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# REPORT ON FINANCIAL MARKET DEVELOPMENTS IN 2011

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June, 2012

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Data contained in this report were downloaded from various sources in the period March - June 2012.

## SUMMARY

<b>Economy</b>	The Czech economy's gross domestic product rose by 1.7 %. While the 2010 economic expansion was driven by all components of GDP only foreign trade recorded growth in the year 2011. The average inflation rate fell to 1.9 %. The growth of commodity prices on world markets and the weakening of the Czech koruna supported inflation. The inflation rate was, however, lowered by the actual stage of the business cycle.
<b>The funds for use in the financial market</b>	The total amount of funds increased by 3.7 % to a total of almost 3.9 trillion CZK. The largest increase was again in bank deposits (by 118.9 billion CZK year-on-year) which account for 69 % of the Czech financial market. On the contrary, absolute decrease occurred only in collective investment schemes.
<b>The structure of household saving</b>	Household savings, thanks to a slight increase of 3.3 %, amounted to 2 392 billion CZK. Changes in the structure thereof were minimal. Most savings were deposited with banking institutions (71.5 %) where the trend continues to shift funds from time deposits to "on call" deposits. Czech households also saved money in life insurance (10.8 %), supplementary pension insurance (9.7 %) and mutual funds (8 %).
<b>Entities of the financial market</b>	The institutional structure of the financial market was stable in the year 2011. Changes in the number of entities in each sector were only marginal. New licenses were issued to 3 banks and 1 insurance company and there was an increase in the number of investment and mutual funds. The highest growth rate occurred in the investment and insurance intermediaries business, but "discrepancy" persisted between the numbers of officially registered entities and entities actually engaged in brokering and advisory services.
<b>Banking sector</b>	The banking sector was well capitalized (capital adequacy of 15.3 %) and reported stable profit (profit before taxation of 63.5 billion CZK) at the end of 2011. total assets increased by 6.9 % to 4 476 billion CZK related to an increase in trading activities. It seems that the deterioration of quality of bank loan portfolios stopped after 3 years.
<b>Interest rates</b>	The key CNB interest rate (2W repo) which consequently influences market interest rates remained unchanged. The average APR rate on new loans for consumption during the year declined from levels of around 17 % to the final 15.8 %. The same trend was clear in APR for home purchases which gradually declined to 4.1 % (year-on-year change of 0.7 pp).
<b>Deposits and loans</b>	The volume of bank deposits increased by 4.5 % and reached 2 914 billion CZK at the end of the year. A stronger dynamics (by 6 %) was behind the increase in the volume of bank loans to the amount of 2 304.5 billion CZK. The dominant client segment were still the households, both for deposits and loans.
<b>Building societies</b>	The sector continued its downward trend of recent years and also reacted to changes in the maximum amount paid in state contribution. The number of new contracts fell by 23 % year-on-year to 410 000. The past decline (since 2004) of the number of contracts in the saving phase thus continued to 4.55 million. The total number of loans decreased by 36 thousand year-on-year to 957 000. The volume of loans equalled 293.1 billion CZK at the end of the year. The amount of state contributions paid out reached 10.7 billion CZK.
<b>Mortgage market</b>	The volume of mortgage loans to households amounted to 659 billion CZK. The rate of year-on-year change of 9 % (54.3 billion CZK) compared to the previous year remained almost unchanged. There was a further, albeit more gradual, decrease of mortgage market rates reported by Hypoindex from 4.20 % (January) to 3.56 % (December).
<b>Credit unions</b>	The smallest sector of the financial market (balance sheet total of 28.3 billion CZK) saw a significant increase in membership (45 000 members) and dynamic balance sheet growth especially due to attractive interest rate policy for retail deposits. The long-term problem

is the quality of the loan portfolio - the share of client loans in default approached 16 %.

#### Regulated markets

The main PX index ranged from 843 to 1 275 points during the year. Its decrease for the full year was 25.6 %. The activity of investors on the Prague Stock Exchange rose by 8.6 % year-on-year. The volume of trading of shares fell by 4.8 %. On the contrary, bond trading volumes increased by 18.5 %.

#### Investment firms and asset management

Bank investment firms significantly increased their dominance in the volumes of own-account transactions trades and retain superiority in non-asset management transactions, even though the number of deals closed by them fell significantly. In contrast, non-banking investment firms increased the volume of closed asset management transactions. The volume of assets under management fell slightly (by 0.4 %) to 793.3 billion CZK.

#### Collective investment

Return of uncertainty in financial markets was reflected in collective investments. The volume of assets declined by 9.5 % year-on-year (by 23.4 billion CZK) and so 224.1 billion CZK was invested in open-ended mutual funds at the end of the year. Foreign funds attracted more assets (115.8 billion CZK) than domestic open-ended mutual funds (108.2 billion CZK) for third year in a row.

#### Insurance companies

The insurance sector was flat or recorded a slight decline in gross written premiums (155.1 billion CZK, a year-on-year decrease of 0.6 %), mainly due to decline in non-life insurance. The slight increase in life insurance was influenced by premiums paid as a lump-sum. Overall penetration of insurance remained at 4.1 %.

#### Supplementary pension insurance

More moderate growth rate of pension insurance points to its relative saturation. The total number of clients reached 4.6 million and the volume of managed assets amounted to 232.1 billion CZK. As to the structure of the participants, it is possible to observe a slight tendency to greater involvement of younger people in supplementary pension insurance. The sector was gearing up to the launch of the pension reform planned for January 1, 2013.

#### The government sector

In 2011, the results of the government sector were more favourable - compared to an expected deficit of 3.7 % of GDP, the result was lower by 0.6 percentage points. General government debt reached the value of 1 567.8 billion CZK (representing 41.2 % of GDP) in 2011, an increased by 9.1 % in comparison with the year 2010. Due to the consolidation of government policy, debt dynamics starts to slow down compared to years 2009-2010.

#### Foreign exchange market

The Czech koruna went thru a different development during the year compared to the major currencies. The koruna strengthened against the dollar in the first half of the year, started to lose value at the end of the year and concluded the year by the rate of 19.94 CZK/USD (a decrease of 6.3 %). The koruna remained stable against the euro until September, then began to weaken and closed at 25.80 CZK/EUR (down by 3 %) at the end of the year.

#### Financial market legislation

The legislative process was completed in the case of the Act on Czech National Bank, on Financial Arbiter, on Financial Security, on Building Savings and State Support of Building Savings, on Circulation of banknotes and coins, on payment system, on collective investment schemes and regarding statutes in connection with the determination of capital requirements and procedures of supervision over banks, savings and credit unions and investment firms.

#### Consumer protection in the financial market

Since July 2011, the powers of the financial arbiter to resolve disputes regarding consumer credit and collective investment schemes have been extended and an organizational unit of the state "Office of Financial Arbiter" has also been established. The activities of the working group for financial education and harmonization of rules of distribution of financial products and services also continued.

## 1. MACROECONOMIC SITUATION

In 2011, GDP of the CR increased by 1.7 % in real terms. Developments during the year can be divided into two separate periods as the economic recovery still continued in the first half but in the second half the economy stagnated or slightly declined due to escalating debt crisis in the euro area. As shown in Table 1.1, the Czech economy is quite tied to the development of the EU economy which is primarily due to the high level of trade cooperation. The real economic convergence of the CR to the EU level significantly slowed since 2009. The development in the EU 27 and the euro area is quite uneven, the results are further negatively influenced by the recession in the countries currently affected by the debt crisis.

**Table 1.1: GDP growth rates<sup>1</sup>**

(annual, %)	2006	2007	2008	2009	2010	2011
Czech Republic	7,0	5,7	3,1	-4,7	2,7	1,7
EU-27	3,3	3,2	0,3	-4,3	2,0	1,5
Eurozone	3,3	3,0	0,4	-4,3	1,9	1,5
USA	2,7	1,9	-0,3	-3,5	3,0	1,7

Source: Eurostat

While the expansion of the national economy was driven by all components of GDP in the year 2010, only foreign trade recorded growth in 2011 (exports of goods and services grew by 11 % while imports by only about 7.5 %). This development is mainly due to continued growth in export markets (particularly the rapidly growing economies of the BRICS countries). All other components of GDP showed a decline in the year 2011. Gross fixed capital formation decreased by 1.2 % due to reduction of construction investment, household consumption fell compared to the year 2010 due to very low growth in real wages, still relatively high unemployment and uncertainty regarding the future. The decline in government consumption is related to the ongoing consolidation of public budgets, including spending cuts.

The average rate of inflation measured by consumer price index (CPI) decreased to 1.9 % in the year 2011. It can be viewed as cost inflation – it was significantly influenced by increases of commodity prices on world markets and by the weakening of the Czech koruna which influenced for instance the price of natural gas. The inflation rate was, on the other hand, lower due to the business cycle as the Czech economy was still in a negative output gap, and so a limited pressure on wages existed.

The unemployment rate measured by Selective Labour Force Survey (SLFS) in 2011 dropped in connection with the economic recovery by 0.6 percentage points to 6.7 %. The development over the last period shows that the rate of economic growth that is necessary to maintain or decrease the unemployment rate is still getting lower, but legislative changes influence it as well. In 2011, the recorded unemployment rate according to the Ministry of Labour and Social Affairs ("MLSA") reached an average of 8.6 % (0.4 pp less than in the year 2010).

The ratio of the current account deficit to nominal GDP reached 2.9 % in the year 2010 (by 1 percentage point less than in the previous year). Same as in the previous years, the Czech economy is on the global financial market in a debtor's position, the debt, however, decreased slightly compared to the year 2010. The trade balance relative to GDP shows a growing surplus caused by nominal exports growing more than nominal imports.

<sup>1</sup> Time series of indicators are more or less different from the data reported in previous years reports on the development of financial market due to level revision of national accounts data.

**Table 1.2: Macroeconomic indicators of the Czech economy**

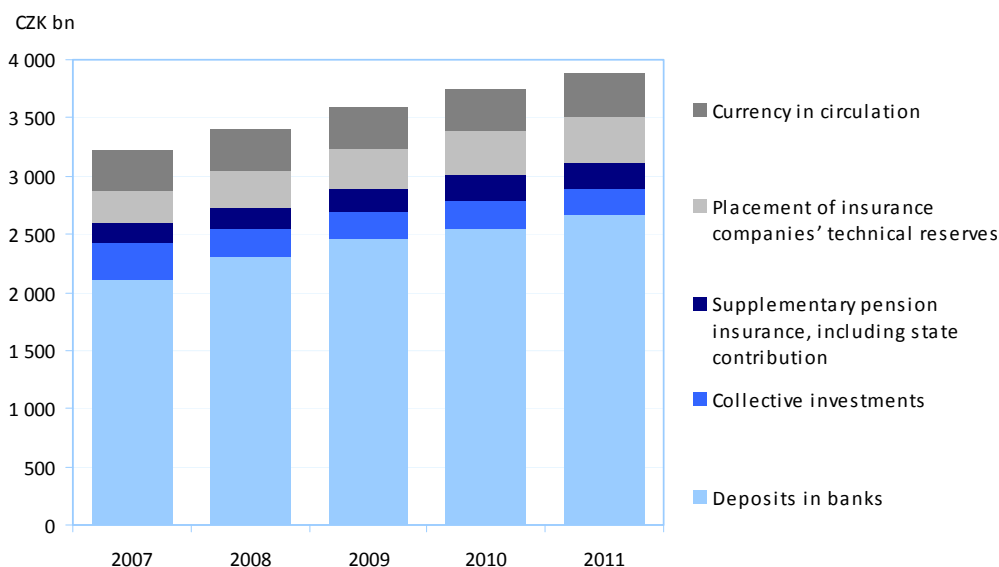
	2008	2009	2010	2011
GDP growth (% , constant prices)	3,1	-4,7	2,7	1,7
Household consumption (change, % , constant prices)	2,8	-0,4	0,6	-0,5
Government consumption (change, % , constant prices)	1,2	3,8	0,6	-1,4
Gross fixed capital formation (change, % , constant prices)	4,1	-11,5	0,1	-1,2
Inflation (CPI, average for period, %)	6,3	1,0	1,5	1,9
Unemployment rate (MLSA, average for period, %)	4,4	6,7	7,3	6,7
Current account balance for GDP (% , current prices) <sup>2</sup>	-2,1	-2,4	-3,9	-2,9
Balance of trade for GDP (% , current prices)	0,7	2,3	1,4	2,5

Source: CZSO, CNB, MLSA

## 2. FUNDS FOR USE IN THE FINANCIAL MARKET

The amount of funds for use in the financial market has been gradually increasing over the years, but with decreasing dynamic. The annual increases in excess of 10 % from the years 2004 to 2007 were replaced by the rate of 4 to 5 %. At the end of the year 2011, the total funds increased by only 3.7 % to the total of nearly 3.9 trillion CZK.

**Graph 2.1: Funds for use in the financial market**



Source: MoF, CNB, AKAT

The largest increases in absolute terms (by 118.9 billion CZK) occurred for the most important item, i.e. bank deposits; bank deposits accounted for 69 % of monitored funds in the year 2011. Other ways of placing funds showed absolute changes only in the order of units, or low tens of billions CZK. In relative terms, the changes reached the level of a few per cent, with the greatest increase in supplemental pension insurance (7.4 %, same as in the past 3 years).

After two years of stagnation or slight decrease, the volume of currency began to grow again, but at half the rate compared to the years 2005 to 2008 (5.7 % vs. about 12 %). But it still holds a stable share of the total assets in the financial market (approx. 10 %).

<sup>2</sup> Time series of trade and current account in 2008 have not been revised according to new methodology and therefore are not comparable with data for years 2009 and 2010.

The assets under management of building societies are close to the top of their growth trajectory (relative growth of only 0.8 %), reflecting the gradual reduction in the number of clients. An absolute decrease occurred only in the case of collective investment where, due to a combination of lower prices of some assets and investors' preferences, there was a reduction in the volume of managed assets.

As a result of the planned pension reforms in the subsequent years, we can expect a further increase in the volume of funds managed by pension companies (pension funds until today). The position of the banking sector as the main asset manager would not, however, be compromised thereby.

**Table 2.1: Funds for use in the financial market**

As at 31 Dec (CZK bn)	2010	2011	Year-on-year change	
			Abs.	(%)
Deposits in banks <sup>3</sup>	2 545,6	2 664,5	118,9	4,67
of which: building savings schemes	430,1	433,4	3,3	0,77
Collective investments	247,5	224,1	-23,4	-9,45
Supplementary pension insurance, including state contribution	216,1	232,1	15,9	7,38
Placement of insurance companies' technical reserves	374,3	381,0	6,7	1,79
Currency in circulation	357,5	377,9	20,4	5,72
<b>Total</b>	<b>3 741,0</b>	<b>3 879,6</b>	<b>138,6</b>	<b>3,70</b>

Source: MoF, CNB, AKAT

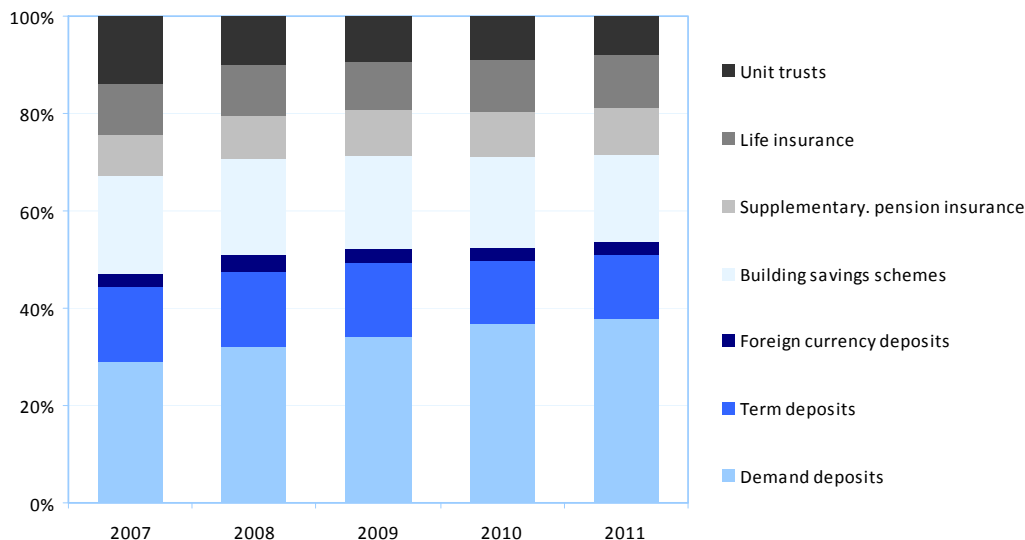
### 3. STRUCTURE OF HOUSEHOLD SAVINGS

Same as in the previous years, there was a slight increase in household savings in the year 2011. The total volume amounted to 2 392 billion CZK at the end of the year. The structure thereof, however, changed only slightly in time. Generally, Czech households have deposited their savings mainly with banking institutions (the long-term percentage has been around 70 %, 71.5 % in the year 2011) and the population prefers low risk and liquid assets. The proportion of "on call" deposits increases (up from 28.8 % in 2007 to 37.9 % in the year 2011) at the expense of time deposits (down gradually from 15.3 % to 13.0 %), reflecting the growing popularity of savings accounts often bringing higher returns, in addition with the possibility of immediate withdrawal (i.e. without notice).

Outside the banking sector, the proportion of supplementary pension insurance has been increasing in the last 5 years; supplementary pension insurance accounted for nearly 10 % of savings of the population in 2011 (compared to 8.5 % in 2007). On the other hand, there has been a gradual reduction in households' allocation of funds into mutual funds (from 14 % in 2007 to 8 % in the year 2011). This shows both reduced confidence in the capital market after the financial crisis and the unfavourable development of market value of assets under management.

<sup>3</sup> Include the koruna deposits of clients (residents and nonresidents) according to the sectoral point of view.

