer (SCT) and the SEPA Direct Debit. The regulation also defines the technical requirements. In the case of non-eurozone countries, there requirements enter into force on 31 October 2016.

OTC Derivatives, Central Counterparties, and Trade Repositories (EMIR)
Regulation 648/2012 of 4 July 2012 on OTC (over-the-counter) derivatives, central counterparties and trade repositories is referred to as EMIR, or the European Market Infrastructure Regulation. Implementing measures are published for this regulation on a regular basis.

The main objective of EMIR is to decrease and, if possible, eliminate systemic risks with the assistance of several key principles, specifically a higher level of standardisation for OTC derivative instruments; the settlement of trades through central counterparties; the strict regulation of central counterparties; a higher level of transparency; and the obligation to provide information. In addition to the central counterparties and the trade repositories, both financial as well as non-financial institutions will be subject to regulation.

Proposal for a Regulation on Central Securities Depositories
The proposal for a regulation on central securities depositories, which was published by the Commission on 14 March 2012, is a part of a recently popular trend in the regulation of the market infrastructure. The rapid increase in financial instrument trading and the development of information technologies has led to the development of certain types of settlement systems, such as central counterparty clearing systems. It has significantly contributed to the robustness of these settlement systems and to their interconnection. All of these trends led to the fact that the market infrastructure is a key component of the capital market. Should this infrastructure fail, all trading on the EU's markets would come to more or less a complete halt. The main objective of the regulation is to increase the security of settlement system operations and to remove the legal obstacles that exist due to the national provisions on the functioning of the systems and the central depositories as the operators of these systems, particularly the obstacles associated with differing provisions for settlement periods and the standards for central securities depositories from the perspective of prudential regulation and the ability to access to the national central securities depositories and the systems operated by them. In the long run, there should be a full dematerialisation or immobilisation of all securities held in the central securities depositories.

Overall, the MoF views the proposed regulation in a positive light, as it will make it possible to offer cross-border central securities depository services, thus strengthening the competition in this segment of the market. In addition, the currently existing administrative obstacles that prevent the effective interconnection of the systems operated by the central securities depositories will be eliminated and prudential rules will be defined for the activities performed by the central securities depositories. At the same time it is necessary to define a sufficiently broad range of exceptions from the regulation for those central banks that operate settlement systems. At the moment discussions are underway in the Council of the EU's working parties at the level of the financial attachés and experts.

10.4. National Financial Market Legislation

Financial Market Supervision
As a result of the reforms to financial market supervision in the European Union, it was necessary to transpose the Omnibus I directive into the national legislation of the Czech Republic. This was done by means of a draft bill amending certain acts in relation to the reform of financial market supervisions at the EU level. The bill was passed and the act took effect in January 2012. During 2012 work continued on the preparation of a draft bill on financial market supervision, the objective of which is to unify the legal provisions for supervision contained in various sectoral acts and to consolidate them into one Act.

Deposit Guarantees
In 2012 the tasks associated with the amendment of Act No. 21/1992 on banks continued, specifically in order to transpose the Directive of the European Parliament and of the Council on deposit guarantee schemes into national legislation. However, the final version of the directive is not yet available.

Building Savings Schemes
The concept for the amendment to the legislation on building savings banks and building savings schemes proposes implementing the requirement of a justified purpose in order to receive the state contribution as well as a "product concept" for building savings schemes. According to the proposed amendment, it will be possible to use the state contribution received under a building saving scheme only for housing purposes. Another possible alternative was proposed that would allow the funds to be used as pension security; however this would be conditional on the transfer of all of the participant's funds into Pillar 3 of the Czech pension system. The amendment also expands the providers who are allowed to provide building savings schemes to include standard banks. The government approved the draft bill on 18 April 2012 and submitted it to the Chamber of Deputies of the Parliament of the Czech Republic for discussion. The first reading did not take place until February 2013.

Czech National Bank
Preparations were started for amending Act No. 6/1993 on the Czech National Bank, as amended, with the goal of removing some of the deficiencies in the national legislation that were identified by the European Central Bank and thus to bring this legislative act into compliance with the provisions of the Treaty on the Functioning of the European Union and the Statutes of the European Central Bank System and the European Central Bank. The draft bill also removes some deficiencies that the CNB encountered in practice after the Czech Republic's accession to the European Union and following the integration of financial market supervision in the Czech Republic. The draft bill was also supplemented to include provisions concerning financial stability and macro-prudential policies in response to Recommendation of the European Systemic Risk Board of 22 November 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3).

The preparation of the legislative text of the act continued during 2012 in intensive cooperation with the CNB. After undergoing the inter-ministerial review and comment phase, consultations with the ECB, and discussions with the Government's Legislative Council, the draft bill was approved by the government in October 2012 and it was recommended that the Act should take effect on 1 April 2013.

The first reading of the draft bill by the Chamber of Deputies of the Parliament of the Czech Republic took place on 6 February 2013. Given the lengthy discussions concerning the draft bill, a recommendation will be made to postpone the effective date until 1 July 2013.

Transposition of CRD IV into National Law
The tasks associated with preparing the draft bill to amend certain legislative acts with respect to establishing access to the activities of banks, credit unions, and investment firms and the supervision of these activities started at the end of 2011. The directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV), which is currently being prepared, will be transposed into this national act. In addition, this legislative amendment will adapt the legal regulations to comply with the prudential requirements of credit institutions and investment firms (CRR). The draft bill will amend the Act on Banks, the Act on Credit Unions, the Act on Undertakings on the Capital Market, and the Act on Building Savings and State Support for Building Savings. The draft bill was prepared on the basis

of the General Approach approved by the finance ministers at the ECOFIN Council meeting on 15 May 2012. The final approval of the directive and the regulation by the European Parliament and by the Council is expected by the end of June 2013.

Distribution of Financial Services

The Ministry of Finance is preparing the draft for a new Act on the distribution of financial services, which unifies the rules for offering and mediating financial products and services and for financial planning. The main objective of the new legislative provisions is to ensure the overall improvement of consumer protection on the financial market and to unify the material and procedural institutional principles for regulating of financial services distribution (business licence, qualifications, communicating with customers, out-of-court dispute resolution, etc.) both across all of the individual sectors as well as within various distribution channels.