**Graph 3.1: Development of structure of households savings in the Czech Republic**



Source: CNB, MoF, AKAT

## 4. FINANCIAL MARKET ENTITIES

The structure of entities of the Czech financial market has been stable over time and has also been competitive enough. In most sectors, there has been minimum of changes in the number of active entities; slight increase often occurs in the form of branch offices of foreign institutions. Experience confirms that when a foreign entity does business in the financial market in the form of a Czech branch, such activities are less demanding, both from an administrative point of view and in terms of capital requirements.

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

As at 31 Dec	2007	2008	2009	2010	2011
Banks	37	37	39	41	44
of which: foreign banks branches	14	16	18	19	21
of which: building societies	6	5	5	5	5
Cooperative banks	19	17	17	14	14
Securities dealers	44	38	39	37	35
Investment funds	7	16	25	47	58
Investment firms	18	19	22	23	21
Open-ended unit trusts	121	142	139	150	156
of which: special OUT	83	101	103	113	119
of which: standard OUT	38	41	36	37	37
Foreign funds /sub-funds	1 499	1 596	1 480	1 320	1 244
of which: based on common European licence	1 479	1 569	1 453	1 293	1 239
of which: special funds	20	27	27	27	28
Investment intermediaries	13 370	12 870	9 112	9 064	10 072
Pension funds	11	10	10	10	9
Insurance companies	52	53	52	52	53
of which: branches of foreign insurance companies	18	18	17	17	18
Reinsurance companies	0	1	1	1	1
Insurance intermediaries	67 500	86 230	105 980	126 123	149 729
Tied agents	-	-	9 123	11 250	14 729

Source: CNB



Banks play an important role in the structure of the financial market. The three largest financial groups (ČSOB, ČS a KB) play a decisive role and their complex activities go far beyond the banking sector itself. Through their subsidiaries, they cover other related financial market products, thus creating a multiplier effect in the offering of their services.

The total number of banks increased by 3 entities. Air Bank started to operate in 2011 and two branches of foreign banks, namely Bank Gutmann Aktiengesellschaft, Czech Republic branch, and Volksbank Löbau-Zittau eG, branch. The ownership change at Banco Popolare (now Equa bank) is one of the significant changes related to entities in the banking sector and we should also mention the Russian bank Sberbank<sup>4</sup> gaining control in Volksbank CZ. The new banks or banks operating under a new name revive the banking market by the flexible range of services often based only on Internet or telephone communication.

The capital market has seen relatively higher volatility in the number of entities. We can observe a slight tendency to reduce the numbers of foreign funds or sub-funds mainly due to acquisitions by mutual merges in order to optimize portfolios. There has also been a change in the supplementary pension insurance sector as two pension funds of the ČSOB Group merged at the end of the year 2011 and started to operate under the name of Pension Fund Stabilita.

In the segment of the investment and insurance intermediaries incl. tied agents, there has been a continuous increase in the number of entities. However, the question is whether all the registered intermediaries are fully active in their field of financial intermediation. Expert estimates are at one third of the number actually reported. The upcoming legislative changes should make the intermediaries' market more transparent and unify the approach to the requirements for particular skills across the entire financial market. The number of intermediaries would thus be decreased by striking formally registered entities that carry out their activities only occasionally.

The number of 'notified bodies' using the freedom of movement under a single license has also been gradually stabilizing. The highest increases from the early times of opening up the market are history. The increases have been modest and the numbers of funds and investment firms have decreased slightly due to the above-mentioned restructuring process of the capital market through mutual mergers of the existing funds. Because these entities do not have a reporting obligation towards the CNB, their range of activities is not known exactly. It is estimated that the scope of their activities is less significant. They have rather a complementary function to the overall offer of financial services which is often narrowly focused. Yet they are already considered to be an integral part of the financial market in the Czech Republic contributing to an increase of its competitiveness.

**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 firms	Providers of investment services
2010	284	658	1 347	48	1 226
2011	302	696	1 239	46	1 389

Source: CNB

The changes in employment with financial institutions are insignificant. Compared to 2010 which saw the full impact of austerity measures resulting in decrease in employment, employment has been increasing slightly in the core banking sector. Profit generation by financial institutions lagged behind the year 2010 (with the exception of leasing companies) as 2010 was the time of market recovery after the previous critical period of time.

<sup>4</sup> The Russian bank Sberbank gained control over the Austrian bank Volksbank International, AG which owns Volksbank CZ in the Czech Republic.

**Table 4.3: Economic results of financial institutions (year-on-year comparison)**

Financial Institutions		Banking financial institutions	Non-banking financial institutions	Insurance companies	Pension funds	Financial leasing companies	Investment companies
Average headcount <sup>5</sup>	as at 31 Dec 2010	38 124	14 320	14 270	446	2 638	345
	as at 31 Dec 2011	39 096	14 157	14 274	472	2 605	328
	change (%)	2,55	-1,14	0,03	5,83	-1,25	-4,93
Profit/loss before tax (CZK bn)	as at 31 Dec 2010	65,6	49,6	28,4	4,6	5,0	13,6
	as at 31 Dec 2011	63,5	24,3	12,0	4,6	8,5	6,5
	change (%)	-3,20	-50,90	-57,70	-1,73	68,19	-52,21

Source: CZSO, CNB

#### 4.1. The banking sector

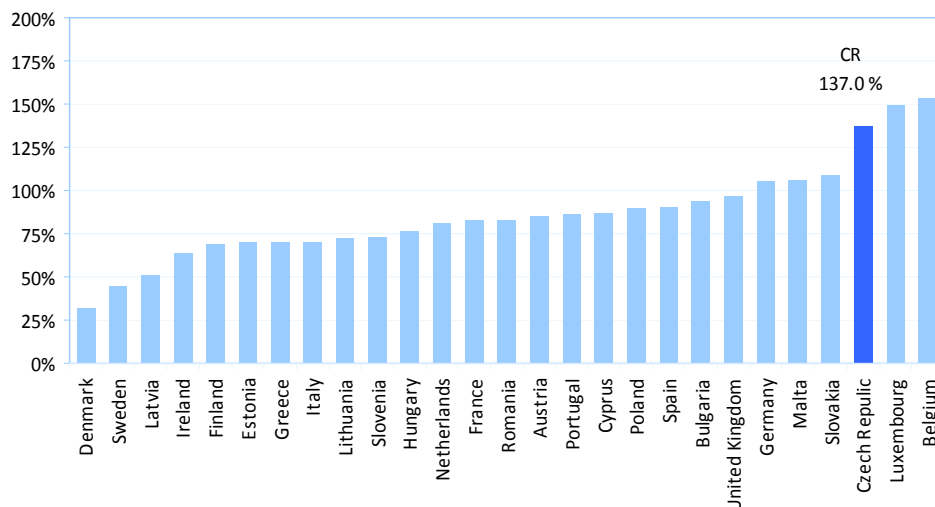
The banking sector in the Czech Republic showed in 2011 that the development thereof was immune to the continuing uncertainty in global financial markets and the risks in some euro area countries. The factors that helped the national banking sector as a whole to successfully cope with the crisis in international financial markets which escalated in 2008 still have a positive effect on the stability of financial institutions in the country.

Capital adequacy of the banking sector in the Czech Republic has improved in the last few years, despite the global uncertainty. At the end of the period, capital adequacy amounted to nearly 15.3 % (the required regulatory minimum is 8 %). This does represent a slight year-on-year decline (by 0.3 percentage points), but also a significant increase compared to the state before the crisis in 2007 when capitalization equalled 11.6 %. We can say that banks operating in the Czech Republic have a substantial capital cushion to cover unexpected losses.

The stability of sources of funding and overall liquidity in the sector is supported by the high proportion of bank financing in the Czech Republic by client deposits. In general, deposits from clients are more reliable and more stable in times of liquidity problems than financing from the interbank market in which financial institutions lend funds to each other. The ratio of deposits to loans has been very stable in the Czech Republic and is approximately 137 %. This ratio shows that loans extended to clients are financed by more than 100 % by client deposits. From this perspective, the banking sector in the Czech Republic ranks among the most stable in Europe. The least favourable values have been reported by Ireland, some economies of Scandinavia and the Baltic States which undergone dynamic credit growth at different times in the past.

<sup>5</sup> Average adjusted number of employees in natural persons.

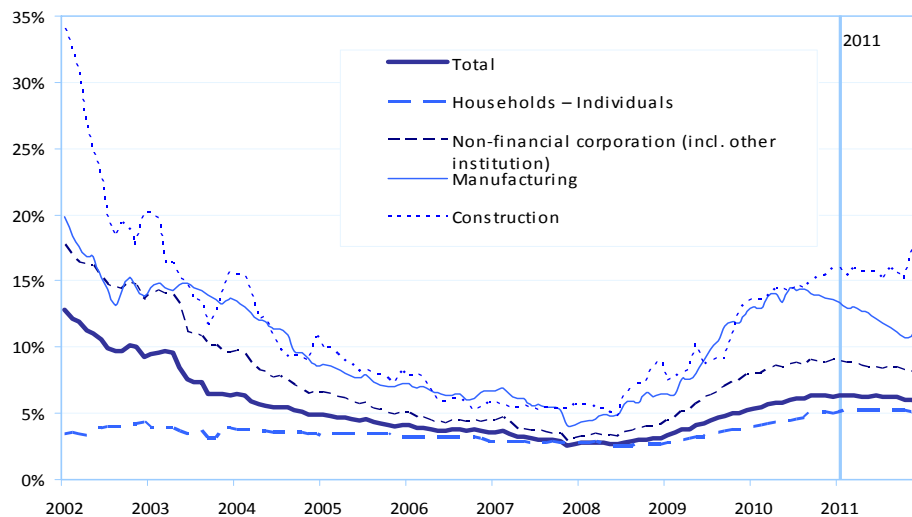
**Graph 4.1: Client bank deposits to loans ratio in 2011**



Source: ECB

Total assets of the banking sector including building societies rose to 4 476 billion CZK at the end of the year 2011. The growth dynamics of this indicator has also accelerated as it rose year-on-year by 6.9 %. That means three times the growth rate compared to the development in the year 2010. Out of assets, the highest increase was in receivables from clients which mainly reflects the recovery of credit activities. In terms of their quality, the balance sheets of banks are in relatively good condition. The quality of loan portfolios that are the most important factor in this sense are illustrated by the following chart which shows the share of loans in default for each group of borrowers.

**Graph 4.2: Share of non-performing loans**



Source: CNB – ARAD

The aggregate figure, i.e. the share of non-performing loans to total loans (provided to both residents and nonresidents) indicates a possible reversal of the previous trend of deterioration of credit portfolio quality. Out of the last five years, this indicator peaked in September 2010 (6.4 %), then declined slightly to just under 6 % at the end of the year 2011. Loans to households – individuals show a lower default rate (4.9 % at end of the given period) than loans extended to non-financial corporations (8.2 %). In the segment of non-financial corporations, however, different values and different developments can be observed between segments. The selected sub-segments of construction and manufacturing industries are significantly above average compared to the total values for non-financial enterprises. In the case of manufacturing in contrast to construction, the

trend has been towards improving the quality of loans during the years 2010 and 2011. This can be attributed to domestic economic recovery and improving demand from abroad.

The relatively low share of loans denominated in foreign currency has not changed significantly compared to 2010. Changes in domestic currency exchange rate do not directly and negatively impact the borrowers or asset quality of credit institutions as is the case in Hungary for instance. The share of foreign currency loans, although varying in the case of firms in the interval from 15 to 20 % in the last few years, is to some extent matched by foreign currency cash flows from export revenues. Household indebtedness in foreign currencies is at the level of tenths of a percent which is negligible.

The entire banking sector generated profit before tax of 63.5 billion CZK in the year 2011. A slight year-on-year decline by 3.2 % was caused mainly by accounting for the decline in the value of investments in sovereign bonds of some troubled euro area countries . Otherwise, the figures would show year-on-year growth. Same as the year before, year-on-year interest income grew faster (by 3.2 %) than the interest expenses (by 1.3 %). Net interest margin therefore increased slightly to 3.0 % and net interest income (i.e. after deduction of interest expenses) amounted to 109.9 billion CZK which means a year-on-year increase of 4.5 billion CZK. Net income from fees and commissions contributed to the profitability by 39.1 billion CZK (without other related costs). The dynamics of this category of income (an increase of 1.6 %) was, however, lower than the growth in net interest income. In absolute terms, the importance of net interest income is even more obvious. Ratios of net interest income to net income from fees and commissions amounted to more than 2.8 multiple. This relationship can be illustrated in relation to profits as well. While the net interest income accounted for almost 68 % of profits from financing & operating income and expenses, net income from fees and commissions amounted to only 24 %.

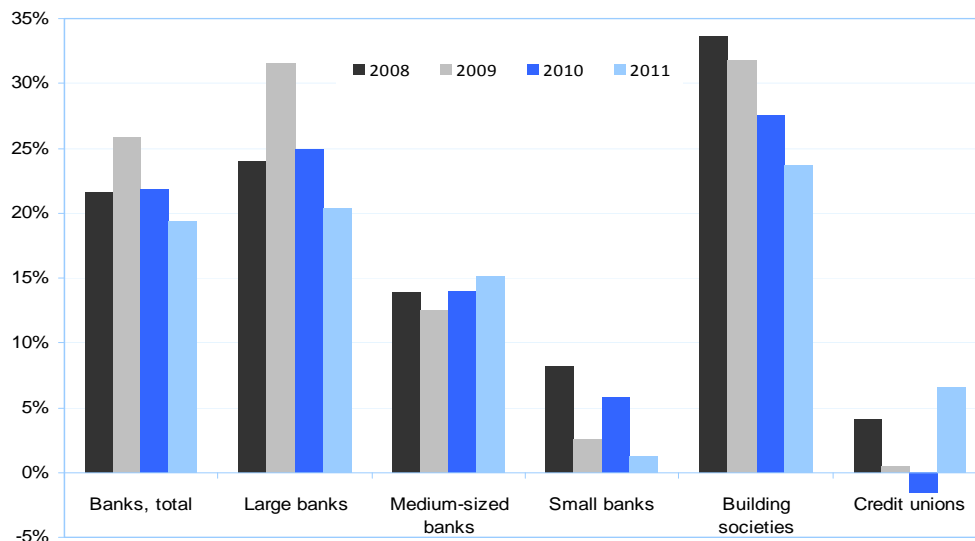
**Table 4.4: Selected items from the profit and loss accounts of the banking sector**

Item (in billion CZK or %)	2008	2009	2010	2011	Year-on-year change
Financial & operating income and expenses	138.0	168.4	157.4	162.1	3.0 %
Total profit or loss before tax from continuing operations	54.0	70.8	65.6	63.5	-3.2 %
Interest income	191.9	174.4	167.0	172.3	3.2 %
Interest expenses	93.9	71.2	61.7	62.5	1.3 %
Net interest income	98.0	103.3	105.3	109.9	4.3 %
Fee and commission income	46.8	46.8	48.4	50.0	3.4 %
Fee and commission expenses	10.7	10.3	9.9	10.9	10.2 %
Net fee and commission income	36.1	36.4	38.5	39.1	1.6 %
Ratio of net interest income and net fee and commission income	2.71	2.83	2.74	2.81	2.7 %
Ratio of net interest income and financial & operating income and expenses	71.0 %	61.3 %	66.9 %	67.8 %	1.3 %
Ratio of net fee and commission income and financial & operating income and expenses	26.2 %	21.6 %	24.5 %	24.1 %	-1.4 %

Source: CNB

The following graph (4.3) illustrates the different levels of relative profitability in the individual segments of the credit institutions sector which are also the focus of some other chapters of this report. The graph compares the profitability relative to the higher quality Tier 1 capital and shows that the individual segments generate very different levels of profitability. Despite year-on-year fluctuations, no significant convergence of these values can be observed. In relative terms, the banking sector fared slightly worse than in the previous years. One explanation for this may be the increase of Tier 1. The reasons may differ, however, for individual entities.

**Graph 4.3: Tier 1 capital rentability**



Source: CNB

The resilience of the banking sector was also confirmed by stress tests conducted by the CNB in February 2012 using data from the end of the year 2011. They indicate that even if a less likely negative scenario was considered, the capital adequacy of the sector would remain above the regulatory minimum of 8 %. This result is reached in spite of a very conservative setup of the scenario of adverse developments which envisages, *inter alia*, deepening of the debt crisis in the euro area, decrease of the economic activity of foreign trade partners and the consequent negative impact on the bank loan portfolios.

#### 4.1.1. Interest Rates Development

The monetary policy rates of the CNB which in turn influence the development of market interest rates did not change in the year 2011. CNB kept the key 2W repo rate at 0.75 % and the monetary policy of the central bank thereby kept its key interest rates at historically low levels.

A similar development of the annual setting of key interest rates can be observed in the case of most central banks in the world as these in fact also have not changed. Bank of England left its key interest rate at 0.5 % and the Federal Reserve in the range from 0.0 to 0.25 %. Only the European Central Bank initially increased its key rate twice during the year 2011 by 0.25 percentage points, but subsequently decided on its gradual decrease back to 1.0 %. It should be noted, however, that in comparison with those central banks, the CNB did not carry out unconventional measures such as buying government securities in the process of quantitative easing.

**Table 4.5: CNB interest rates**

(%)	30 Jun 2009	31 Dec 2009	30 Jun 2010	31 Dec 2010	30 Jun 2011	31 Dec 2011
2T repo	1,50	1,00	0,75	0,75	0,75	0,75
Discount	0,50	0,25	0,25	0,25	0,25	0,25
Lombard	2,50	2,00	1,75	1,75	1,75	1,75

Source: CNB

The APR rate<sup>6</sup> on new loans for consumption was basically unchanged, same as in the previous year. It amounted to 15.7 % in December 2010 and after an initial increase in January 2011 (by 1.2 percentage points month on month) gradually declined during the year. In December 2011, it again almost reached the values from the previous December. Conversely, for the APR for the purchase of residential property, it can be stated

<sup>6</sup> APR shows the percentage of the amount owed that the client must pay for a period of one year beyond redemption of the amount due in connection with the instalments, administration and other costs associated with drawing the loan. This is the APR of koruna-denominated loans granted by banks in the CR (new business).

that the continued low interest rates of the central bank together with the stable development of the financial sector and real economy and competition in the provision of these loans contributed to a further decline in market interest rates to end customers. The rate dropped by 0.7 percentage points to 4.1 %.

**Table 4.6: APR (Annual Percentage Rate) of CZK loans provided by banks in the CR**

New loans 2011 (%)	January	February	March	April	May	June	July	August	September	October	November	December
Consumer credit	16,9	17,0	16,5	16,1	16,0	15,8	15,9	16,0	16,0	16,2	16,1	15,8
For residential real estate	4,8	4,8	4,8	4,7	4,7	4,6	4,5	4,6	4,4	4,3	4,1	4,1

Source: CNB

#### 4.1.2. Deposits and loans

The volume of bank deposits grew during the year 2011 by 1.2 percentage points faster than the previous year, increased by 4.5 % and reached 2 914.0 billion CZK at the end of the year 2011. The volume of loans grew even faster than the volume of deposits, up by 6 % year-on-year. Nevertheless, the volume of deposits still significantly exceeds the amount of total loans which is favourable for the stability of financing the national banking sector. As shown in Table 4.7, the total volume of bank loans provided reached 2 304.5 billion CZK at the end of the year.

**Table 4.7: Distribution of deposits and loans with banks by sectors**

As at 31 Dec, Sector	Bank deposits (CZK bn)				Loan beneficiaries (CZK bn)			
	2010	2011	Change	Change (%)	2010	2011	Change	Change (%)
Households	1 641,6	1 711,3	69,7	4,2	1 028,2	1 095,2	67,1	6,5
Non-financial companies	632,9	673,1	40,2	6,4	779,7	828,2	48,5	6,2
Government institutions	284,6	305,1	20,5	7,2	64,9	64,2	-0,7	-1,2
Financial institutions	116,6	116,9	0,4	0,3	118,4	117,0	-1,4	-1,2
Non-residents	89,1	84,9	-4,3	-4,8	166,9	196,9	30,0	18,0
Other	23,2	22,6	-0,6	-2,7	15,9	2,9	-13,0	-81,6
<b>Total</b>	<b>2 788,1</b>	<b>2 914,0</b>	<b>125,8</b>	<b>4,5</b>	<b>2 174,0</b>	<b>2 304,5</b>	<b>130,4</b>	<b>6,0</b>

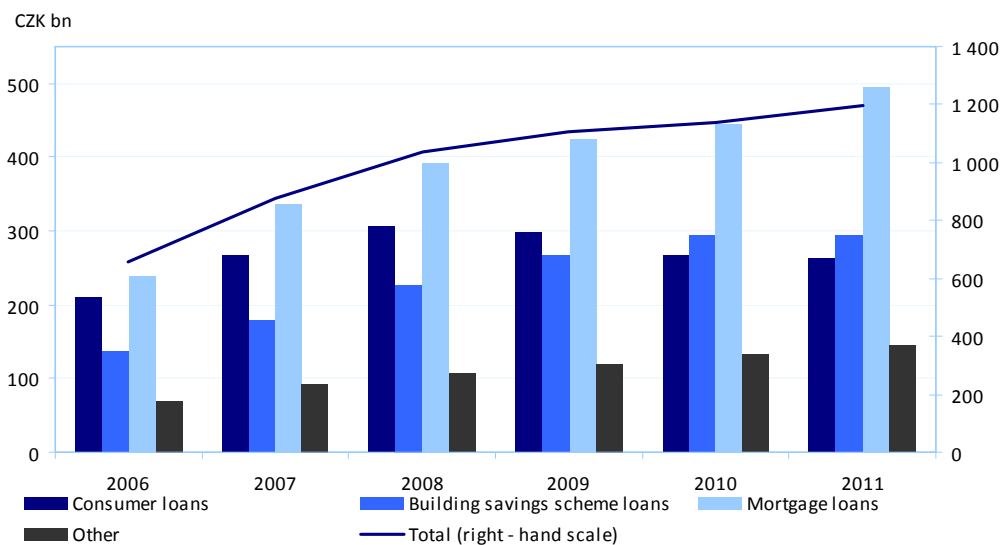
Source: CNB - ARAD

Note: The table shows deposits with banks in koruna and foreign currencies, which are subsequently converted to billions CZK. The values are therefore different from table 2.1, which only lists koruna bank deposits.

Same as in the previous two years, the most important contributor to the increase of deposits volume in 2011 was the household sector; the deposits of households grew by nearly 70 billion to more than 1 711 billion CZK. Other major client segments were non-financial corporations and government institutions which together deposited 60.7 billion more at the end of the year 2011 than a year ago. When we look at the change in the term structure of deposits, the greater increase occurred for "on call" deposit accounts (an increase of 6.4 %) compared to term deposits (an increase of 1.9 %). 58.9 % of all deposits was deposited in "on call" accounts at the end of the year 2011.

The recovery in lending was supported by both of the two most significant segments. The volume of total loans to non-financial corporations increased by 48.5 billion to 828.2 billion CZK (by 6.2 %). A year earlier, by contrast, there was a stagnation in loans to non-financial corporations (a drop by 0.3 %). Loans to households grew at rates similar to rates for loans to enterprises (by 6.5 % to 1 095.2 billion CZK). The fastest growth was in the non-residents segment. The increase by CZK 30.0 billion represented an annual growth rate of 18.0 %.

**Graph 4.4: Total household indebtedness<sup>7</sup>**



Source: CNB - ARAD

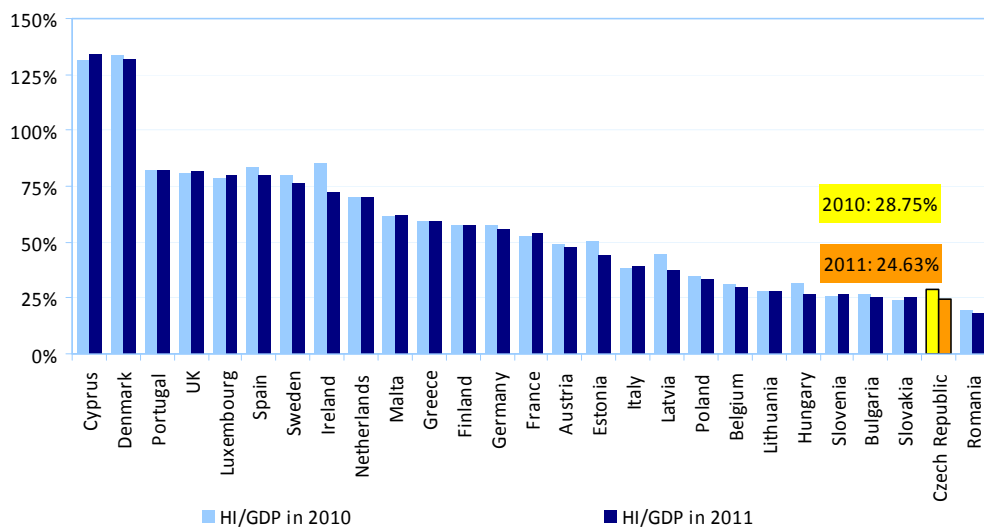
Total household debt to banks and non-banking financial institutions reached 1 196 billion CZK. This represents an increase by 5.1 % during 2011. The dynamics of growth of indebtedness thus increased by 2.4 percentage points. The developments of debt differed in the individual segments also in 2011. Debt to finance consumption showed a slight decrease (by 1.4 %). Compared with the previous period, this is a significant slowdown in decline as the year 2010 saw reduction of consumption debt by more than 10 %. On the other hand, debt in order to invest in housing grew at a similar pace as in the previous year (6.7 %). The share of housing loans in total debt thus increased again to nearly 66 % at the end of the year 2011. The absolute increase in housing loans amounted to CZK 49.5 billion, while loans for consumption dropped by 3.8 billion CZK.

Graph 4.5 illustrates that the level of household debt relative to the size of the national economy remains relatively low (about 24.6 % of GDP) in the Czech Republic compared to the rest of the EU.<sup>8</sup> Similarly as before, therefore, the cost of servicing the liabilities of households are generally not a factor that could reduce private consumption to the extent as may be the case in countries with higher relative levels of indebtedness. As the chart shows, low debt levels are also reality in other new member states from Central Europe. This may be because of a relatively recent transition of these countries to market economy, during which these have not accumulated relative volumes of credit common in Western Europe. A more recent trend is a decrease in the relative level of household debt in some countries which underwent rapid credit growth before 2008. These include in particular Ireland, Latvia and Estonia and to a lesser extent also Spain and Hungary. The reason for this is not only a decrease in loans for reasons of tightened credit conditions and lower credit capacity of borrowers, but also the growth of the denominator of this relative indicator in connection with the economic recovery, especially in the Baltics.

<sup>7</sup> Loans granted by building societies in this case represent the total amount of bridge loans and "standard" building societies loans.

<sup>8</sup> The yoy evolution of this indicator has limited interpretability in the case of economies with different domestic currency than the euro. In these cases, there is the annual risk of volatility in value owing to the local currency exchange rate fluctuations against the euro, which is then used to express the commitment of households in domestic currency in units of a common European currency euro.

**Graph 4.5: Total household indebtedness in the EU**



Source: ECB, Eurostat

The fact that more than 99 % household debt is denominated in the local currency is in favour of a more stable repayment in the long-term. The size of payments in CZK is not influenced by exchange rate volatility as in some other countries in the geographic region of Central and Eastern Europe. On the contrary, countries with higher foreign currency debt are facing negative effects thereof in two areas. Primarily, the higher volatility of payments denominated in the national currency reflects in fluctuations in the volume of private consumption and thus destabilizes the domestic aggregate demand. In addition, if consumer spending cushion does not allow for covering these fluctuations, the volatility of the exchange rate can subsequently be reflected in a decline in the repayment of loans and deterioration in the quality of bank assets. The banking sector in the Czech Republic with low debt in foreign currency therefore has a significant advantage.

In addition to the above, it is also true that the ratios of total debt levels and aggregate GDP (due to the nature of its aggregate macroeconomic nature) not take into account some microeconomic specifics such as the different situation in individual income groups or regional differences in debt. Generally speaking, the most serious problems in repaying are especially among the most vulnerable groups. These include low-income households that must spend most of their relative income to service their obligations.

### 4.1.3. Building societies

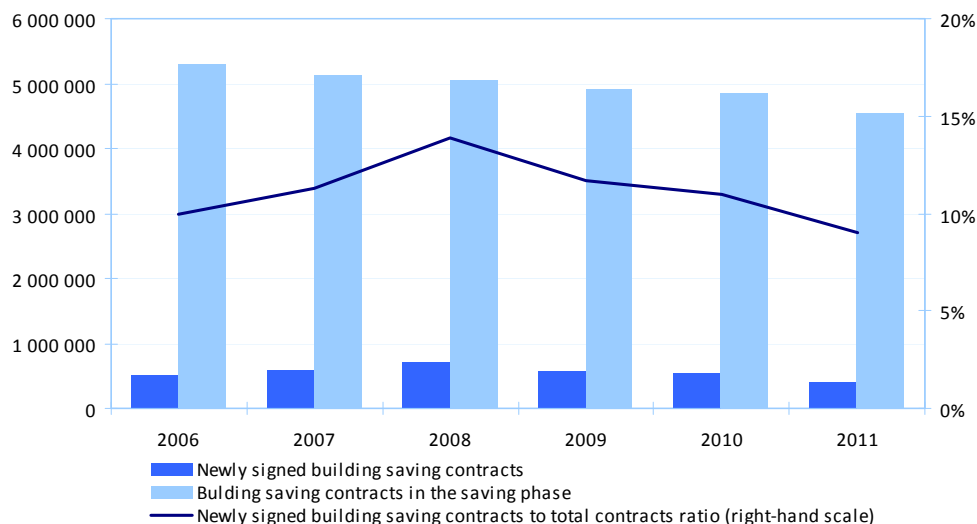
In 2011, building savings schemes sector went through several major modifications that have affected this sector. The most important change was the reduction of the maximum amount of state contribution for all contracts to CZK 2 000 per calendar year. After seven years (since 2004) the dual structure of contracts was cancelled, where part of the participants in building savings schemes in the case of "old contract" (closed before December 31, 2003) was entitled to the maximum state contribution amounting to 4 500 CZK and the participants with a "new contract" (concluded after January 1, 2004) were entitled to the maximum state contribution amounting to 3 000 CZK. The introduction of the maximum entitlement to state contribution in the amount of 2 000 CZK on all contracts unified the terms in the two groups of participants. Another change in the building savings schemes sector was the introduction of taxation of interest income from building savings by 15 % withholding tax. Last modification - taxation of state contributions credited to the party in 2011 - was cancelled by the Constitutional Court in April 2011 (Act published under the No. 119/2011 Coll.), and so the amount of the originally withheld taxes from the state contribution was subsequently (in May 2011) transferred to building society accounts.

The number of new contracts fell to 410 thousand in 2011 (a year-on-year decrease of 23 %), the target amount thereof reached 145 billion CZK. The decline can be attributed to the measures described above (decreasing value of deposits in building savings schemes), but only partially – reduction in the number of new



contracts has been the trend of the last three years. The average level of the target amount for natural persons amounted to 346 thousand CZK and reached its highest value since the beginning of the existence of building savings schemes in the country. The number of terminated contracts was higher in 2011 than the number of newly signed contracts which resulted in a further decline in the number of contracts in the savings phase to 4.55 million. The trend of loss of the total number of contracts has existed since 2004 when the decline in the number of contracts in the saving phase ranged from 1 to 6 %, while between the years 2010 and 2011 the decline was 6.1 %.

**Graph 4.6: Number of building savings contracts**



Source: MoF

Total loans<sup>9</sup> decreased by 36 thousand year-on-year to 957 thousand. The total volume of loans at the end of the year 2011 equalled 293.1 billion CZK which virtually means stagnation (a yoy decrease of only 0.1 %). The result contrasts with the development of mortgages loans to households where there was a yoy increase of 9 % (see Table 4.9).

The average loan amount reached 517 thousand CZK. The ratio of loans and the amount saved has fallen by 0.6 percentage points to the level of 67.6 % which means that about a third of deposits in building societies in 2011 was not used in the form of loans but was placed in other assets, namely in bonds.

**Table 4.8: Total loans to saved amount ratio in the building savings schemes sector**

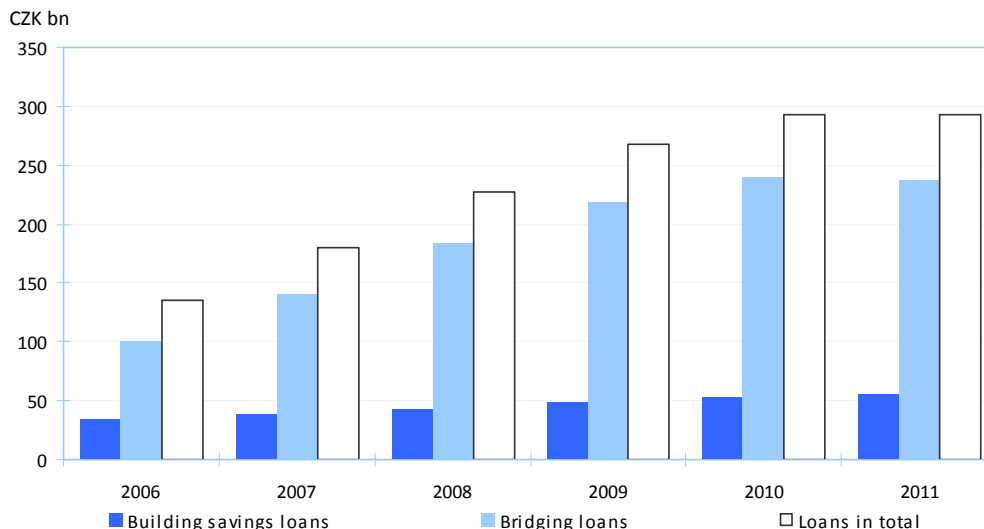
	2006	2007	2008	2009	2010	2011
Total loans to saved amount ratio	37,6 %	46,6 %	56,7 %	64,4 %	68,2 %	67,6 %

Source: MoF

Changes in the credit provided by building societies are recorded in the following two graphs:

<sup>9</sup> Building societies provide building savings loans and bridging loans. The term "loans" is meant to cover both types of loans. If the information relates to only one type of loan, this is explicitly stated herein.

**Graph 4.7: Development of loans in building savings scheme sector**

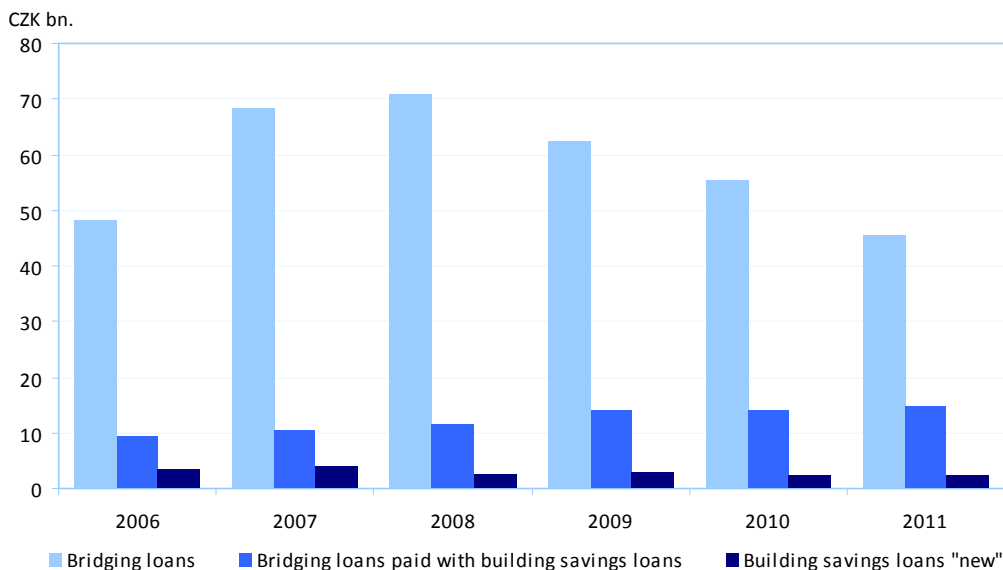


Source: MoF

The graph above (4.7) shows a change in the structure of loans in the building savings schemes sector in the years 2006 to 2010 when there was a significant decline of ratio of loans under the building savings schemes to total loans (from 29 % to 18 %). This trend was reversed in 2011 by a slight increase in the share of loans by building societies to 19 % of loans (55.8 billion CZK). Bridging loans reached 81 % of loans (237.3 billion CZK).