The MoF also submitted a proposed amendment to the Act on Insurance Intermediaries and Independent Loss Adjusters, which was forwarded as a government bill to the Chamber of Deputies for discussion at the end of 2012. The key aspects of the amendment consist of a new system for classifying insurance intermediaries; changes in the registration process and supervision; new provisions for the system in place for verifying qualifications; measures that provide protection against a conflict of interest; and improving the information provided to customers. The draft bill specifies that the amendment should enter into effect starting on the first day of the month after the month in which it is published. This can be expected to occur at either the end of 2013 or the start of 2014.

Consumer Credit

The MoF prepared a government draft bill for amending Act No 145/2010 Coll. on consumer credit and amendments to certain related legislation, which was approved in the version containing the revisions proposed by the Chamber of Deputies and subsequently forwarded to the Senate. The draft bill, which was published in the Collection of Acts on 25 February 2013 and took effect on the day of its publication, eliminates some of the most critical unfair practices that occur on the consumer credit market in the Czech Republic and ensures an improved level of consumer protection as well as protecting the principles of responsible lending. In particular, this includes the prohibition of the use of bills of exchange in relation to consumer credit; the prohibition of using overpriced phone numbers starting with a "9" when providing or intermediating consumer credit; and the creditor's obligation to provide consumer credit only if the consumer's creditworthiness has been duly confirmed and it is obvious that the consumer will be able to repay the credit. It also defines in much more detail the relationship between consumer credit intermediaries and consumers. A consumer is allowed to withdraw from any consumer credit intermediation agreement without any penalties within fourteen days of the date the contract is concluded. The amended legislation also transposes into national legislation Directive 90/2011/EU providing additional assumptions for the calculation of the annual percentage rate of charge, in order to attain the highest possible reporting value and level of comparability of this credit indicator for any consumer credit for which not all of the parameters required for calculating APRC are known in advance (e.g. credit cards, revolving credit, overdraft loan, etc.).

Pension Reform

A number of legal regulations were adopted in 2012 which amend and supplement the legal provisions for Pillar 2 and Pillar 3 of the pension system, specifically Act No 426/2011 Coll. on Retirement Savings; Act No 427/2011 Coll. on Supplementary Pension Savings; and Act No 428/2011 Coll. amending certain legislation with regard to the adoption of the act on retirement savings and the act on supplementary pension savings.

Act No 397/2012 Coll. (on Retirement Savings Premium) and Act No 399/2012 Coll. (amending certain legislation with regard to the adoption of the act on Retirement Savings Premium) adapts the pension reform framework in response to the postponement of the effective date for Act No 458/2011 Coll., which amends certain legislation in relation to the establishment of a "single payment point" and other changes to tax and insurance legislation, from the originally proposed date of 1 January 2013 to 1 January 2015. The changes were necessary in order for the pension reform to start functioning on 1 January 2013 without the inclusion of the originally planned single payment point.

Act No 403/2012 Coll. amending Act No 427/2011 Coll. on Supplementary Pension Savings and other related legislation introduced the concept of "pre-retirement pensions". The aim of this legislation is to allow persons who will reach retirement age in no more than five years to obtain pensions from the supplementary pension savings system during a period when it might be difficult for them to find a job. The act also ensures that public health insurance will be provided to recipients of pensions from Pillar 3, as, during the time they are receiving these payments, they are considered to fall into the category of "state insured". In addition, the period during which pensions are received from Pillar 3 is excluded from the period used to calculate the state pension amount and thus the amount of the pension from Pillar 1 is not affected in any way.

All of the above-specified Acts took effect on 1 January 2013. A number of decrees associated with the pension reform acts were published in 2012. These included multiple Decrees of the Czech National Bank and Decree of the Ministry of Labour and Social Affairs No 423/2012 Coll. on an increase in pension amounts paid from a pension insurance policy. In addition the MoF prepared the text for Government Regulation No 361/2012 Coll. on key information documents for participants in supplementary pension savings and retirement savings.

Insurance Sector

In June 2012 the government submitted to the Chamber of Deputies a draft bill amending certain legislation in the insurance sector and the supplementary pension insurance segment in relation to the repeal of the exception from the principle of equal treatment in the European Union law. The bill was approved and took effect on 25 April 2013. Its aim is to bring the legal order of the Czech Republic into compliance with the ruling passed down by the Court of Justice of the European Union in Case C-236/09 (Test Achats – 2012/C 11/01), which terminates the exception that has thus far existed in Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services. The exception made it possible for there to be reasonable differences in insurance premiums and insurance benefits for individual types of insurance coverage if gender is a decisive factor for assessing the associated risk based on appropriate and accurate mathematical and statistical insurance methods. After the repeal of this exception, the use of gender as a factor for calculating insurance premiums and benefits for insurance purposes or for any associated financial services for individual types of insurance cannot lead to differences in insurance premiums or insurance benefits.

The submission of a draft bill amending Act No 277/2009 Coll. on the insurance industry in relation to the transposition into national law of Directive 2009/138/EC (Solvency II) was planned for September 2012. However, because the Omnibus II directive, without which the Solvency II directive cannot be implemented, was not approved in time and, in addition, the trialogues for the directive were suspended in order to allow the performance of an impact study regarding some problematic issues, the timeframe for submitting the draft bill to the government was postponed for an indefinite period of time. It is expected that the Omnibus II directive will be adopted some time in 2013 dependent on the results from the impact study. Only then will it be possible to continue working on the amendment. The new timeframe for submitting the amendment will depend on the results of the trialogues for the Omnibus II directive. It is also possible that it might be affected by another "quick fix" directive, which could change the dates for the implementation and application of the Solvency II directive.

At this time a government draft bill amending Act No 38/2004 on insurance intermediaries and independent loss adjusters and amendments to the Trade Licensing Act (Insurance Intermediaries and Loss Adjusters Act), as amended, as well as other related acts that were submitted to the Chamber of Deputies in November 2012 are currently in the legislative process.