In total, the volume of loans increased until 2010 (Graph 4.7) and there was a stagnation in 2011 or we should rather say a slight decrease (a decrease by 247 million CZK, i.e. by 0.1 %). The reason was the year-on-year decline of new bridging loans (a decrease of approximately 10 billion CZK, Graph 4.8) which only compensated for the volume of annual instalments. This decline in persons interested in loans from building societies reflected the reduction in rates for mortgage loans. Universal banks offered lower rates and succeeded in taking over part of the clients of building societies. Due to the expected growth of rates in the financial market, it can be assumed that the attractiveness of building society loans will rise again in 2012.

**Graph 4.8: Development of new loans in building savings schemes sector**

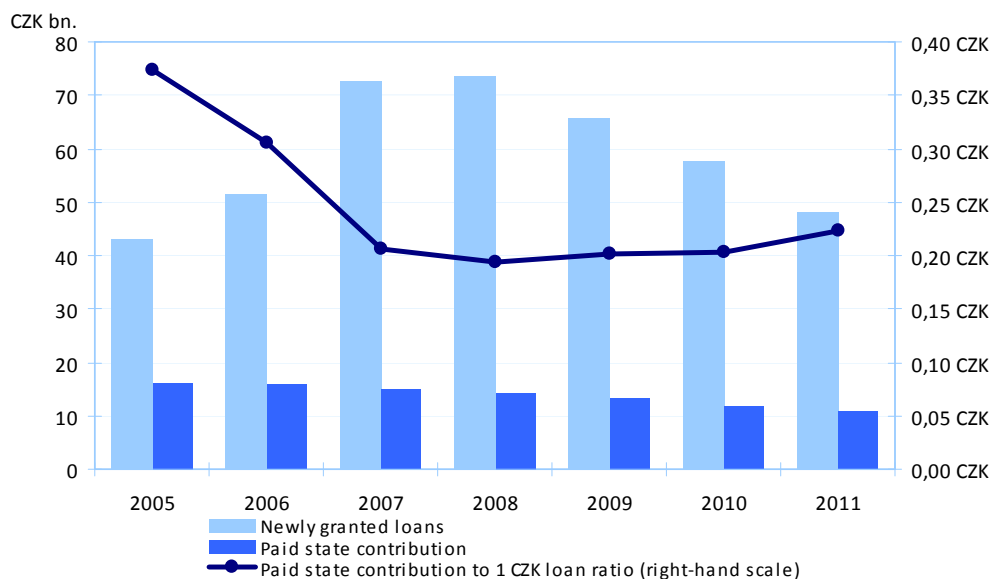


Source: MoF

The amount of state contributions paid within building savings schemes sector (Graph 4.9) reached CZK 10.7 billion in the year 2011. It is by about 1 billion CZK less than in the year 2010. During the existence of

the building savings schemes, the state has supported this kind of saving by the amount of 172.5 billion CZK. For the next years, a noticeable decrease is expected to around 5 to 6 billion CZK of the annual state contributions paid which is due to the reduction of the maximum amount of state contribution to one participant to 2 000 CZK. Given that the state has been paying contributions to building savings schemes from the state budget and the use of the funds is only reviewed when drawing loans, it is relevant to monitor also the amount of state contribution per 1 CZK of the earmarked expenditures (i.e. loan) to finance housing needs generated by the building savings schemes sector. In the last 5 years, this indicator has fallen to the level about 20 hellers. From 2012 on, the aforementioned change in the parameters of state contributions will bring about a further decrease to about 10 hellers.

**Graph 4.9: Development of paid state contributions**



Source: MoF

#### 4.1.4. Mortgage market

The volume of mortgage loans to households amounted to 659 billion CZK at the end of the year 2011, as shown in Table 9.4. The rate of year-on-year change is essentially unchanged and represents an increase of 9 % (54.3 billion CZK) compared to the year 2010. It should be noted, however, that the time series is affected by the change in reporting methodology.<sup>10</sup> This complicates the analysis of long-term evolution of the total time series.

**Table 4.9: Balance of mortgage loans (ML) to households**

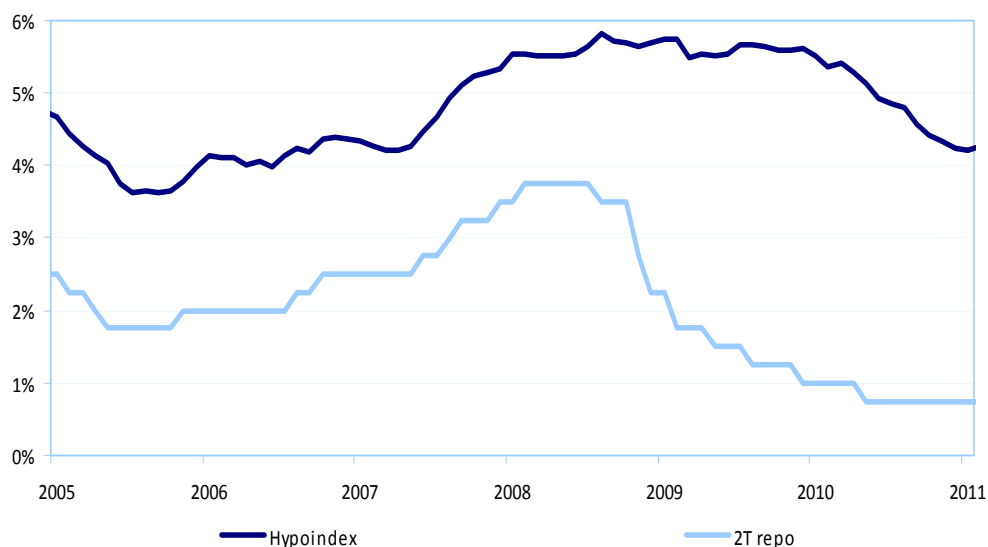
As at 31 Dec	2008	2009	2010	2011	Year-on-year change	
					Abs.	(%)
Number of mortgage loans (000s)	406,5	450,8	501,5	572,6	71,1	14,17
Agreed principal (CZK bn)	589,7	663,5	748,3	867,4	119,1	15,91
Volume of loans (CZK bn)	397,1	554,4	604,7	659,0	54,3	8,99

Source: MRD, CNB - ARAD

<sup>10</sup> When analyzing the volume of mortgage credit in 2008 and 2009, we must take into account that the statistics of the CNB has changed the classification in the sense that new this set includes all loans secured by at least 50%, instead of the earlier prerequisite of 100% collateral. This change applied to mortgage loans for residential and commercial property. A step change in values was caused primarily by this administrative change. A related change is in the volume of bridging loans reported within the CNB statistics (does not apply to data reported by the MF). Part of bridging loans is not secured 100% and was therefore in terms of the CNB statistics conducted earlier recorded as bridge loans and is now registered as a mortgage loan. In reality, however, it is still the same bridge loan provided by the building society.

It is fairly complex to estimate the future trends regarding the volume of mortgage loans to households. Generally speaking, however, the continuing relatively low level of indebtedness of Czech households may be one of the factors that will enable further growth of the mortgage market in the longer term. The factors involved in the short term will undoubtedly include the pace of economic growth which mainly relates to the demand for loans and development in financial markets. The effect of deferred demand as a result of previous economic and financial uncertainty or expectations of further declines in house prices can both play their temporary role. Improvements in the last two years have been brought about by the falling costs of mortgages financing which can be tracked as the Hypoindex rate. Same as a year ago, we can say that further development will be impacted by whether there is a rise in interest rates on loans. Demand for mortgage loans may also be affected by, *inter alia*, price expectations. The overall outcome remains uncertain as these factors may influence the market in opposite directions. Influences that could lead to an increase in demand - such as economic recovery - also indirectly support the increase in interest rates of mortgage loans and thereby counteract the growth in property prices. Economic growth and increases of wages may in fact be reflected in growth in 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. Interest costs subsequently rise and attractiveness of mortgages declines which may have a negative impact on demand.

**Graph 4.10: Selected interest rates' development<sup>11</sup>**



Source: Fincentrum, CNB

The trend of decline in the Czech mortgage market rates reported thru Hypoindex continued also in the year 2011. The decrease during the year was by 0.7 pp to 3.56 % at the end of the said period of time. During 2010, the drop was 1.4 percentage points. Compared to the previous year, deceleration of the decline can be observed as the mortgage rates move closer to the monetary policy interest rates. Thereby, the difference between Hypoindex and the 2W repo rate has decreased from its peak of 4.6 % at the end of the year 2009 to 2.8 % two years later. With some delay, Hypoindex thereby followed the reduction of the basic interest rates of the CNB which already began in 2008 in connection with the global financial crisis. The spread between the two rates was at the lowest level at the end of the year 2011 since October 2008, but the monetary policy rates were significantly higher then. This has therefore led to an increase in the availability of mortgage credit as far as the interest rate is concerned. Among the factors behind the decline of the Hypoindex rates is the competition among lenders that pushed mortgage rates lower, the popularity of floating-rate contracts, and of course cheaper sources of financing as a result of monetary policy. A look at the causes of the decline suggests, however, that there is a limited potential for the continuation of this trend as the mortgage rates near towards the historically lowest rates of the central bank.

<sup>11</sup> FINCENTRUM HYPOINDEX indicator is the weighted average interest rate at which mortgage loans to individuals are provided in a given calendar month. The development of this interest rate in time is captured in the graph.

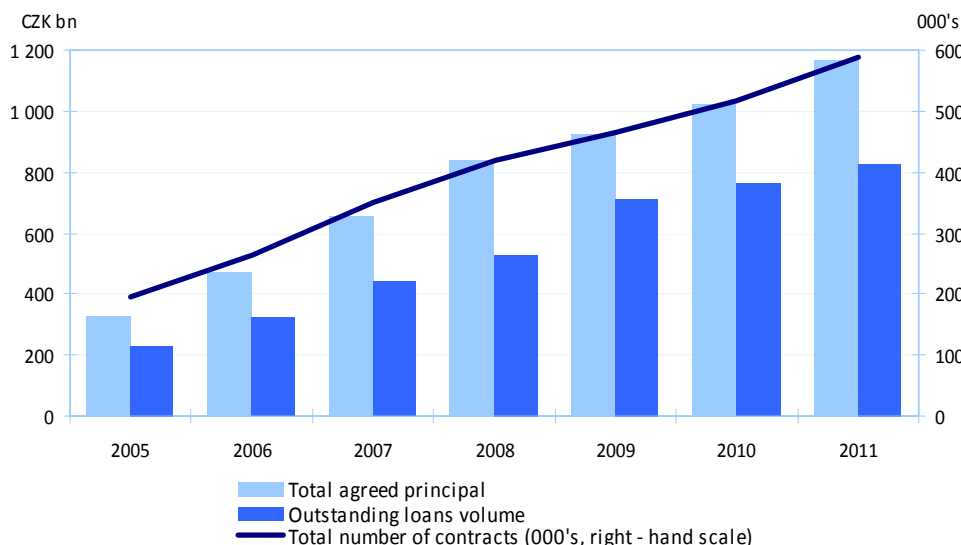
**Table 4.10: Mortgage loans (ML) balances**

As at 31 Dec		2009	2010	2011	Year-on-year change	
					Abs.	(%)
Individuals <sup>12</sup>	total (000's)	450,8	501,5	572,6	71,1	14,17
	total agreed principal (CZK bn)	663,5	748,3	867,4	119,1	15,91
Business entities	total (000's)	12,8	14,1	15,7	1,6	11,52
	total agreed principal (CZK bn)	254,5	265,4	287,4	22,0	8,29
Municipalities	total (000's)	0,9	0,9	0,9	0,0	1,08
	total agreed principal (CZK bn)	9,0	9,2	9,3	0,1	1,23
Total	total (000's)	464,5	516,6	589,3	72,7	14,08
	total agreed principal (CZK bn)	927,0	1 022,9	1 164,1	141,2	13,80
	Loans volume (CZK bn)	634,7	682,7	710,1	27,4	4,01

Source: MRD, CNB - ARAD

Table 4.10 provides an overview of mortgage loans by the major groups of recipients. The total number of mortgage loan contracts increased by more than 70 000 which represents a year-on-year increase in annual growth of about 40 % compared with development in the previous period. We can, therefore, see a re-acceleration of the increase of the total number of mortgages. Households contributed more than four-fifths of the increase in total contractual principal amount of 141.2 billion CZK, by 119.1 billion CZK. Business debtors accounted for 22 billion CZK of the increase in the principal amount. In the case of enterprises, the number of contracts grew faster than the total volume of loans – the principal under one contract has therefore declined. The trend has been opposite for households – the mortgages provided averaged higher amounts than in the year 2010. The total reported volume of mortgage loans, however, only rose by 27.4 billion CZK (by 4 %) due to higher repayment rates.

**Graph 4.11: Aggregate mortgage market indicators**



Source: MRD, CNB – ARAD

The development of the overall mortgage market indicators is illustrated in Graph 4.11. The data on the total number of contracts and contractual principal amounts in this chart include both households and businesses and municipalities. The volume of loans includes mortgage loans for both residential and commercial property. A change to this indicator cannot automatically be interpreted as an increase in lending by banks or as an increase of their willingness to lend money. The increase in this indicator does not have to be caused only by provision of new loans but can also be a result of impaired ability of borrowers to repay their debts. On the contrary, improvement in the ability of households to repay loans leads by itself to a decrease in this indicator, as it implies a reduction in the amount of loans.

<sup>12</sup> The definition of each group of recipients is clear from statistics published by the MRD.

#### 4.1.5. Credit unions

In spite of growth during 2011, credit unions were quantitatively one of the least significant segments of Czech financial market at the end of the year 2011. The number of members of credit unions increased by more than 10 000 to the total of almost 45 000, representing year-on-year growth rate of over 30 %. Total balance sheet of the sector grew even faster, by 42 % to 28.3 billion CZK. Credit unions managed to increase the volume of deposits from clients which rose by more than 41 % year-on-year. The growth in deposits can be attributed in particular to competitive interest policy of the credit unions.

Interest expense to total liabilities (of which deposits have a dominant share) amounted in the case of credit unions to about 2.8 % in 2011, while it was only 1.5 % the banking sector. Loans grew even faster than deposits, by 53 % to over 19 billion CZK. In connection with this dramatic growth, it is necessary to pay attention to credit quality indicators that has deteriorated yoy again in the sector as a whole, as the percentage of client non-performing loans approached the value of 16 % at the end of the year 2011. This indicator amounted to only 6 % two years ago. Comparison of quality of loans with the banking sector shows significant differences. First of all, the state of credit quality is significantly less favourable in the case of credit unions in which the proportion of non-performing loans in the banking sector was bellow 6 % at the end of the year 2011. Moreover, there is a difference in the dynamics of this development; the share of NPLs in the banking sector has had the tendency to fall again in recent months, while it is growing rapidly for credit unions.

**Table 4.11: Credit unions – selected indicators**

As at 31 Dec	2009	2010	2011
Number of members of credit unions	47 952	34 003 <sup>13</sup>	44 696
Total assets (CZK mn)	17 649,1	19 890,3	28 297,3
Claims on clients (CZK mn)	8 778,2	12 569,3	19 293,7
Liabilities to clients (CZK mn)	15 673,4	17 668,3	25 061,3
Share of loans in default (%)	6,14	11,47	15,89

Source: CNB

The number of credit unions did not change during 2011. In the first half of 2012, however, the CNB decided to withdraw its authorization to Unibon credit union.

Profit after tax in the sector of credit unions saw an improvement over the previous year by about 161 million CZK. Instead of loss of CZK 39 million in the year 2010, the sector generated CZK 122 million of profit in 2011 (still unconfirmed by audit). More comparable indicator of the relative profitability of capital of the credit unions indicates a lower efficiency of capital in this sector (see Graph 4.3).

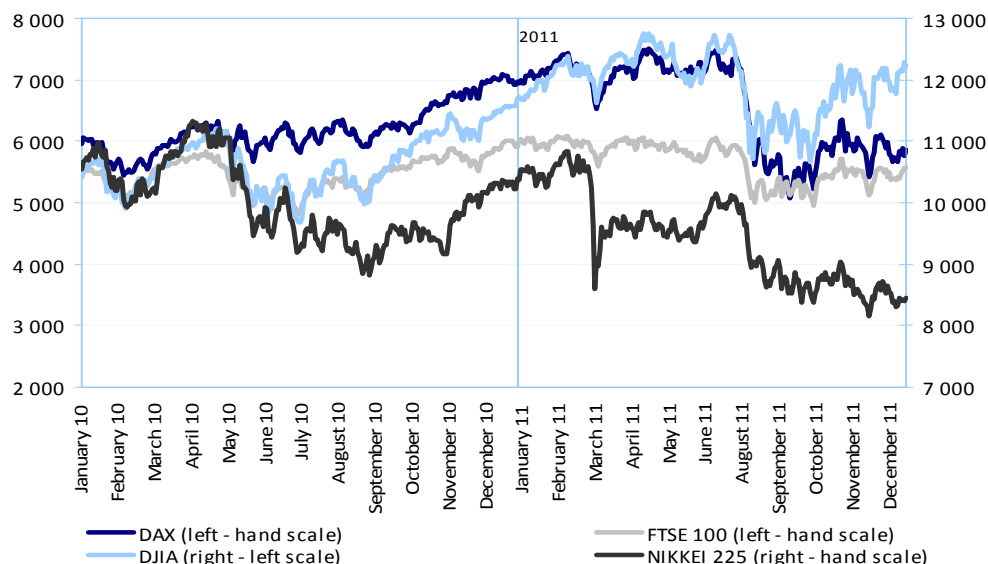
## 4.2. Capital market

Events in the capital markets in 2011 were influenced mainly by the European debt crisis which spread from Greece to some other euro area peripheral countries. The spread of debt problems to Italy and Spain had the biggest influence on deepening the uncertainty about future economic developments and thus the development of equity markets. The European leaders have tried to address the growing problems by organizing a record number of summits. Equity markets often reacted positively to the steps of the politicians, but this optimism never lasted for too long. Considerable volatility was still present in the world's major stock markets. Unlike in the previous years, different development of the major world indices ensued when the major European stock markets experienced relatively different development than the U.S. Dow Jones Industrial Average (DJIA) and the Japanese Nikkei 225. The lower decrease in the British FTSE 100 over the German DAX was influenced to some extent by the Bank of England by using quantitative easing. One of the main causes of the DJIA decrease in July was the uncertainty about the increase of the statutory debt ceiling

<sup>13</sup> Between 2009 and 2010, the decline in indicators such as number of clients or members of credit unions was affected by the fact that one of the most important players - the credit union Fio - ceased operation, and its current activities have moved under a banking license.

for the U.S. (almost reached at that time) along with a lowering in U.S. credit rating from one of the credit rating agencies. This step increased uncertainty in financial markets around the world and provoked a wave of sales of shares. The main reason for the decrease of the Japanese stock index was the large earthquake in March and its consequences.

**Graph 4.12: Development of major global indices**

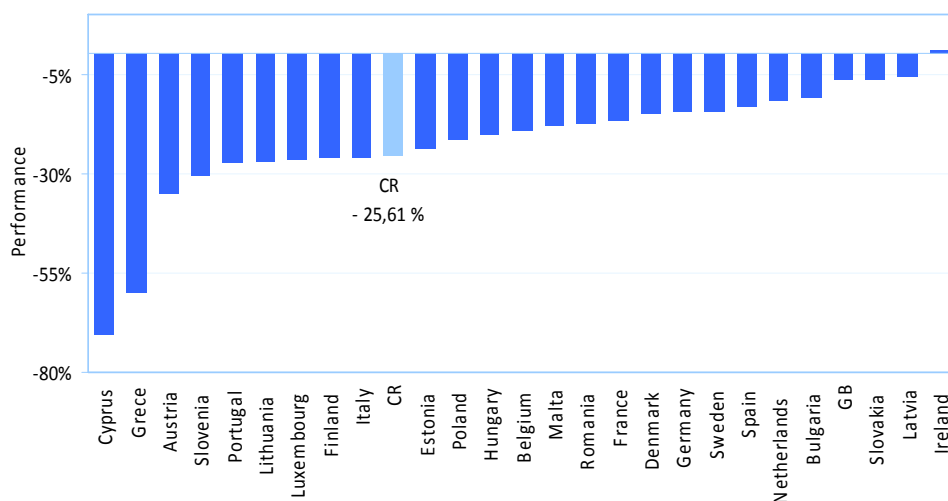


Source: Market organizers.

Within the EU, the only index showing profit was the Irish ISEQ which increased by 0.8 %. The highest fall in stock indices was recorded in Greece and Cyprus. In both cases the main reason for it was the threat of Greek sovereign bankruptcy as Cypriot banks have a large exposure to Greek bonds. Generally speaking, the European stock indices developed in line with the view of the given economy and the involvement of local banks regarding bonds of problem states. Among EU stock exchanges, the PSE index ranked as to its performance in the bottom half, behind regional stock indices in Poland or Hungary. In international comparison, however, the dividend yield of the PX index still remains very favourable, reaching 5.6 % in 2011.<sup>14</sup>

<sup>14</sup> Dividend yield = (dividend per share / market price of shares) ; dividend yield S&P 500 and DAX 30 in 2011 was 2.7% and 4.2% respectively.

**Graph 4.13: Performance of significant stock exchange indexes in EU Member States in 2011<sup>15</sup>**

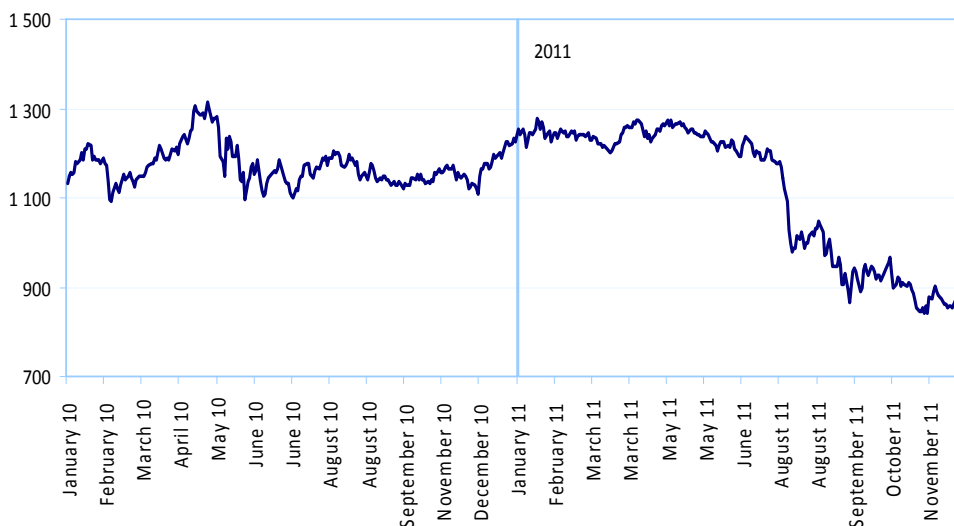


Source: FESE

### 4.2.1. Regulated markets

The main PX index ranged from 843 to 1 275 points during the year. It held its positions by July 2011, but then began to decline based on to the deepening uncertainty due to the debt crisis. This trend has not reversed by the end of the year and it decreased by 25.61 % for the full year 2011. The strongest month-on-month decline in the PX index occurred in August when the index fell by more than 10 %.

**Graph 4.14: PX index development**



Source: PSE

The following table shows that the PX index showed the first annual decline since the recent financial crisis subsides and approached at the end of the year 2008.

<sup>15</sup> Belgium BEL-20, Czech Republic-PX, Denmark-OMXC 20, Estonia-OMXT, Finland OMXH-25, France-CAC 40, Ireland-ISEQ<sup>®</sup>20, Italy-MIB, Kypr-FTSE/CySE 20, Lithuania-OMXV, Latvia-OMXR, Luxembourg-LuxX, Hungary-BUX, Malta-MSE, Germany-DAX, Netherlands-AEX, Poland-WIG 20, Portugal PSI-20, Austria-ATX, Greece-FTSE/ATHEX 20, Slovakia-SAX, Slovenia-SBI 20, Spain-IBEX-35, Sweden-OMXS 30, the UK-FTSE 100. The graph does not include stock exchanges of Romania and Bulgaria.



**Table 4.12: PX index development**

		2006	2007	2008	2009	2010	2011
PX	as at 31 Dec	1 588,9	1 815,1	858,2	1 117,3	1 224,8	911,1
	Change (%)	7,87	14,24	-52,72	30,19	9,62	-25,61

Source: PSE

Out of the securities on the Prague Stock Exchange, Philip Morris ČR strengthened the most in 2011 when it grew 22.9 % year-on-year. The operator Telefónica O2 ČR and ČEZ were at a similar level at the end of the year 2011 compared to the end of 2010. Both securities grew by 0.4 %. ČEZ has also traditionally become the most traded title on the Prague Stock Exchange. On the contrary, the most significant decrease was reached by the share of the media company CETV which wrote off 67 % of its value. The second biggest loss was the one by the shares of the Austrian Erste Bank. Among the new securities, relatively better result showed Fortuna which lost 11.5 % in value, the shares of KIT Digital fell by 45.4 %. The worst result by industries in 2011 was reached by the financial sector, yet its base at the PX index strengthened to almost 47 %. The list of titles does not list shares of the mining company NWR. NWR completed the process of re-incorporation to the UK in the first half of 2011 and commenced trading on the London Stock Exchange. During the year, two different issues of this corporation were traded and therefore it does not make sense to make year-on-year comparisons.

**Table 4.13: Share price development (Companies included in the PX index)**

Mil. CZK	Trade volume	Market capitalisation	Share price 30.12.2010	Share price 30.12.2011	Year-on-year change %
ČEZ	142 207	422 860	783	786	0,38
KOMERČNÍ BANKA	85 127	135 596	4 435	3 330	-24,92
ERSTE GROUP BANK	48 086	126 573	890	347	-61,01
TELEFÓNICA O2	34 012	123 393	382	383	0,42
VIG	2 094	102 387	996	800	-19,66
UNIPETROL	7 498	31 008	197	171	-13,20
PHILIP MORRIS CR	4 595	24 074	10 240	12 580	22,85
KITD	1 213	7 571	308	168	-45,37
CETV	7 589	7 274	385	128	-66,72
FORTUNA	2 418	4 771	104	92	-11,52
ORCO	951	1 457	183	85	-53,43
AAA	195	1 212	22	18	-18,54

Source: PSE

The activity of investors on the PSE grew year-on-year by 8.6 %. Share trading volume in 2011 decreased by 4.8 % while it remained at the level of 44 % compared to the end of the year 2008. On the contrary, bond trading volumes increased by 18.5 %. For the third consecutive year, trading within the Prague Stock Exchange has been dominated by bonds, most of which are government bonds.

**Table 4.14: Trade value**

Annual (CZK bn)		2008	2009	2010	2011	Year-on-year change (%)
PSE	Shares and units	852,0	463,9	389,9	371,0	-4,8
	Bonds	643,2	585,7	529,9	628,0	18,5
	Futures	0,6	0,2	0,2	0,2	2,6
	Derivatives Certificates and warrants	0,5	0,3	0,2	1,1	538,8
	Total	1,1	0,5	0,4	1,3	256,5
Total		1 496,2	1 050,0	920,1	1 000,3	8,7
RM-S		8,0	10,5	9,2	8,9	-3,0
Total		1 504,3	1 060,5	929,3	1 009,2	8,6

Source: PSE, RM-S

The total number of stocks traded on the stock market increased in 2011. This increase was, however, caused by a strong increase of warrants traded and the trading volume of warrants is marginal in the stock exchange. PSE failed to bring in new issues of shares. On the contrary, trading in shares of ECM development was suspended in July. The number of registered bond issues continued its sharp decline.

**Table 4.15: Number of registered issues<sup>16</sup>**

As at 31 Dec		2007	2008	2009	2010	2011
Shares	Main market	21	17	13	15	14
	Secondary market	-	-	-	-	0
	Free market	11	11	12	12	12
	Total	32	28	25	27	26
Bonds	Main market	41	38	36	33	27
	Secondary market	-	-	-	-	0
	Free market	91	83	80	73	68
	Total	132	121	116	106	95
Derivatives and other products	Futures	6	6	6	6	6
	Investment certificates	39	46	65	42	44
	Warrants	2	2	2	2	24
	Total	47	54	73	50	74
Total		211	203	214	183	195

Source: PSE

#### 4.2.2. Energy Exchange

Power Exchange Central Europe (formerly Prague Energy Exchange) which is used mainly for trading derivative contracts, recorded a growth in trading volumes of 13 % to 1.3 billion EUR. This energy exchange therefore plays a rather minor role as to the volume. Same as in the previous years, most of the trading focused on contracts for futures. The marginal spot market saw a significant decline in trading volume by 56 %. The decline of traded products in 2011 is in contrast to the territorial expansion of the power exchange in Hungary in the year 2010.

**Table 4.16: Main indicators of trading on PXE**

Indicator	Market	2010	2011	Change	
				Abs.	(%)
Trade value (EUR mn)	Futures	1 171,0	1 327,4	156,4	13,36
	Spot	3,9	1,7	-2,2	-55,95
	Total	1 174,9	1 329,1	154,2	13,13
Number of products (at the end of period)	Futures	98	90	-8	-8,16

Source: PXE

#### 4.2.3. Investment firms and asset management

The role of actors in the sector of investment firms remained clearly separated in 2011. Bank investment firms even significantly increased their dominance in the volume of own-account transactions. They also still have the upper hand in other than asset management transactions, however a significant decrease occurred in the volume of deals with securities in this area done by banking investment firms. In contrast, non-banking investment firms increased the volume of closed asset management transactions in 2011. Non-banking investment firms along with investment firms still focus more on managing the assets of their clients. But even here the banking investment firms managed to increase their market share and became the only type of entities which could increase the volume of clients' assets. Together with the effects of methodological

<sup>16</sup> The main and secondary markets merged as of July 1, 2007.

changes, deepening of uncertainty in financial markets during the year 2011 led to the general decline in indicators of customers in the sector.

**Table 4.17: Selected indicators of domestic investment firm sector (by segment)<sup>17</sup>**

As at 31 Dec (excl. derivatives, CZK bn)	2011			Change (%)		
	Banking IF	Non-banking IF	Investment firms <sup>18</sup>	Banking IF	Non-banking IF	Investment firms
Total number of domestic licensed entities	12	23	6	0	-1	0
Total transactions value <sup>19</sup>	39 697,4	2 681,0	44,1	4,7	-1,9	-53,9
of which: management	101,1	708,4	27,3	34,6	7,7	-68,3
procurement	4 336,2	1 370,1	16,8	-47,9	18,0	73,9
for own account	35 260,2	602,5	0,0	19,4	-34,2	-
Value of managed funds	54,7	413,2	110,3	14,8	-3,3	2,6
Value of clients' assets	1 849,6	468,6	108,5	17,5	-3,5	-47,2
Number of clients (according to contracts, 000s)	723,1	136,6	0,1	-0,7	-10,8	-94,8

Source: CNB

#### Asset management

The volume of managed assets decreased slightly in 2011, by 0.4 % to the final 793.3 billion CZK. The number of mergers in the market of asset management decreased in 2011. The three largest companies saw a decrease of assets under management and their market share thus decreased by 1.5 percentage point to 61.4 %. In contrast, three of the smallest companies - as shown in the following table - reported the largest increase in assets under management.

**Table 4.18: Financial groups by value of managed assets**

As at 31 Dec (CZK bn)	Value of assets under management		
	2010	2011	Change (%)
Generali PPF Asset Management	202,9	201,3	-0,77
Česká spořitelna	151,6	148,8	-1,89
ČSOB investiční společnost	146,8	137,2	-6,56
ING Investment Management (C.R.), a.s.	99,6	100,6	1,05
Investiční kapitálová společnost KB	82,4	79,6	-3,42
AXA investiční společnost	49,0	50,1	2,18
UniCredit Bank + Pioneer Investments	17,3	16,8	-2,94
Conseq Investment Management	13,6	15,0	10,22
Raiffeisenbank	9,9	11,2	13,72
AMISTA investiční společnost	8,2	13,5	64,64
Others	15,1	19,2	27,33
<b>Total</b>	<b>796,4</b>	<b>793,3</b>	<b>-0,39</b>

Source: AKAT

#### Investment intermediaries

The year 2011 saw an increase in the number of investment intermediaries after two years of decline, by 1 008 entities. 10 072 of them were active in the Czech Republic at the end of the year. The large decrease in 2009 by 3738 intermediaries was due to an amendment to the Act on Doing Business in the Capital Market under which the investment intermediaries of the second degree became tied agents. These tied agents are no longer entered in the register of investment intermediaries but in a separate registry. The number of tied

<sup>17</sup> Given the fact that the value of derivative contracts is available only as the value of the underlying assets, these are not included in the table.

<sup>18</sup> Investment firms with operations of management of client assets.

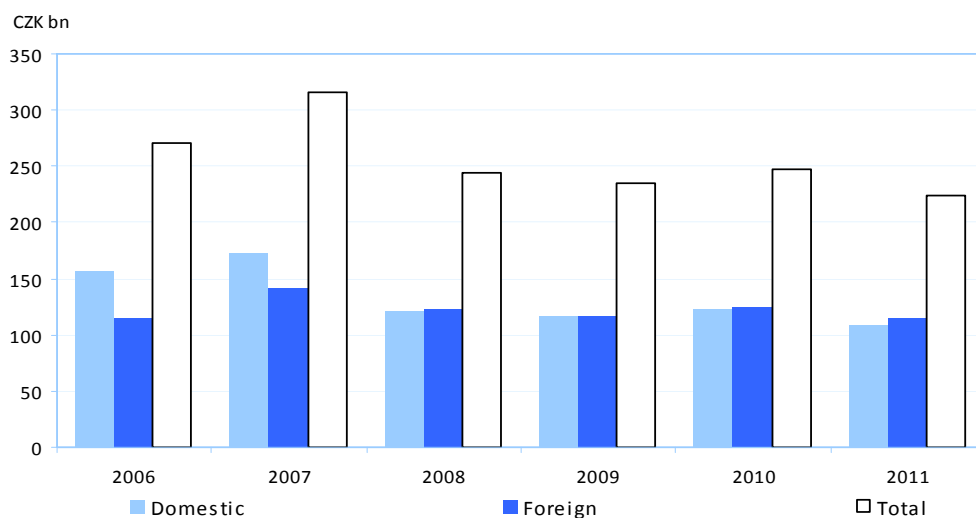
<sup>19</sup> All deals (buying and selling) on the PSE, RM-S, foreign markets and direct deals; cumulative for shares, investment certificates and bonds; on their own account and on behalf of a client; without derivative transactions.

agents has been continuously increasing since the effective date of the said amendment. CNB registered 14 729 of them at the end of the year 2011, which is by 3 479 people more than at the end of 2010.