10.5. Non-Legislative Financial Market Activities of the MoF

Anti-Debt Alliance (ADA)

The MoF participates in the activities of the Anti-Debt Alliance, which is an expert platform comprising representatives from various state institutions and non-profit organisations. The ADA was established in May 2011 on the basis of an initiative of the Ministry of the Interior's Department of Crime Prevention; Probation and Mediations Services; and the Association for Probation and Mediation in Justice. The goal of the Alliance is to search for solutions to the problems associated with over-indebtedness, which can lead even to a higher rate of repeat offenses. The ADA aims to connect with partners, including organisations from abroad, who are involved in the same issues, to draw on their analogous activities and to use their experience and analyses in order to create proposals that will minimise over-indebtedness and the associated risk.

The ADA's ten key objectives are expressed in the Founding Statement of the Anti-Debt Alliance. Four working groups have been established to help to realise these objectives, specifically working groups for: Consumer Credit; Debt Collection; Financial Literacy; and Alternative Debt Relief Methods. The members of these working groups meet on a regular basis. In addition, representatives from the professional public are invited to participate in round table discussions.

The ADA's activities in 2012 included consultations regarding the amendment of Act No. 145/2010 Coll. on consumer credit, which was prepared by the Ministry of Finance, particularly in the sections addressing the regulation of reasonable loan security and the prohibition of using bills of exchange. Other specific areas in which the Alliance is involved included activities associated with finding a legislative solution for unseizable property in the amendment to the Code of Civil Procedure; promoting debt relief in the form of bankruptcy for self-employed individuals; and helping to define the legal provisions for debt relief for married couples in the revision amendment to the Insolvency Act. Other topics that were addressed include the issues associated with the reminders to be sent prior to a claim being lodged and the costs associated with debt collection proceedings.

The ADA's goals for 2013 include the continuation of all of the activities specified above as well as additional issues, such as the over-indebtedness of seniors and solutions of over-indebtedness in excluded locations.

Financial Education

The Working Group on Financial Education (WGFE) continued its activities in 2012. The WGFE provides a platform for an exchange of information and opinions by representatives of the Ministry of Finance, the CNB, the Ministry of Education, the Ministry of Industry and Trade, and the Ministry of the Interior as well as representatives of professional associations active in the financial market, organisations implementing educational projects, consumer organizations, and educational professionals. The members of the WGFE discuss their projects and experiences and try to find a common approach for improving the financial literacy of the Czech population.

The first meeting of the WGFE Subgroup on Objectivity Principles took place in October 2012. Its task was to describe the boundary between financial education and advertising in a way that would be acceptable to various entities involved in financial education. These objectivity principles were approved at the WGFE meeting on 25 March 2013 and can be found on the MoF website.[57]

On its website, the Organisation for Economic Co-operation and Development (OECD) published the results of a study "Measuring Financial Literacy: Results of the OECD INFE Pilot Study". The Czech Republic was one of the participants in this pilot project, which was focused on the financial skills, behaviour, and attitudes of adults from fourteen countries included in the INFE.

On 30 November 2012 the conference "The proper way to financially educate adults" was held under the auspices of the Ministry of Finance.. It also included workshops, which provided a platform for more extensive discussions and an exchange of experience.

Since autumn 2012, the Ministry of Finance has been the expert adviser for spots promoting financial literacy project of Školní informační kanál (School Information Channel, SIC). The spots are primarily of a warning nature and are transmitted on the screens in primary and secondary schools.

It is expected that the coordination portal for financial education "Pojďme se finančně vzdělávat! (Let's get financially educated!)" will be launched in September 2013. This portal is intended for both the professional and the general public.

Pension Reform Forum for Suppliers

In March 2012 the MoF convened the first meeting of the Pension Reform Forum for Suppliers, which has become a platform for the regular meetings of representatives from the Association of Pension Funds,

[57] http://www.mfcr.cz/cps/rde/xchg/mfcr/xsl/ft_finvzd_aktuality.html

the Ministry of Finance, the Ministry of Labour and Social Affairs, the General Financial Directorate, the Czech Social Security Administration, and their IT providers. The objective of the forum is to ensure the problem-free start of pension reform and to provide a common platform for the exchange of methodological, operational, data, and communication standards and processes amongst all of the stakeholders in the process. During the first meetings, the focus was on legislative development. It subsequently shifted to issues associated with the operational solution for implementing Pillar 2 and Pillar 3 at both the state level as well as from the perspective of pension companies. The forum meets on a regular monthly basis and the most recent meeting was held in May 2013. The pension funds and their IT providers view the establishment of the Pension Reform Forum for Suppliers in a very positive light.

LIST OF TABLES

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LIST OF ACRONYMS AND ABBREVIATIONS

abs.	absolute
ACMU	Act on Capital Market Undertakings
ADR	Alternative Dispute Resolution
AIFMD	Alternative Investment Fund Managers Directive
AKAT	Czech Capital Market Association (Asociace pro kapitálový trh)
APF ČR	Association of Pension Funds of the Czech Republic (Asociace penzijních fondů České republiky)
APR	Annual; Percentage Rate of Charge
ARAD	Czech National Bank's time series database
bn	billion
bp	basis point
BCEA	Branch Classification of Economic Activities
BRICS	Economic grouping comprising Brazil, Russia, India, China, and South Africa
BRRD	Bank Recovery and Resolution Directive
CA	Current account
CESR	Committee of European Securities Regulators
CMF	Committee for Financial Markets
CNB	Czech National Bank
CoNWG	Close-out Netting Working Group
COREPER	Committee of Permanent Representatives
CPI	Consumer price index
CRD	Capital Requirements Directive
CRDWG	Capital Requirement Directive Working Group
CRR	Capital Requirements Regulation
CSDWG	Market Infrastructure Working Group - Central Securities Depositories
CSO	Czech Statistical Office
CZ	Czech Republic
CZK	International currency code for the Czech crown
ČAP	Czech Insurance Association (Česká asociace pojišťoven)
ČSAS	Česká spořitelna, a. s. (Czech Savings Bank)
ČSOB	Československá obchodní banka, a. s. (Czechoslovak Commercial Bank)
DGS	Deposit Guarantee Schemes
DIF	Deposit Insurance Fund
DIJA	Dow Jones Industrial Average
EAPR	Effective Annual Percentage Rate
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Communities /European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EEA	European Economic Area
EFC	Economic and Financial Committee
EFCC	European Financial Conglomerates Committee
EFSF	European Financial Stability Facility
EGAP	Export Guarantee and Insurance Corporation (Exportní garanční a pojišťovací společnost, a.s.)
EGESC	Expert Group of the European Securities Committee
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EIOPC	European Insurance and Occupational Pensions Committee
EIWG	Early Intervention Working Group
EMD	Electronic Money Directive
EMIR	European Market Infrastructure Regulation
ESC	European Securities Committee
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	International currency code for the euro
Fed	Federal Reserve System (Central Bank of the USA)
FESE	Federation of European Securities Exchanges
FICOD	Financial Conglomerates Directive