#### 4.2.4. Collective investment

Return of uncertainty to financial markets was negatively reflected in the collective investment sector. In 2011, the volume of funds invested in the open-ended mutual fund dropped by 9.46 % (by 23.4 billion CZK). At the end of the year 2011, 224.1 billion CZK was invested in the open-ended mutual funds. The year 2011 marked the confirmation of long-term trend that foreign funds still attracted more money and have kept a larger volume of assets (115.8 billion CZK) during the last three years than domestic open-ended mutual funds (108.2 billion CZK). Foreign funds also recorded a lower decline of assets (by 9.3 billion CZK) in 2011 than domestic funds (by 14.1 billion CZK).

Graph 4.15: Development of investments in unit trusts



Source: AKAT

Under the new definition of money market funds, the classification of certain categories of funds was changed in 2011 from 'money market funds' into the 'bond funds' category. This change significantly affected the year-on-year comparison of finances invested in the different types of mutual funds as listed in the following table. Naturally, money market funds saw a significant decline in assets and a significant increase in assets occurred in bond funds. Regardless of the methodology change, a decrease occurred in equity and secured property funds and also in money market funds. On the other hand, funds of funds did well.

Table 4.19: Assets in individual types of unit trusts by domicile

Unit trust type	2010			2011			Year-on-year change (%)		
	Domestic	Foreign	Total	Domestic	Foreign	Total	Domestic	Foreign	Total
Money market	43,4	25,1	68,5	9,7	14,5	24,1	-77,8	-42,3	-64,8
Bond	17,9	14,8	32,7	39,7	21,6	61,3	121,9	46,0	87,6
Equity	15,2	26,2	41,4	12,7	23,9	36,6	-16,5	-8,8	-11,7
Mixed	22,9	9,2	32,1	22,9	10,1	32,9	0,1	9,4	2,8
Funds of funds	15,0	0,6	15,6	16,8	0,5	17,3	11,8	-24,7	10,3
Guaranteed	6,0	49,1	55,1	4,5	45,1	49,6	-25,5	-8,0	-10,0
Real estate	1,9	0,1	2,0	2,0	0,2	2,2	4,0	148,4	9,5
<b>Total</b>	<b>122,4</b>	<b>125,1</b>	<b>247,5</b>	<b>108,2</b>	<b>115,8</b>	<b>224,1</b>	<b>-11,5</b>	<b>-7,4</b>	<b>-9,5</b>

Source: AKAT

Change in volume of assets under management is, however, influenced by two factors – the returns that the fund generated and by net sales. Net sales of units represent a change in the funds' assets as a result of the sale and redemptions of units which does not affect the performance of the fund, only the volume of assets. The following table shows that mainly equity funds lost money last year. On the contrary, mixed funds added the most value to their assets. Reduction of assets of money market funds was - despite the change to the methodology – also caused by redemptions of units. This trend can be attributed to a certain extent to the development in the banking sector where there was an increase in interest income from savings accounts which can be perceived as less risky substitute for collective investment funds.

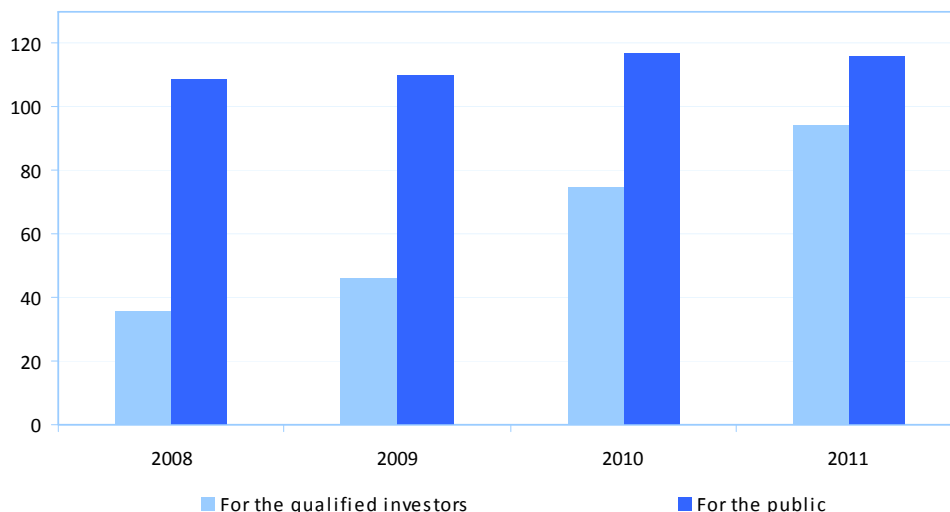
**Table 4.20: Unit sales and redemptions in 2011**

Sales and redemptions of shares (CZK bn)	Equity	Bond	Money market	Funds of funds	Mixed	Real estate	Total
Sales	5,3	6,8	10,6	7,5	4,6	0,4	35,3
Redemptions	4,5	7,9	18,9	5,5	5,6	0,4	42,9
Net sales	0,8	-1,1	-8,2	2,0	-1,0	0,0	-7,5
Change in the asset value (year-on-year)	-2,5	21,8	-33,8	1,8	0,0	0,1	-12,6
Change adjusted for net sales	-3,3	22,9	-25,5	-0,3	1,1	0,1	-5,1

Source: AKAT

Very rapid development has existed in recent years in the sector of funds that are not public (funds of qualified investors). The number of these funds has increased over the last four years by 260 % and is now close to the number of funds open to the public. These funds are still not close to funds open to the public measured by the value assets under management though - the amount of members of CCMA in 2011 amounted to 45.9 billion CZK. In addition, it is not easy to distinguish between qualified investor funds established for the purpose of collective investment schemes and qualified investor funds that were set up for the purpose of tax optimization, which is a very common phenomenon.

**Graph 4.16: Number and structure of collective investment funds**



Source: CNB

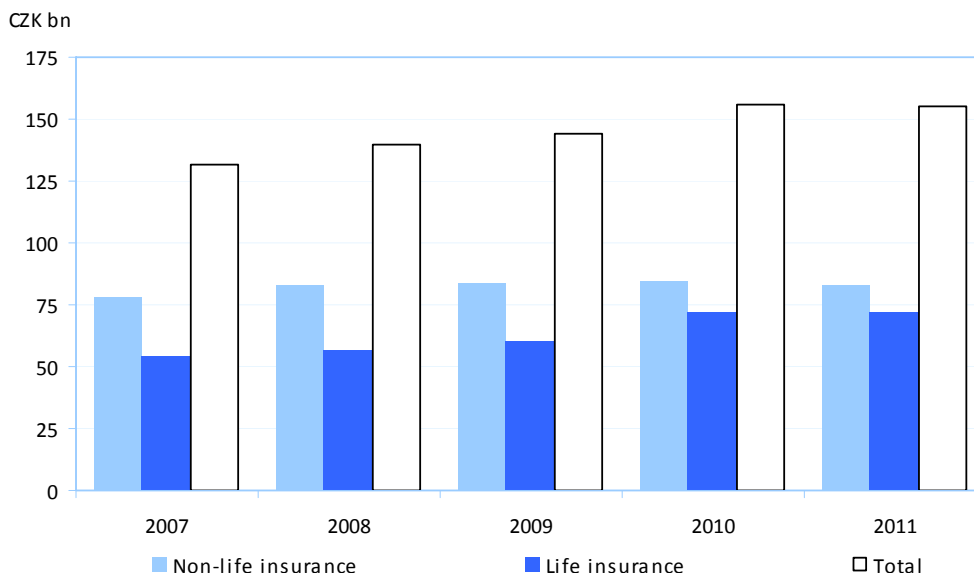
Note: Status as of the end of the period.

### 4.3. Insurance companies

Last year in the CR was not affected by any extraordinary events that would require a bigger involvement of insurance companies to compensate for damages to property caused by wide-area natural effects.

The insurance market experienced stagnation (or slight decline) after a long period of uninterrupted growth. Total written gross premiums reached 155.1 billion CZK, representing an annual decrease of 0.6 %. Compared to the previous year when the increase was over 8 %, this is a sharp reversal in the current long-term growth trend. Although the life insurance market showed moderate growth, its pace failed to offset the decline in non-life insurance.

**Graph 4.17: Development of gross premiums written**



Source: CNB

Non-life insurance decreased by 1.4 %, gross premiums reached 83.1 billion CZK. The negative trend in non-life insurance was affected mainly by a fall in gross premiums for car insurance (by 5 %) including insurance of liability for damage caused by vehicles - Motor Third Party Liability Insurance (by 8.2 %). Although the number of vehicles insured within insurance for liability for damage caused by vehicles increased by 126 000 to 6.8 million, the reason for decline in gross written premiums are the declining premium rates that remains one of the decisive factors for clients of insurance companies in the negotiation of contracts. Non-life insurance is also regarded as one of the non-essential needs which can be limited in case of a lacking family budget. A slight increase was observed in the insurance of business entities.

The growth rate of life insurance significantly slowed compared to the year 2010 (to 0.3 % versus 19.3 % in the year 2010), while the value of gross written premiums reached 72 billion CZK. similar as in the previous year, the driver of growth were premiums paid as a lump sum which, however, only grew by 1.9 % (compared to 19.2 % in the year 2010). The specific nature of this insurance does not represent a typical insurance protection for the client. In some cases it is more of a savings or investment product in which the risk component of premiums is often only very low and the savings component dominates the total premium. From this perspective, life insurance products with a lump sum premium payment do not fulfil the protective function of primarily hedging the risk. Unlike the premiums paid as a lump sum, periodically paid premiums saw a slight decrease (by 0.6 %). Restoring life insurance policies did not occur to a similar extent as in the year 2010. Although new contracts showed a slight year-on-year growth (by 87 000 policies), the total number of life insurance policies decreased by 231 000 (i.e. by 2.6 %).

The methodology of reporting data on life insurance by the Czech Insurance Association changed. The value of lump sum premiums is now included in the reporting of premiums for life insurance by only 10 % thereof. The underlying reason is an attempt to get a more realistic view of development in life insurance. There has also been effort to purge the reported data from the non-market insurance (EGAP insurance and workmen's compensation insurance). This can thus lead to variations in the results or in the overall interpretation and assessment of the insurance market compared to Czech Insurance Association statements/reporting.

The amount of technical interest rate for life insurance (this is the guaranteed share of the income from financial investments) was not changed by the CNB and remains at 2.5 %.

The proportion between life and non-life insurance remains at approximately the same level (46 : 54). So while the Czech market approached the usual unwritten benchmark for developed economies (60 : 40) in 2011, it did so at only a slight pace. Due to growth in GDP combined with a slight decline in gross written premiums, the total insurance penetration remained at 4.1 %. According to survey results presented/conducted by Ipsos for the ČAP,<sup>20</sup> Czech households put into insurance on average less than 8 % of total expenditure, while in developed EU countries the expenditure on premiums ranges from 10 to 20 %. The Czech insurance market still has a significant growth potential.

**Table 4.21: Results of insurance companies<sup>21</sup>**

As at 31 Dec	2009	2010	2011	Year-on-year change	
				Abs.	(%)
Number of policies (000's)	27 706	27 346	27 921	575	2,10
of which: non-life insurance	18 356	18 427	19 233	806	4,37
life insurance	9 350	8 919	8 688	-231	-2,59
Number of newly concluded policies (000's)	10 469	10 628	10 830	202	1,90
of which: non-life insurance	9 335	9 190	9 305	115	1,25
life insurance	1 134	1 438	1 525	87	6,05
Total gross premiums written (CZK bn)	144,2	156,0	155,1	-0,9	-0,59
of which: non-life insurance	84,0	84,2	83,1	-1,2	-1,38
life insurance	60,2	71,8	72,0	0,2	0,34
Total insurance penetration (%)	3,9	4,1	4,1	0,0	-

Source: CNB

The insurance market is a strong and stable part of the financial market of the country. The financial crisis has affected the insurance sector only marginally or indirectly so far. The number of entities authorized to engage in insurance activities has not changed considerably. At the end of the year, there were 53 insurance companies including 18 foreign branches of foreign companies and one reinsurance company. The two largest insurance groups, Generali PPF Holding (Česká pojišťovna and Generali insurance company) and VIG (Kooperativa, Česká podnikatelská pojišťovna and Pojišťovna České spořitelny) have market share of approximately 64 %. Furthermore, other 696 foreign insurance companies were notified (of which 168 branches) in the regime of the single European passport as they can do business on the market within the 'transborder provision of services' (see Table 4.2).

Financial indicators of insurance companies show relatively adequate capital in the sector - equity capital increased by 5.7 %. The capital is of foreign origin by more than 3/4. Total assets increased by 2.2 % and reached 436 billion CZK. The assets are covered by insurance companies capital up to 5.5 %. The overall profitability decreased due to lower investment returns in financial markets, but profit after tax of 9.4 billion CZK was achieved. The available solvency margin for non-life insurance exceeded the required solvency margin more than three times (3.4 times) and the solvency margin for life insurance is at a similar level (3.3 times). The created technical provisions of insurance companies are most often placed in bond instruments (68 %) or in equity securities (18.2 %).

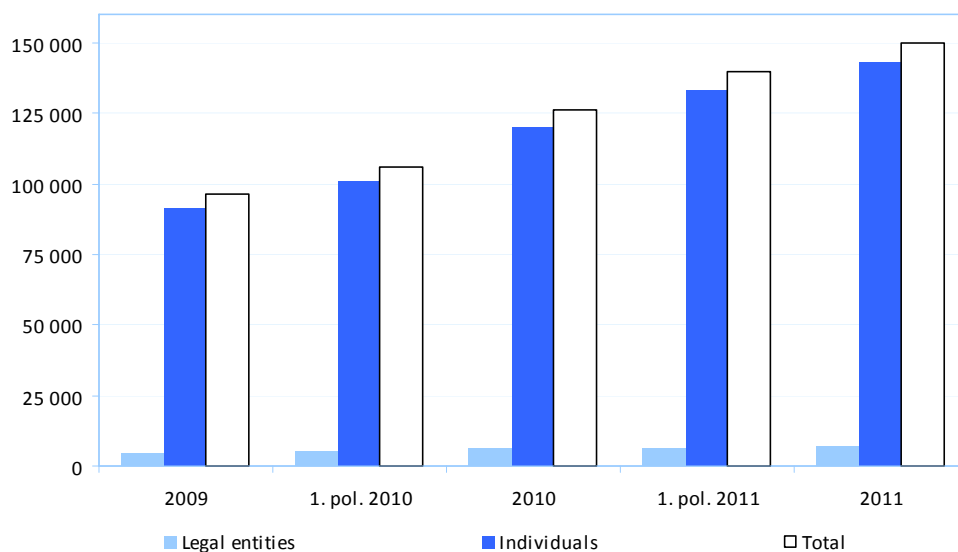
Insurance companies revealed a record number and volume of insurance fraud in the past year. The value of detected insurance fraud reached 840 million CZK which represents an annual increase of 34 %. According to expert estimates, 10 to 15 % of costs on insurance benefits are paid for undetected unauthorized claims for payment. Traditionally, the highest number of fraud was revealed in motor insurance. In the sector of car insurance, there is also another type of fraud that involves a fictitious change of the owner of the vehicle in order to terminate more quickly the insurance policy so that a cheaper liability insurance of vehicle could be negotiated. The high incidence of this fraud occurs in the insurance of business when some businesses under pressure from financial difficulties want to solve their problems at the expense of insurance companies.

<sup>20</sup> Source: CIA Web site

<sup>21</sup> PS = insurance agreement, number of life insurance agreements does not include supplementary insurance agreements.

For insurance companies based in the EU, a new obligation was introduced by the EU Court of Justice (dated March 1, 2011) with effect from December 21, 2012 to ensure that the use of sex factor in the calculation of premiums and benefits in insurance and related financial services for each insured person would not lead to differences in the amount of premiums and benefits. The Czech insurance market uses sex as a factor for determining premiums and benefits especially in life insurance, pension insurance, sickness insurance, and some accident insurance products. It is expected that insurance premiums will not be united at average rates for both sexes but rather will be closer to the higher of the two rates. It is assumed that the premiums will rise in life insurance (i.e. insurance against death) significantly for women and will become slightly cheaper for men. In insurance for survival, on the contrary, men can get higher premiums and women may obtain slightly cheaper insurance in the future. Insurers should therefore prepare intensively to apply this new rule later this year.

**Graph 4.18: Development of the number of insurance intermediaries**



Source: CNB

The growth of the number of insurance intermediaries continued as in the previous years. Overall, nearly 150 000 intermediaries and independent loss adjusters were registered at the end of the year 2011. At the same time, about 12.200 entities had their authorization to operate a brokerage business revoked, in most cases at their own request. The largest categories are subordinate insurance brokers and exclusive insurance agents who together represent 83 % of the total number of intermediaries.

The share of insurance intermediaries to the nation's population has increased significantly. While in 2009 there was 1 intermediary per 99 people, it was only 1 per 70 in 2011.