FSB	Financial Stability Board
FSC	Financial Services Committee
G20	Group of Twenty Finance Ministers and Central Bank Governors
GEGRFS	Government Expert Group on Retail Financial Services
GDP	Gross Domestic Product
HUF	International currency code for the Hungarian forint
IBRD	International Bank for Reconstruction and Development
ICS	Investor Compensation Schemes
ICSD	Investor Compensation Schemes Directive
IMD	Insurance Mediation Directive
INFE	International Network on Financial Education
IORP	Institutions for Occupational Retirement Provision Directive
IP	Insurance policy
IPPC	Insurance and Private Pensions Committee
KB	Komerční banka, a. s. (Commercial Bank)
LFSS	Labour Force Sample Survey
LTRO	Long-Term Refinancing Operation
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MEYS	Ministry of Education, Youth and Sports of the Czech Republic
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MIT	Ministry of Industry and Trade of the Czech Republic
ML	Mortgage loan
MLSA	Ministry of Labour and Social Affairs
mn	million
MoF	Ministry of Finance of the Czech Republic
MRD	Ministry for Regional Development of the Czech Republic
No	Number
NPL	Non-performing loans
ODR	Online Dispute Resolution
OECD	Organisation for Economic Co-operation and Development
OL	Overdraft Loan
OMF	Open-ended mutual fund
OTC	over-the-counter
OTF	Organised Trading Facility
p.a.	per annum
PC	Payment Committee
PF	Pension fund
PIT	Personal Income Tax
PLN	International currency code for the Polish zloty
pp	percentage point
PRIPs	Packaged Retail Investment Products
PSE	Prague Stock Exchange
PXE	Power Exchange Central Europe (Energetická burza Praha)
RIA	Railway Infrastructure Administration
RM-S	RM-System
SC	Share certificate
SecD	Securities Dealers
SEPA	Single Euro Payments Area
SIFIs	Systemically Important Financial Institutions
SLDWG	Securities Law Directive Working Group
SSM	Single Supervisory Mechanism
STGF	Securities Traders' Guarantee Fund
T2S	TARGET2-Securities
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
UNIDROIT	Convention on substantive rules regarding intermediated securities
USA	United States of America
USD	International currency code for the United States dollar
VAT	Value added tax
WPPP	Working Party on Private Pensions

APPENDIX 1: FINANCIAL MARKET LEGISLATION

The following changes were made to the financial market legislation of the Czech Republic and of the European Union in 2012:

P1.1. Cross-Sectoral Financial Market Regulations

1) European legislation and other initiatives published in 2012:

- None.

2) Pending European legislation (including legislation published after 31 December 2012) and other initiatives of the European Commission:

- Preparation of a fundamental revision to Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate;
- Consultation Document of 5 October 2012 on a possible recovery and resolution framework for financial institutions other than banks.
- Proposal of 5 April 2011 for a Directive of the European Parliament and of the Council on credit agreements relating to residential property.
- Proposal of 6 June 2012 for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 88/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (referred to as BRRD).
- Proposal of 3 July 2012 for a Regulation of the European Parliament and of the Council on key information documents for investment products (referred to as PRIPs).

3) Acts that took effect in 2012:

- Act No 37/2012 Coll. amending certain Acts in connection with the reform of financial market supervision in the European Union (Act No 21/1992 Coll. on Banks; Act No 87/1995 Coll. on Credit Unions; Act No 15/1998 Coll. on Capital Market Supervision; Act No 256/2004 Coll. on Capital Market Undertakings; Act No 189/2004 Coll. on Collective Investment; Act No 377/2005 Coll. on Financial Conglomerates; and Act No 284/2009 Coll. on Payments). This act implements Directive 2010/78/EU of the European Parliament and of the Council (the Omnibus I Directive) and took effect on 31 January 2012.

4) Pending legislation (including acts already adopted that have either taken effect or will take effect after 31 December 2012):

- Draft bill for Act No 43/2013 Coll. amending Act No 145/2010 Coll. on Consumer Loans and amendments to certain related legislation.
- Draft bill amending Act No 377/2005 Coll. on the **supplementary supervision** of banks, credit unions, insurance undertakings, and investment firms in financial conglomerates, and on amendments to certain related legislation (the Financial Conglomerates Act), as amended and Act No 277/2009 Coll. on the insurance industry, as amended.
- Draft bill amending certain legislation in connection with the implementation of a crisis management framework. This Act will transpose into national law the Directive of the European Parliament and of the Council establishing a recovery and resolution framework for credit institutions and investment firms.
- Draft bill on financial market supervision. The aim of the proposed legislation is to unify and consolidate the legal provisions for supervision currently contained in individual sector-specific acts into one legal regulation.

5) Secondary legislation:

- None.

P1.2. Capital Market Legislation

1) European legislation and other initiatives published in 2012:

- Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.
- Commission Delegated Regulation (EU) No 272/2012 of 7 February 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to fees charged by the European Securities and Markets Authority to credit rating agencies.
- Commission Delegated Regulation (EU) No 446/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on the content and format of ratings data periodic reporting to be submitted to the European Securities and Markets Authority by credit rating agencies.
- Commission Delegated Regulation (EU) No 447/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies by laying down regulatory technical standards for the assessment of compliance with credit rating methodologies.
- Commission Delegated Regulation (EU) No 448/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards for the presentation of the information that credit rating agencies shall make available in a central repository established by the European Securities and Markets Authority.
- Commission Delegated Regulation (EU) No 449/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies.
- Commission Delegated Regulation (EU) No 486/2012 of 30 March 2012 supplementing Regulation (EC) No 890/2004 as regards the format and the content of the prospectus, the base prospectus, the summary and the final terms and as regards the disclosure requirements.
- Commission Delegated Regulation (EU) No 862/2012 of 4 June 2012 amending Regulation (EC) No 809/2004 as regards information on the consent to use of the prospectus, information on underlying indexes and the requirement for a report prepared by independent accountants or auditors.
- Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012 supplementing Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events.
- Commission Delegated Regulation (EU) No 919/2012 of 5 July 2012 supplementing Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments.
- Commission Delegated Regulation (EU) No 946/2012 of 12 July 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to rules of procedure on fines imposed on credit rating agencies by the European Securities and Markets Authority, including rules on the right of defence and temporal provisions.
- Commission Implementing Decision No 2012/627/EU of 5 October 2012 on the recognition of the legal and supervisory framework of Australia as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies.
- Commission Implementing Decision No 2012/628/EU of 5 October 2012 on the recognition of the legal and supervisory framework of the United States of America as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies.
- Commission Implementing Decision No 2012/630/EU of 5 October 2012 on the recognition of the legal and supervisory framework of Canada as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies.

2) Pending European legislation (including legislation published after 31 December 2012) and other initiatives of the European Commission:

- Proposal of 12 July 2010 for a Directive of the European Parliament and of the Council amending Directive 97/9/EC of the European Parliament and of the Council on investor compensation schemes (referred to as ICSD).
- Proposal of 20 October 2011 for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (referred to as MiFID2).
- Proposal of 20 October 2011 for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EMIR) on OTC derivatives, central counterparties and trade repositories (referred to as MiFIR).
- Proposed amendments of 25 July 2012 to the proposal of 20 October 2010 for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse) (referred to as MAR).
- Proposal of the Commission of 25 July 2012 amending the proposal of 20 October 2011 for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation (referred to as CSMAD).
- Proposal of 25 October 2011 for a Directive of the European Parliament and of the Council amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC (referred to as TD2).
- Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) 1006/2009 on credit rating agencies (referred to as NORA3).
- Proposal of 7 December 2011 for a Regulation of the European Parliament and of the Council on European Venture Capital Funds (referred to as the EuVECA Regulation).
- Proposal of 7 December 2011 for a Regulation of the European Parliament and of the Council on European social entrepreneurship funds (referred to as the EuSEF Regulation).
- Proposal of 3 July 2012 for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers in respect of the excessive reliance on credit ratings.
- Proposal of 3 July 2012 for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (referred to as UCITS 5).
- Consultation Document of 26 July 2012 covering the issues associated with eligible investment assets for UCITS funds, efficient UCITS portfolio management techniques, the treatment of OTC derivatives in portfolio management, extraordinary liquidity management rules, and a UCITS "depositary passport" (referred to as UCITS6).
- Consultation Document of 5 September 2012 on benchmarks and indices.

3) Acts that took effect in 2012:

- Act No 172/2012 Coll. of 26 April 2012 amending Act No 190/2004 Coll. on bonds, Act No 256/2004 Coll. on capital market undertakings, Act No 634/2004 on administrative fees, and Act No 97/1963 Coll. on private and procedural international law (in effect as of 1 July 2012 and, as applicable, 1 August 2012).
- Act No 254/2012 Coll. of 14 June 2012 amending Act No 21/1992 Coll. on banks, as amended, and other related legislation (in effect as of 3 August 2012).

4) Pending legislation (including acts already adopted that have either taken effect or will take effect after 31 December 2012):

- Draft bill on investment companies and investment funds, submitted as Parliamentary Bill (ST) 896 (expected to take effect on 20 July 2013).
- Draft bill amending certain legislation in relation to the adoption of the Act on Investment Companies and Investment Funds and in relation to the adoption of the directly applicable regulations

of the European Union on the settlement of certain types of derivatives, submitted as Parliamentary Bill (ST) 897 (expected to take effect on 1 July 2013).
- Act No 89/2012 Coll. of 3 February 2012, the Civil Code – selected provisions (expected to take effect on 1 January 2014).
- Draft bill amending certain legislation in relation to the adoption of the recodification of certain provisions of private law, submitted as Parliamentary Bill (ST) 930 (expected to take effect on 1 January 2014).

5) **Secondary legislation:**
- Decree of the Ministry of Finance No. 323/2012 Coll. defining a sample application for the consent of the Ministry of Finance to issue municipal bonds and laying down the requirements for the mandatory attachments (in effect as of 3 October 2012).
- Conditions for the issuance of state bonds published in 2012 by the Ministry of Finance as Communications 23/2012 Coll., 149/2012 Coll., 150/2012 Coll., 151/2012 Coll., 152/2012 Coll., 323/2012 Coll., 373/2012 Coll., 374/2012 Coll., 375/2012 Coll., and 376/2012 Coll.

P1.3. Banking Sector Legislation, Including Building Savings Schemes and Credit Unions

1) ***European legislation and other initiatives published in 2012:***
- None.

2) **Pending European legislation (including legislation published after 31 December 2012) and other initiatives of the European Commission:**
- Proposal of 12 July 2010 for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes (referred to as DGD, revised version).
- Proposal of 12 September 2012 for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.
- Proposal of 12 September 2012 for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards its interaction with Council Regulation (EU) conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.
- Proposal of 20 July 2012 for a Regulation of the European Parliament and of the Council on the prudential supervision of credit institutions and investment firms (referred to as CRR).
- Proposal of 20 July 2011 for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (referred to as CRD 4).

3) **Acts that took effect in 2012:**
- Act No 254/2012 Coll. of 14 June 2012 amending Act No 21/1992 Coll. on Banks, as amended, and other related legislation (in effect as of 3 August 2012).