**Table 4.22: Insurance intermediaries by position (category)<sup>22</sup>**

Entity registered as at 31 Dec	2010			2011			Year-on-year change (%)		
	IN	LE	Total	IN	LE	Total	IN	LE	Total
TIA	12 389	315	12 704	13 047	333	13 380	5,31	5,71	5,32
SII	69 154	1 975	71 129	85 950	2 264	88 214	24,29	14,63	24,02
EIA	31 338	223	31 561	36 146	275	36 421	15,34	23,32	15,40
IA	556	858	1 414	571	949	1 520	2,70	10,61	7,50
IB	176	585	761	181	630	811	2,84	7,69	6,57
ILA	65	119	184	71	128	199	9,23	7,56	8,15
FII	6 453	1 917	8 370	6 988	2 196	9 184	8,29	14,55	9,73
<b>Total</b>	<b>120 131</b>	<b>5 992</b>	<b>126 123</b>	<b>142 954</b>	<b>6 775</b>	<b>149 729</b>	<b>19,00</b>	<b>13,07</b>	<b>18,72</b>

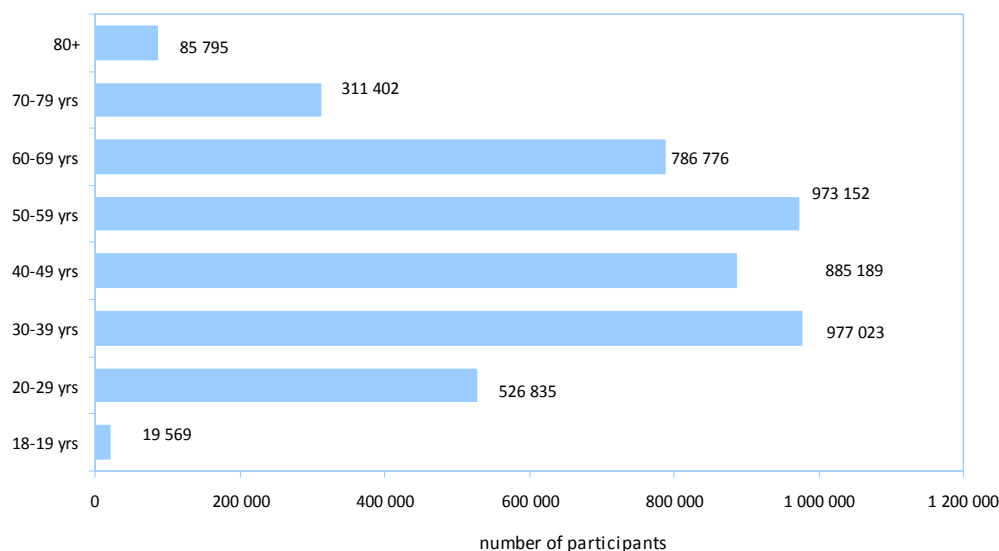
Source: CNB

\* Of which 12.200 brokers lost their license

#### 4.4. Supplementary Pension Insurance

The sector of supplementary pension schemes did not record any significant changes in 2011. The total number of participants increased only by 0.8 % and the total number of active supplementary pension insurance policies reached 4.6 million. A slower growth rate than in the previous years points to a relative saturation of the market because the degree of involvement of the inhabitants is approaching 90 % of the economically active population. Funds of the participants which were recorded by pension funds at the end of 2011 reached 232.1 billion CZK. Pension funds reached approximately the same profit (4.6 billion CZK) as in the year 2010.

**Graph 4.19: Age structure of participants in supplementary pension insurance**



Source: MoF

About a third of the population under 30 years of age is covered by supplementary pension insurance, while the market penetration is approximately double that percentage for the generation over 40 years of age.

In terms of age structure of participants in the pension schemes, the most strongly represented age groups are 30 to 39 years and 50 to 59 years (the two categories together account for 43 % of all participants). For the first time in history, the involvement of people in the age group 30 to 39 years in the supplementary pension insurance is the largest one of all age groups. As the excess in the age category 50 to 59 is only 0.1 %, it is clear

<sup>22</sup> Legend: TIA = tied insurance agent, SII = subordinated insurance intermediary, EIA = exclusive insurance agent, IA = insurance agent, IB = insurance broker, ILA = independent loss adjusters, FII = foreign insurance intermediary, IN = individual and LE = legal entities.

that the trend to try to take over responsibility for one's own future in old age is gradually spreading to the younger age groups. However, the youngest age group (under 29) saw the number of participants decrease. The relatively high involvement of participants in supplementary pension schemes is seen for the age group 60 to 69 years (17.2 %).

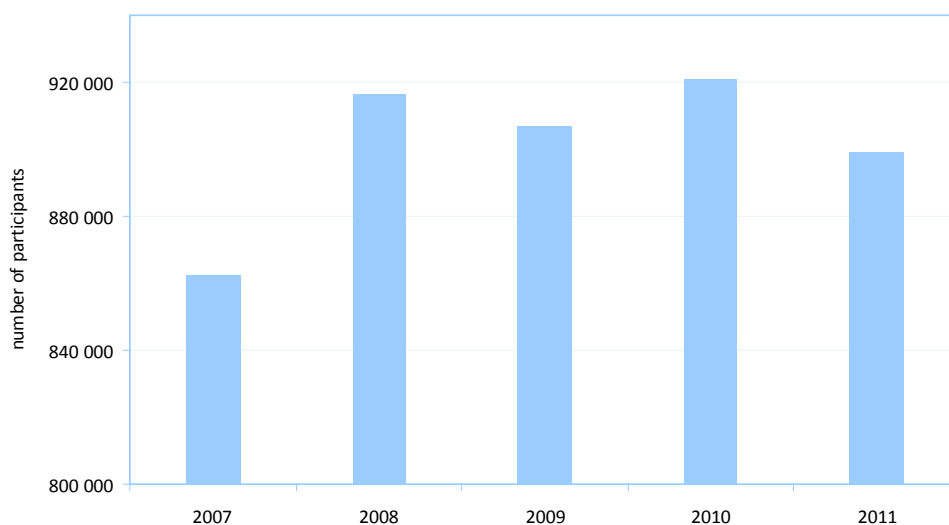
**Table 4.23: Participants in supplementary pension insurance by age**

As at 30 Dec	2007	2008	2009	2010	2011	Year-on-year change	
						Abs.	(%)
18-19 yrs	21 461	22 526	23 433	22 150	19 569	-2 581	-11,65
20-29 yrs	475 887	512 496	530 382	537 701	526 835	-10 866	-2,02
30-39 yrs	786 781	867 574	927 964	965 683	977 023	11 340	1,17
40-49 yrs	777 167	807 665	839 614	867 483	885 169	17 686	2,04
50-59 yrs	996 474	1 010 509	1 008 265	998 104	973 152	-24 952	-2,50
60-69 yrs	610 778	682 601	729 339	765 997	786 776	20 779	2,71
70-79 yrs	218 919	245 558	267 966	292 809	311 402	18 593	6,35
80 + yrs	48 890	58 307	67 559	77 847	85 795	7 948	10,21
<b>Total</b>	<b>3 936 357</b>	<b>4 207 236</b>	<b>4 394 522</b>	<b>4 527 774</b>	<b>4 565 741</b>	<b>37 967</b>	<b>0,84</b>

Source: MoF

The number of participants to whom the employer contributed to pension funds decreased by 2.4 %. The most significant decline in employers' contributions are at ages 20 to 29 years and 50 to 59 years. Employers are currently adopting a number of austerity measures and reduction of contribution to supplementary pension insurance seems to be one of them.

**Graph 4.20: Number of policies with employer's contribution**<sup>23</sup>



Source: MoF

Increased efforts by the pension funds to obtain new clients in a relatively saturated market leads to an increase in the acquisition costs of a new contract. The practice is to tug clients from competing funds since the number of people still not participating in supplementary pension schemes is very limited. Pension funds, on the contrary, gradually reduce the deferred costs (a yearly decrease of approximately 25 %), which should affect the expensiveness of funds in 2012. Since 2013, in connection with the pension reform, there will be a separation of the assets of the participants from the assets of the administrator - pension companies into whose balance sheet this item should be moved.

<sup>23</sup> Data as of December 31 of the given year.

**Table 4.24: Costs incurred in connection with new policies**

CZK / average amount	2008	2009	2010	2011	Year-on-year change	
					Abs.	%
Costs incurred in connection with a new policy	2 033	3 365	3 184	4 249	1 065	33,44
Deferred expenses to a number of existing supplementary pension insurance policies	959	883	777	580	-197	-25,34

Source: MoF, CNB

The amount of average monthly contributions of participants rose slightly (by 0.5 %) and equals 442 CZK. The contribution, however, is only less than 2 % of the average gross wage in the country. For the supplementary pension insurance to compensate the standard of living after retirement, participants would have to contribute a much higher amount, provided the supplementary pension insurance is valid for the duration of employment. A significant motivation for further growth of the average monthly contribution should have the form of the upcoming pension reform.

The minimum growth of the monthly contribution is also reflected in the stagnation of the average state contribution (105.4 CZK per month). The total amount of state contributions amounted to 5.6 billion CZK, by CZK 92 million more than in the year 2010.

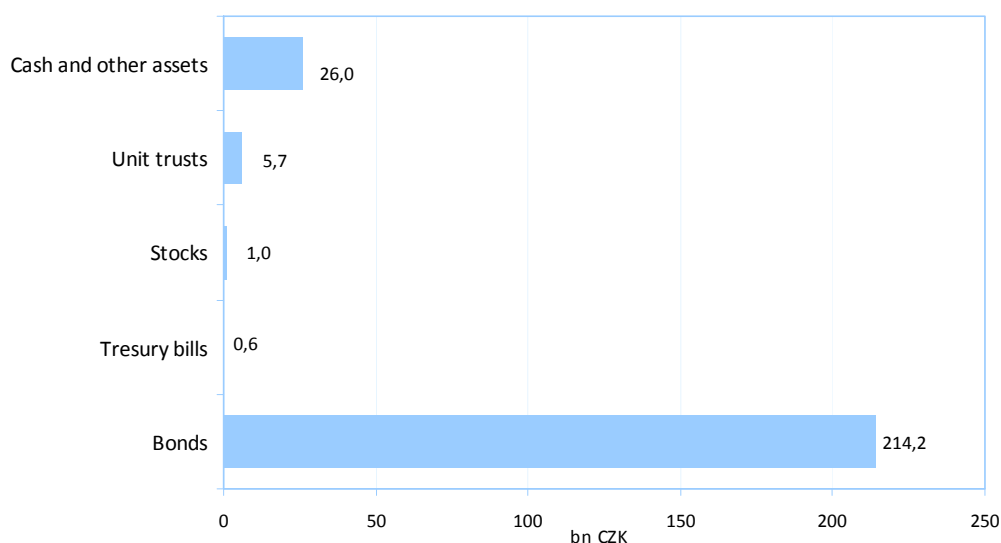
**Table 4.25: Breakdown of average amount monthly contributions amount**

CZK/month	2007	2008	2009	2010	2011	Year-on-year change	
						Abs.	(%)
Participant's contribution	449,7	450,5	443,9	439,6	441,7	2,1	0,5
State contribution	103,9	104,9	105,2	105,0	105,4	0,4	0,4

Source: MoF

Often mentioned low return on investment to supplementary pension participants is due to the conservative investments of the pension funds which results from the regulatory framework which only defines limited possibilities of nominal depreciation of the funds. The structure of the investment portfolio tends to reinforce the bond component (214.2 billion CZK, i.e. almost 87 % of the portfolio) at the expense of other items, especially shares. Bonds issued by the CR equal 78 % of the total debt.

**Graph 4.21: Allocation of assets of pension funds as at 31 December 2011**



Source: APF CR

#### 4.4.1. Reform of the pension system

In December 2011, laws were published in the Collection of Laws, providing the essential legal framework for the reform of the pension system in the Czech Republic. This is Act 426/2011 Coll., on retirement savings, Act 427/2011 Coll., on supplementary pension savings, and Act 428/2011 Coll., amending certain laws in relation to the adoption of the law on retirement savings and supplementary pension savings.

The current two-pillar system should be extended by another pillar in 2013, and will contain three pillars. Citizens will continue to participate in the first (mandatory) pillar based on a state so called pay as you go system (PAYG). In addition, they will be able to voluntarily join the newly established second (capitalization) pillar; it will be obligatory to stay in this pillar until the retirement age, i.e. subscribers will be obliged to pay premiums for their pension savings from their income. Citizens will finally continue to be allowed to participate in the third pillar, both within the so-called transformed fund with a pension company, where the present clients will be transferred, and within supplementary pension savings represented by the reformed third pension pillar. It will be possible to enter or leave the third pillar at any time. However, the entitlement to the state contribution and tax relief will require that the participants stay within the supplementary pension savings scheme until reaching 60 years of age and complete the required duration of the saving period.<sup>24</sup>

##### Selected aspects of the new second pillar

The individuals who are subscribers of the second pillar will be able to save money on their personal accounts, of which part of the premium on pension insurance (3% of the assessment base) will be transferred to the second pillar (i.e. the payment to the first pillar will be reduced to 25% of the assessment base). To this amount, they will need to add another 2 % of the assessment base. Therefore, the total contribution will be 5 % of the assessment base. Because the payments by these individuals to the first pillar will decrease, their state pension from the first pillar will be adequately reduced. As regards the payment of benefits, the subscribers will be able to choose between life annuity with the possibility of the payment of survivor's pension for 3 years, or old-age pension for 20 years, to be paid by life insurance companies.

The funds under the second pillar will be managed by pension companies. They will be established either from the transformation of existing pension funds or as new entities. Pension companies will be exposed to strict requirements regarding system stability. For example, the basic capital of at least CZK 300 million will guarantee, that the second pillar will only accept businesses focusing on long-term operations, i.e. not investors with a short-term profit focus.

Pension companies will be obliged to offer four funds (dynamic, balanced, conservative and government bonds), differing in investment limits, the structure of the managed portfolio and the related risk. It is possible to generally state that:

- The government bond fund will invest the most of the managed funds in Czech government bonds, followed by government bonds of the EU and OECD, meeting certain quality criteria,
- The conservative fund will invest in bonds of EU Member States and comparatively safe bonds, and in money market instruments, money market funds and other similar assets,
- Unlike the conservative fund, the balanced and dynamic funds will be able to invest part of the managed funds in equities and collective investment securities; in the dynamic fund, the scope of the available assets will be wider and the part of the managed resources that can be invested in such assets will be wider than in the balanced fund.

To avoid excessive costs in connection with the commission for the acquisition of new subscribers, a maximum amount of the consideration for offering and mediation of retirement savings has been set (agents' commission), together with the maximum cost of promotion, advertising and sales support. The remuneration of pension companies consists of the asset management fee and the performance fee, and is strictly regulated. The structure of the remuneration of a pension company (the base consideration for the management of assets calculated from the volume of the assets in the fund, and the consideration for the increase in value)

<sup>24</sup> In 2012, legislation is expected to be passed for the drawing of benefits (excluding lump sum) from the supplementary pension savings five years before reaching the retirement age. The parameters of these benefits will be set for subscribers to be fulfilled in order to be able to make use of state paying for them the public health insurance and certain aspects of pension insurance (the issue of so-called pre-retirement benefits).

will result in lower expenses in the event of lower income, and will provide pension companies with a relatively higher compensation, if the increase in value is also interesting for the client. Specifically, the amount of consideration from the volume of the fund assets is limited to a maximum of 0.3 - 0.6 % of the assets, depending on the fund type (lowest in government bonds and highest in dynamic funds). The remuneration for the increase in value is 10 % of the value increased (no remuneration will be allowed in government bonds). It can generally be described in such a way that if a fund generates an increase in value of 5 % annually, subscribers will be credited with 4.5 % and the remaining 0.5 % will be used as remuneration for the manager (pension company). This general structure is complemented in the proposed bill by measures which will reflect the potential decrease in the value of assets in the past. If the value of the fund assets decreases and then increases, the compensation for the increase will only be paid if the value of the fund assets reaches the original level. This rule is referred to as “high water mark” and it is commonly used on international capital markets.

#### Selected aspects of the reformed third pillar

The reform will separate the existing assets of pension scheme subscribers from the managers’ assets. Subscribers’ assets will be transferred to the so-called transformed fund which will be managed by the pension company and will be financially separated from it. The remaining assets of the pension fund will belong to the new pension company. Thanks to the separation of the assets, it will no longer be possible that the managers’ high expenses (e.g. for the acquisition of new participants) are settled directly from the subscribers’ funds, which is currently possible in supplementary pension insurance schemes. Similarly to the second pillar, new subscribers’ funds and the transformed fund under the third pillar will be managed by pension companies.

Individuals subscribing for supplementary pension insurance will be automatically transferred to the transformed fund of the third pillar, where their existing entitlements will be retained (with the exception of the amount of the state contribution and the possibility of transferring funds to another transformed fund), especially as regards the no-loss guarantee, the so-called positive zero. They will therefore bear no investment risk. New subscribers, or existing subscribers in the event of the voluntary transfer to new subscriber funds, will invest their resources to the new funds under the third pillar, with the potential of higher increase in value compared with the current supplementary pension insurance. Subscriber funds will be subject to less strict investment rules, which will create conditions for achieving long-term yield above the inflation rate (which is achieved only rarely in existing pension funds). However, the investment risk will not be borne by the subscribers themselves.

State aid will be retained within the third pillar for both existing and new subscribers; however, the parameters will be adjusted. The minimum amount of the subscribers’ monthly deposit for which the state contribution is paid will increase from CZK 100 to CZK 300; meanwhile, the state contribution will grow from the current CZK 150 to CZK 230, for which it will be necessary to deposit CZK 1 000 per month. Tax allowances will only apply to monthly deposits of between CZK 1 000 and 2 000 (compared to the current CZK 500 - 1 500). It is the aim of these changes to the parameters of the state contribution and tax allowances to increase the subscribers’ monthly deposits, which currently reach CZK 442 per month on average.

**Table 4.26: Supplementary pension insurance state contribution in relation to participant’s monthly contribution**

Participant’s monthly contribution (in CZK)	100	200	300	400	500	600	700	800	900	1000 a více
Current state contribution	50	90	120	140	150	150	150	150	150	150
State contribution as from 1.1.2013	0	0	90	110	130	150	170	190	210	230

Source: MoF

## 5. RELATION OF THE GOVERNMENT SECTOR TO THE FINANCIAL MARKET

### 5.1. General government balance

Government sector finances were positively influenced in the past years by the culmination of the economic cycle, but the recession from the turn of 2008 and 2009 gave rise to a profoundly negative production gap. The recession, which substantially affected the government sector's revenues, again highlighted the structure of the government sector deficit. Since 2009, all government subsectors have generated continuous deficits, with the worst results reported for 2009. The highest deficit was generated in 2009, i.e. more than CZK 185 bn (5.8% of GDP). After that the deficit significantly decreased, both thanks to the positive development in real economy and thanks to the government's consolidation efforts.