4) **Pending legislation (including acts already adopted that have either taken effect or will take effect after 31 December 2012):**
- Draft bill amending Act No 21/1992 Coll. on banks, as amended. The act will transpose into national legislation the Directive of the European Parliament and of the Council on Deposit Guarantee Schemes. The aim is to harmonise the functioning of deposit guarantee schemes at the European level from the perspective of coverage limits, payout period, scope of covered products and depositors, the information provided to depositors, and cross-border co-operation.
- Draft bill amending Act No 6/1993 on the Czech National Bank, as amended, and other related legislation. The aim of the draft legislation is to remove some of the current incompatibilities with

European legislation, which have been repeatedly criticised in the convergence reports published by the European Commission and the European Central Bank. The draft legislation also removes some of the deficiencies in the current text that the Czech National Bank has encountered in practice after the Czech Republic's accession to the European Union and after the integration of financial market supervision in the Czech Republic.

- Draft bill amending certain legislation in relation to defining access to the activities of banks, credit unions, and investment firms and the supervision of these activities. The draft legislation implements the Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, as well as the Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms.
- Draft bill amending certain legislation in relation to a change in the conditions for building savings schemes. The act will introduce certain conceptual changes with regard to building savings schemes, such as the requirement of a justified purpose in order to receive the state contribution and a product concept for building savings schemes that will allow standard banks to offer this product as well.

5) Secondary Legislation:

- Decree of the Czech National Bank No 187/2012 Coll. amending Decree 123/2007 Coll. stipulating the prudential rules for banks, credit unions, and investment firms, as amended.

P1.4. Payment Services and Market Infrastructure Legislation

1) *European legislation and other initiatives published in 2012:*

- Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009. The Regulation aims to create a Single European Payment Area for payments made in euros without any differentiation between national and cross-border transactions.
- Regulation (EU) of the European Parliament and of the Council of 29 March 2012 on OTC derivatives, central counterparties, and trade repositories (EMIR). The Regulation aims to eliminate systemic risk when settling derivative transactions. Implementing measures to this Regulation are published on a regular basis.

2) Pending European legislation (including legislation published after 31 December 2012) and other initiatives of the European Commission:

- Proposal for a Regulation of the European Parliament and of the Council of 7 March 2012 on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC. The Regulation introduces an obligation to represent all transferable securities in book entry form and to record these in CSDs before trading them at regulated venues.

3) Acts that took effect in 2012:

- Act No 254/2012 Coll. of 14 June 2012 amending Act No 21/1992 Coll. on banks, as amended, and other related legislation. Most importantly, this legislation changes the access to the branches of third-country banks operating in the Czech Republic with the aim of establishing equal conditions for all banking sector entities and in order to ensure a stable and credible competitive banking environment. One of the amended related acts is the Act on the Circulation of Banknotes and Coins.

4) Pending legislation (including acts already adopted that have either taken effect or will take effect after 31 December 2012):

- Draft bill on currency exchange activities and a draft bill amending certain other legislation in relation to the adoption of the act on currency exchange activities. The new legislation includes comprehensive legal provisions for carrying out currency exchange activities, with regard to both the performance of these activities as well as the private law relationships established on the basis of these activities.

- Draft bill amending the Act on Payments and the Act on Limitation of Cash Payments. This draft legislation brings the Czech Act on Payments into line with Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009. It is also a response to the judgment passed down by the Supreme Administrative Court of the Czech Republic and published under Ref. No. 1 Afs 91/2010-45 of 23 February 2011.

5) Secondary legislation:

- None.

P1.5. Insurance Legislation, Including Supplementary Pension Insurance

1) *European legislation and other initiatives published in 2012:*

- Directive 2012/23/EU of the European Parliament and of the Council of 12 September 2012 amending Directive 2009/138/EC (Solvency II) as regards the date for its transposition and the date of its application, and the date of repeal of certain Directives.

2) Pending European legislation (including legislation published after 31 December 2012) and other initiatives of the European Commission:

- Proposal of 19 January 2011 for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (referred to as Omnibus II).
- Proposal of 7 July 2012 for a Directive of the European Parliament and of the Council amending Directive 2002/92/EC on insurance mediation (referred to as IMD2).
- Preparation of delegated acts (Level 2) with regard to Directive 2009/138/EC (referred to as Solvency II).
- Preparation of technical standards (Level 3) with regard to Directive 2009/138/EC (referred to as Solvency II).
- Preparation of a revision to Directive 2003/41/EC on the activities of institutions for occupational retirement provision (referred to as IORP);
- Preparation of a directive on insurance guarantee schemes (referred to as IGS).

3) Acts that took effect in 2012:

- None.

4) Pending legislation (including Acts already adopted that have either taken effect or will take effect after 31 December 2012):

- Act No 426/2011 Coll. on Retirement Savings (in effect since 1 January 2013).
- Act No 427/2011 Coll. on Supplementary Pension Savings (in effect since 1 January 2013).
- Act No 428/2011 Coll. amending certain legislation with regard to the adoption of the act on retirement savings and the act on supplementary pension savings (in effect since 1 January 2013).
- Act No 397/2012 Coll. on Retirement Savings Premium (in effect since 1 January 2013).
- Act No 399/2012 Coll. amending certain legislation with regard to the adoption of the act on retirement savings premium (in effect since 1 January 2013).
- Act No 403/2012 Coll. amending Act No 427/2011 Coll. on supplementary pension savings and other related legislation.
- Act No 99/2013 Coll. amending certain insurance and supplementary pension insurance legislation with regard to the withdrawal of the exemption from the principle of equal treatment under European Union law.
- Government draft bill amending Insurance Act No 277/2009 Coll., as amended, and certain other related legislation.

- Government draft bill amending Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters and the Trade Licensing Act (Insurance Intermediaries and Loss Adjusters Act), as amended, and certain other related legislation.

5) Secondary legislation:

- Decree of the Czech National Bank No 57/2012 Coll. on the minimum requirements for the statute of participation fund and retirement fund.
- Decree of the Czech National Bank No 58/2012 Coll. amending Decree No 233/2009 Coll. on applications, the approval of persons, the methods for proving professional qualifications, credibility, and personal experience, and the minimal amount of funds to be provided by a foreign bank to its branch, as amended by Decree No 192/2011 Coll.
- Decree of the Czech National Bank No 117/2012 Coll. stipulating more detailed provisions for the activities of pension company, retirement fund, and participation fund.
- Decree of the Czech National Bank No 341/2012 Coll. defining the scope of activities for retirement fund depositary and participation fund depositary.
- Decree No 423/2012 Coll. on increasing the pensions paid from a pension insurance contract.
- Decree of the Czech National Bank No 424/2012 Coll. amending Decree No 433/2009 Coll. on the methods, format, and requirements for the mandatory submission of reports by insurance and reinsurance companies, as amended by Decree No 359/2010 Coll.
- Decree of the Czech National Bank No 425/2012 Coll., on the submission of information by pension companies to the Czech National Bank.
- Government Regulation No 361/2012 Coll. on the provision of key information to participants in supplementary pension savings and retirement savings
- Decree of the Czech National Bank No 40/2013 Coll., of 4 February 2013 establishing the requirements for pension insurance offer (in effect since 1 March 2013).

APPENDIX 2: SUPPLEMENTARY TABLES

Table P2.1: Loans by type

As at 31 Dec (CZK bn)	2010	2011	2012	Year-on-year change	
				Abs.	(%)
Overdrafts and debit balances of current accounts	141.1	143.3	142.9	-0.4	-0.3
Consumer loans (excl. overdrafts and debit balances of current accounts)	190.2	186.7	185.3	-1.4	-0.8
Housing loans excl. mortgages	149.1	143.8	138.6	-5.2	-3.6
Mortgage loans for residential properties	682.7	710.1	747.6	37.5	5.3
Mortgage loans for non-residential properties	82.5	114.8	116.6	1.8	1.6
Other loans	392.9	415.5	415.8	0.3	0.1
Investment loans	501.3	554.4	577.5	23.1	4.2
Bridge loans	2.2	4.0	2.7	-1.2	-30.6
Trade receivables	32.8	31.7	33.0	1.3	4.0
Total	2,174.7	2,304.3	2,360.1	55.8	2.4

Source: CNB – ARAD

Table P2.2: Net assets in trusts domiciled abroad, by distributor

As at 31 Dec 2012	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
ČSOB investiční společnost	61.9	51.6	-1.3
ING Investment Management (C.R.)	14.4	12.0	2.9
Česká spořitelna	10.0	8.3	-23.1
Conseq Investment Management	9.4	7.8	16.0
Raiffeisenbank	9.1	7.6	62.5
Komerční banka	5.0	4.2	2.0
UniCredit Bank Czech Republic	3.7	3.1	60.9
Pioneer Asset Management	2.5	2.1	31.6
ČP Invest	2.1	1.8	16.7
Citibank Europe	1.2	1.0	33.3
Others members of AKAT	0.5	0.4	0.0
Total	119.9	100.0	3.5

Source: AKAT

Table P2.3: Net assets of domestic trusts, by management company

As at 31 Dec 2012	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
Investiční společnost České spořitelny	50.0	43.3	1.4
Investiční kapitálová společnost KB	25.6	22.2	15.3
ČP INVEST investiční společnost	13.2	11.4	21.1
Pioneer investiční společnost	8.1	7.0	-1.2
ČSOB Asset Management	7.2	6.2	5.9
AXA investiční společnost	5.3	4.6	3.9
J&T ASSET MANAGEMENT, IS	2.1	1.8	10.5
REICO investiční společnost ČS	2.1	1.8	16.7
PROSPERITA investiční společnost	0.9	0.8	0.0
AKRO investiční společnost	0.5	0.4	0.0
Others	0.5	0.4	-54.5
Total	115.5	100.0	6.7

Source: AKAT

Table P2.4: Main development indicators for the building savings banks sector in the Czech Republic

As at 31 Dec		2007	2008	2009	2010	2011	2012
New building savings contracts	number	579,730	705,463	575,292	532,765	410,461	433,093
	change (%)	12.3	21.7	-18.5	-7.4	-23.0	5.5
Average target value for new building savings contracts with private individuals	value (CZK th.)	284.9	302.8	308.7	300.5	346.2	366.1
	change (%)	20.8	6.3	1.9	-2.7	15.2	5.7
Building savings contracts in savings phase	number	5,132,595	5,070,510	4,926,183	4,845,319	4,550,468	4,316,999
	change (%)	-3.1	-1.2	-2.8	-1.6	-6.1	-5.1
Paid state contribution	value (CZK bn)	15.0	14.2	13.3	11.7	10.7	5.3
	change (%)	-5.0	-5.0	-6.7	-11.5	-8.6	-50.7
Average state contribution paid per building savings contract for the relevant year	value (CZK)	3,090.0	2,927.0	2,776.0	2,631.0	1,324.0	n/a
	change (%)	-2.6	-5.3	-5.2	-5.2	-49.7	n/a
Saved amount	value (CZK bn)	384.8	401.1	415.2	430.1	433.4	435.0
	change (%)	6.9	4.2	3.5	3.6	0.8	0.4
Loans in total	number	942,944	971,176	988,353	993,357	956,659	894,358
of which: building saving schemes	number	580,352	569,870	565,485	564,633	552,999	521,312
bridging[58]	number	362,592	401,306	422,868	428,724	403,660	373,046
	change (%)	4.7	3.0	1.8	0.5	-3.7	-6.5
Loans in total	value (CZK bn)	179.3	227.4	267.5	293.4	293.1	282.2
of which: building saving schemes	value (CZK bn)	38.9	42.9	48.9	53.1	55.8	55.7
bridging[58]	value (CZK bn)	140.4	184.5	218.6	240.3	237.3	226.5
	change (%)	32.4	26.8	17.6	9.7	-0.1	-3.7
Ration of loans in total to saved amount	ratio (%)	46.6	56.7	64.4	68.2	67.6	64.9

Source: MoF

[58] Loans according to Section 5 (5) of Act 96/1993 Coll. on building savings and state support for building savings, as amended.

Table P2.5: Allocation of pension fund assets

As at 31 Dec (market prices, CZK bn)	2007	2008	2009	2010	2011	2012	Share in 2012 (%)
Bonds	119.4	144.8	171.6	195.3	214.2	235.9	84.1
Treasury bills	7.4	6.4	2.2	1.1	0.6	6.8	0.5
Shares	9.8	5.7	3.5	1.9	1.0	0.6	0.8
Unit certificates	7.6	6.2	6.9	8.7	5.7	3.1	3.7
Money and other assets	22.8	28.4	31.5	25.2	26.0	26.8	10.8
Total	167.0	191.5	215.7	232.1	247.5	273.2	100.0

Source: APF CR

Table P2.6: Main development indicators for the supplementary pension insurance segment in the Czech Republic

As at 31 Dec		2007	2008	2009	2010	2011	2012
Supplementary pension insurance contracts [59]	number	3,936,357	4,207,236	4,394,522	4,527,774	4,565,741	5,134,862
	change (%)	9.5	6.9	4.5	3.0	0.8	12.5
New supplementary pension insurance contracts	number	586,310	590,490	524,867	495,516	457,033	1,128,020
	change (%)	5.0	0.7	-11.1	-5.6	-7.8	146.8
Supplementary pension insurance policies with employer contribution[60]	number	1,129,618	1,222,639	1,261,525	1,284,736	1,271,934	1,317,563
	change (%)	9.8	8.2	3.2	1.8	-1.0	3.6
State contributions for a given period	value (CZK bn)	4.7	5.1	5.3	5.5	5.6	5.9
	change (%)	11.7	9.4	5.1	3.1	1.7	5.6
Participant contributions [61]	value (CZK bn)	20.2	21.9	23.0	23.2	23.4	25.5
	change (%)	14.8	8.3	4.9	1.1	0.9	8.8
Average monthly state contribution	value (CZK)	103.9	104.9	105.2	105.0	105.4	108.0
	change (%)	1.6	1.0	0.3	-0.2	0.4	2.5
Average monthly participant contribution	value (CZK bn)	449.7	450.5	443.9	439.6	441.7	465.0
	change (%)	4.4	0.2	-1.5	-1.0	0.5	5.3

Source: MoF

[59] Data reflects number of policies, which are not closed in the relevant records.
[60] Since Act No 42/1994 Coll. as amended by Act 170/1999 Coll. entered into force (since 3 August 1999).
[61] Participant's contributions are reported without the contributions paid by employers for their employees.

Table P2.7: Placement of insurance technical reserves

As at 31 Dec (CZK bn)	2011			2012			Abs. change			Year-on-year change (%)		
	LI	NLI	Total	LI	NLI	Total	LI	NLI	Total	LI	NLI	Total
Debt securities	174.5	66.5	262.0	186.9	67.7	280.1	12.4	1.2	18.0	7.1	1.7	6.9
Of which: Bonds issued by the Member State or its national central bank	107.4	50.0	165.2	111.2	48.9	173.6	3.8	-1.1	8.5	3.5	-2.2	5.1
Bonds issued by banks of Member States	17.1	5.0	23.8	19.6	5.1	27.1	2.5	0.0	3.3	14.7	0.7	14.1
Listed bonds issued by corporations	14.1	3.6	23.5	14.6	3.7	24.1	0.5	0.0	0.6	3.9	0.1	2.5
Treasury bills	1.0	0.6	1.8	0.9	1.9	3.0	-0.1	1.3	1.2	-10.0	197.7	64.5
Listed municipal bonds	1.0	0.0	1.1	1.0	0.0	1.1	0.1	0.0	0.0	7.4	2.5	3.7
Mortgage bonds	14.3	4.1	20.1	17.3	5.6	24.4	2.9	1.5	4.3	20.5	36.2	21.2
Bonds issued by EIB, ECB, EBRD or IBRD	5.3	0.8	7.0	6.7	0.8	7.5	1.4	0.0	0.5	26.7	1.2	6.6
Foreign debt securities traded on any regulated market of OECD Member States	11.6	2.0	15.1	13.8	1.8	16.8	2.2	-0.2	1.7	18.5	-11.9	11.5
Equity securities	45.0	6.6	69.6	49.8	7.4	78.6	4.8	0.8	9.0	10.6	12.8	13.0
Of which: Llisted shares	4.5	0.4	5.0	5.1	0.9	6.7	0.7	0.5	1.7	14.7	105.3	34.5
Securities by mutual funds complying with EC regulations	30.6	2.4	35.0	32.6	3.1	38.1	2.1	0.7	3.1	6.8	27.0	8.9
Credits, loans and other receivables	0.0	0.1	0.6	0.0	0.0	0.6	0.0	-0.1	0.0	-	-100.0	1.2
Other receivables	0.4	1.2	2.3	0.6	1.1	2.5	0.2	0.0	0.2	51.3	-0.2	9.5
Bills	0.0	0.1	0.3	0.0	0.1	0.2	0.0	0.0	-0.1	-25.0	-6.5	-27.1
Real estate	0.3	2.2	4.8	0.3	2.2	4.8	0.0	0.0	0.0	-3.3	-1.0	-0.4
Deposits and certificates of deposits or depository bonds	6.6	5.2	23.8	5.9	6.2	24.4	-0.7	1.0	0.7	-10.2	19.1	2.7
Items and works of artistic/cultural value	0.0	0.1	0.3	0.0	0.2	0.3	0.0	0.1	0.0	-	52.0	9.2
Receivables from reinsurance companies	0.6	14.1	20.4	0.5	12.7	18.4	-0.1	-1.4	-2.1	-21.7	-10.1	-10.0
Derivatives	-0.8	-0.1	-2.9	-0.2	0.0	-2.0	0.6	0.1	0.9	-74.0	-138.6	-32.6
Other financial placement	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-	-	-
Financial placements total	226.6	96.0	381.2	243.7	97.6	407.9	17.2	1.6	26.7	7.6	1.6	7.0

Source: CNB

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