In 2011 the general government sector reported very positive results - compared with the expected deficit of 3.7 % of GDP, the final result was lower by 0.6 percentage points. The revenue side of the government sector recorded a growth of 3.4 %, primarily due to higher tax revenues, which rose by 4.2 %. The management was affected by a range of discretionary measures, this year focusing primarily on the expenditure side. As regards tax income, the most dynamic development was reported in the collection of individual income tax, growing by 10.2% against 2010. This was caused by number of legislative measures, especially the decreased taxpayer allowance by CZK 100 per month (so-called "hundred crowns for floods"). The effects of other measures, such as the cancelled exemption on deposits in building savings or cancelled exemption of early-retirement contributions for soldiers and members of security forces, was less significant. The second most significantly growing tax was the excise tax, where despite no significant legislative changes, many distributors have increased their stock in connection with the planned increase in the excise duty on tobacco products. Despite the exemption of licence fees, the corporate income tax grew by 3.4 %. This tax continues to be positively influenced by the one-off measure adopted in 2009, i.e. the accelerated depreciations. Another aspect is the less intensive use of tax losses from the crisis years. The receipts of value added tax grew by 1.8 % in 2011, where the only measure was the introduction of domestic reverse-charge, with just cosmetic consequences. Social contributions grew by 2.5% which is very close to the growth of the macro-economic base of this tax, and compared with the change scenario, we see a positive effect of the retained limit of the annual assessment base at the level of 2010 and keeping the same premium rate as in 2010.

The consolidation efforts of this year were especially aimed at the **expenditure side of the government sector**; thanks to the austerity measures the government expenditure dropped by almost 1 %. The first consolidation effort was to reduce payroll by 10 % in the regulated sector (except for state officials and teachers), and further reduce the salaries for constitutional officials by 9 %. These savings were balanced by the increased salaries of teachers and doctors. The increase in the doctors' salaries does not have a direct impact on the staff costs, because most hospitals do not belong under the government sector; however, these costs will be reflected in the changing structure of the payments for medical care. This consolidation in the area of pays was especially conducted at the central level, where especially local government institutions and social security funds (health insurance companies) did not participate in these efforts. The total decrease in salaries reached only 2.7% in 2011. Another important item of consolidation was the reduction in the spendings on social benefits, where a series of legislative measures have been adopted, especially as regards sickness insurance; in addition, significant changes were adopted in the area of social allowances, birth allowances, family benefits, etc. In the whole sector, the payments of social allowances decreased by 4%. The total cash social security benefits grew by 4%, mainly due to the influence of the growth in pensions. The aforesaid measures were accompanied by the general adjustments of expenses, especially as regards non-mandatory current and capital expenditures, with a specific emphasis on current expenditure. These effects led to a decrease in the intermediate consumption, by 4.9% against the previous year, reflecting the general cuts and decrease in spendings across the government sector. As regards intermediate consumption, the most significant consolidation occurred in the central government subsector. This is a proof of the fact that especially local government institutions may find more internal financing reserves, because they did not contribute to the sector's cost reduction as regards salaries and intermediate consumption, like the central government. In addition to these savings, the government investments surprisingly decreased by more than 15 % in 2011. These included especially the Railway Infrastructure Administration, public universities, allowance

organizations and local budgets, where primarily investments from own resources were considerably lower. The reason can be seen both in the cautious principle, when reserves for the co-financing of EU projects are retained during the time of significant cuts, and especially in Railway Infrastructure Administration it is necessary to include the risk of deferred payments from the EU. In this case, it is rational to create reserves for the completion of projects in progress, and take into account the possible risk of these funds not being refunded by the EU.

In 2012 we can expect further decrease in the general government deficit, to 3.0% of GDP (CZK 117 billion). The GDP deficit will only decrease by 0.1 percentage points compared with the previous year, but the fiscal effort calculated as the year-on-year change in the structural balance is 0.5 percentage point, especially thanks to the higher production gap in 2012. The original fiscal target for 2012 of 3.5% of GDP was subsequently reduced to 3.0 % owing to the more favourable results (of the previous year). As regards the **revenue** side the government sector, the growth is expected to slow down to 2 % in 2012, while the tax revenues will increase by 3 %. The most significant increase of 11 % is expected in the value added tax, where the reduced rate increased by 4 percentage points as of 1 January 2012 (i.e. from 10 % to 14 %). In addition, the increase in the excise duty on tobacco products has a positive effect on the higher VAT collections, even though it is significantly lower. On the other hand, individual income tax is expected to decrease by more than 2 %, especially owing to the fact that the child allowance grew to CZK 1,800 per year, as compensation for the growing lower VAT rate. In addition, the corporate income tax will grow by more than 2 %; 2012 will be the last year when the tax collections grow thanks to the temporarily accelerated depreciations adopted in 2009. Another positive aspect in direct taxes is the income from lotteries (20% tax); however, the net effect is not the full CZK 8.2 bn, as it is necessary to reflect the lower fees from gambling machines, with a negative impact of approximately CZK 4 bn. Excise duty will practically stagnate in 2011 and 2012 - even though the excise tax on tobacco products grew in 2012 as the result of EU harmonization, the effect of this change will be significantly weakened as a consequence of the fact that distributors have purchased extra stock in the expectation of this growth. Social contributions will grow by less than 1 %; we expect that two opposing actions will take effect, which will practically eliminate each other. One of these effects is the amended Health Insurance Act, under which the total numbers of persons involved in this system will increase, while on the other hand the limits of social security will decrease from 72 to 48 times the average wages. Unlike in the previous year, this year's consolidation accent is rather put on the revenue side. The **expenditure** is expected to be up by 1.8 % against 2011. Even though the expenditure development trend is not negative as in 2011, the pace is still lower than that of income. The most significant savings are expected in the domain of intermediate consumption, which will decrease by 4.2%, especially thanks to the binding of expenses in the amount of CZK 23.6 bn approved by the government. On the other hand, the labour costs will slightly increase (by about 1 %) compared with the last year's decrease, especially to reflect the increase in the salaries of teachers, judges and prosecutors. The doctors' salaries will increase as well but this will not affect the deficit in terms of labour costs, but through social benefits. No major surprises or legislation changes are expected in the area of other expenses. As regards government investment (or the creation of gross fixed capital), a slight recovery and growth of 1.4 % is expected this year. This growth will be funded especially from national sources, because the investment income subsidies from the EU will be slightly lower than in the previous year.

The general government **balance** is logically most affected by the central government subsector, usually followed by the local government subsector. In 2011, all subsectors reported improvements compared with the previous year. An absolutely dominant carrier of the consolidation efforts in this case was the central government subsector, which reported an improvement of more than CZK 50 bn and reached CZK 100.6 bn. Local governments came second, with their consolidation efforts amounting to almost CZK 10 bn and the deficit falling to CZK 9.7 bn. The subsector of social security funds improved only slightly (by about CZK 1 bn) and reached CZK -7.6 bn. In 2012, slight deterioration to CZK 106.6 bn is expected in the central government, while the other two subsectors will continue to gradually decrease their deficit, and will together improve by almost CZK 7 bn.

The government sector's **debt** reached CZK 1,567.8 bn in 2011 (representing 41.2% of GDP), up by 9.1 % compared with 2010. Compared with the previous two years, however, the debt dynamics started to slow down which is the result of the government's consolidation efforts. From the perspective of structure, the most significant part of the debt is attributable to the central government subsector, representing the vast majority of government debt (CZK 1,470.5 bn in 2011), while the second place was occupied by local

government debt, amounting to approximately CZK 100 bn. The debts of the social security funds reaching up to CZK 0.1 bn, is of almost no relevance, especially owing to the fact that most liabilities of this subsector are posted in other liabilities (which is an equivalent to trade payables) and these do not form part of the debt. In 2012, the debt dynamics is not hampered as in previous years, by the involvement of reserves from previous years. By the end of 2012, the debt is expected to reach CZK 1,713.7 bn (44% of GDP); the dynamics will be similar to that in 2011. In 2012 the reserves created in the past will not be used to slow down the debt growth dynamics.

## 5.2. State budget

**The state budget for 2011** was approved with a deficit of CZK 135 bn. Total expenditure of CZK 1,190.7 bn and total revenues of CZK 1,055.7 bn were planned. The revenues and expenditures were subsequently changed and so the total expenditure planned after the change was CZK 1,210.0 bn and the total revenues were CZK 1,074.8 bn. Actual expenditure was CZK 1,155.5 bn and revenues CZK 1,012.8 bn. The state budget therefore ended with a deficit of CZK 142.8 bn, i.e. approximately CZK 7 bn more than planned.<sup>25</sup>

As regards the **revenues**, the plans were not fulfilled by CZK 62.1 bn., up by CZK 12.4 bn year-on-year (by 1.2 %; compared with 2010, the amended budget envisaged a growth by 7.4 %). Tax revenues (excluding social insurance contributions) were only fulfilled at 96.4 %, which is a generally better result than in 2010. The amount of revenues was lower by CZK 19.7 bn than planned; however, it was up by 3 % year-on-year (i.e. approximately CZK 15 bn). The budget (tax revenues) was built on the assumption of 6.9% growth. VAT collection was lower by CZK 3.2 bn than planned; the growth was 2.2 % year-on-year but the budget expected a 3.9% growth. As regards excise taxes (including energy taxes and levies from solar radiation), the budget was fulfilled at 98.9 %. The annual growth was 6.4 % year-on-year, which is by 1.2 percentage points lower than the growth reflected in the budget. The amount of the excise taxes collected is influenced by the levies from solar power energy, with the budgeted income of CZK 4.2 bn, while the actual collection was CZK 5.9 bn. The corporate income tax was fulfilled at 98 % of the budgeted amount, which is a very good result, taking in view the high volatility. The tax collection decreased by 4.6 % year-on-year, which is more than planned in the budget (2.7 %). In 2011, the amount of the collected tax was affected by the fact that in 2010 the tax rate decreased by another percentage point (19%) and by the depreciation of the losses incurred during the economic crisis. A significantly lower tax collection was reported in individual income tax, where only 89.3% of the budget was fulfilled. The growth was 3.6 % year-on-year, but the expected 16% growth in the tax collection was not fulfilled. Such a rapid growth was mainly expected from the personal income tax on employment and in connection with the measures relating to the withholding personal income tax. One of the major reasons for the failure to meet the expectations is the finding of the Constitutional Court concerning the cancellation of the 50% tax on the state building savings contributions. The introduction of this tax had been included in the budget estimates. The second major effect is the significant failure to collect the planned amount of the individual income tax paid on the basis of tax returns, where the budget was only fulfilled at 28.2 % (less by almost CZK 4 bn), owing to the depreciation of losses caused by the financial crisis, which led to the refunding of overpaid taxes. As regards property taxes, the plan was not fulfilled by CZK 1.3 bn, which is also a relatively weak result, owing to the low overall amount of this tax (fulfilled at 90.1 %). The revenues from social security premiums reached 98.3 % of the plan, up by 3.1 % against the previous year. The lower collection was especially caused by the economic situation that was worse than expected. Non-tax and capital income and transfers received were only fulfilled at 77.4 % of the budget after the amendments (lower by CZK 35.9 bn than planned), especially owing to the lower income from the EU budget (or transfers received from EU and the National Fund).

The total state budget **expenditures** were used at 95.5 % after the budget amendments (lower by CZK 54.5 bn than planned), down by 0.1 % year-on-year. The current expenditures were used at 95.6 %, up by 1 % year-on-year (the amended budget planned a growth by 5.6 % compared to the situation in 2010). The largest amount of current expenditures is spent on social benefits, for which 99.6 % of the budget plan was used, up by 3.1 % year-on-year. Of this, CZK 368.1 bn was spent on pensions, corresponding to 100.0 % of the amended budget plan. Other social benefits decreased year-on-year (state social support by CZK 4.8 bn, unemployment benefits

<sup>25</sup> Compared with the amended state budget, the deficit was higher by CZK 7.6 bn.



by CZK 3 bn and other social benefits by CZK 0.9 bn). Non-capital transfers to regional government budgets were used at 99.1 %, especially for the financing of municipal and regional schools, and for municipal social services. Non-capital transfers to health insurance funds were used almost in the amount expected in the plan. Significant savings in expenditure were related to the government debt (especially interest expense), drawn at only 77.4 %. The CZK 16 bn savings compared with the budget plan were especially caused by the low interest rates compared with the budget expectations. In addition, the payments regarding own EC resources to the EU budget were higher than expected, reaching 103.1 % of the approved budget amount. In early December there was an extraordinary payment of CZK 5 bn in excess of the budget, following the revised GDP growth during the period from the Czech Republic's accession to the EU, as of 2010. Capital expenditures reached 94.7 % of the amended budget, down by 8.7 % year-on-year, of which the investment transfers to the State Transport Infrastructure Fund amounted to CZK 33.7 bn and transfers to the State Agricultural Intervention Fund reached CZK 6.0 bn.

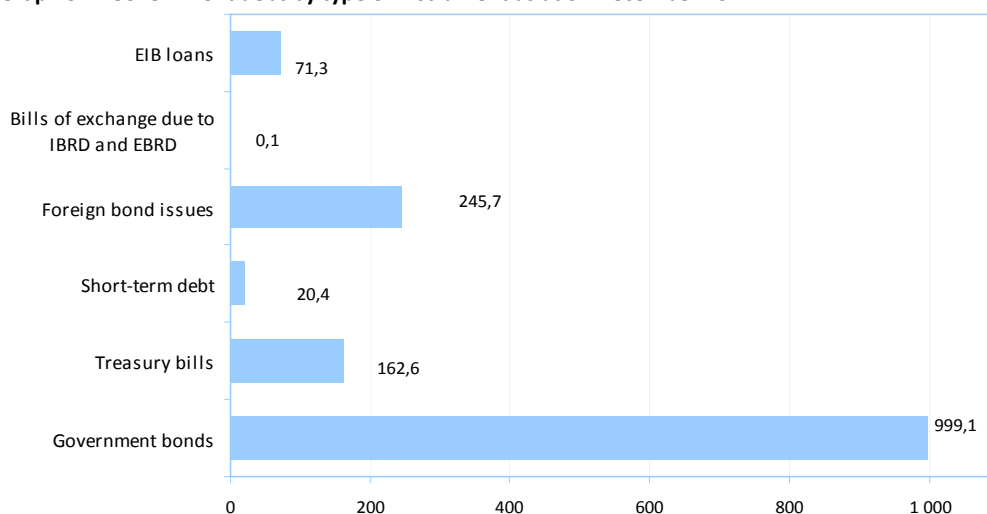
The **total state budget balance** in 2011 was CZK 142.8 bn, and the amount was affected by several negative non-budget impacts. This especially included the cancellation of the 50% tax on the state building savings contributions, extraordinary transfer to the EU budget and the suspension of payments from the EU which are pre-financed from national sources. Without these influences the deficit planned in the budget would be fulfilled.

The **proposed state budget for 2012** put approved by the Chamber of Deputies with a deficit of CZK 105 bn (i.e. by approximately CZK 30 bn less than planned in the 2011 budget). The budget consists of the total income of CZK 1,084.7 bn and total expenses of CZK 1,189.7 bn. In order to fulfil the planned consolidated effort and a deficit of 3 % GDP using the ESA95 methodology, it is necessary to bind extra expenses of CZK 23.6 bn in excess of the approved budget, which was approved by the government for this year.

### 5.3. Government debt

At the end of 2011 the unconsolidated government debt was CZK 1,499.4 bn, of which CZK 1,182.2 bn was the domestic debt (treasury bills, government saving bonds, medium and long term government bonds and other resources), and CZK 317.2 bn was the international debt of which international bond issues have a dominant share (CZK 245.7 bn), followed by EIB loans (CZK 71.3 bn). The increase is clearly a chronic result of the state budget deficit. However, thanks to the consolidation efforts the debt growth dynamics was slightly lower in recent years, and we can expect that the debt growth rate will continue to decrease in the future. At the end of the first quarter of 2012, the government debt was CZK 1,613 bn, i.e. 42.1% of GDP.

**Graph 5.1: Government debt by type of instrument as at 31 December 2011**

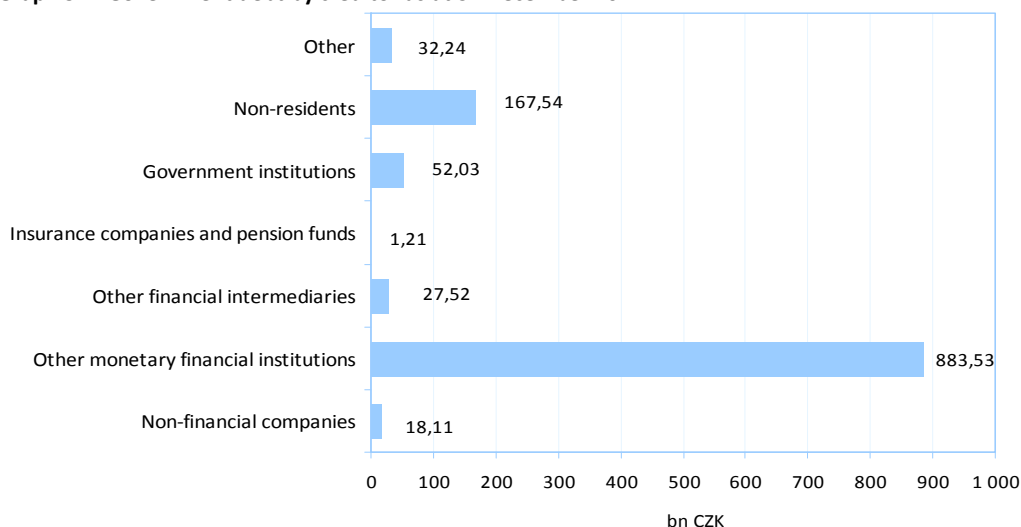


Source: MoF

The stable refinancing structure is evident from the average government debt maturity, which fluctuated between 6 and 7 years in recent years. In 2009 and 2010, the lower limit was reduced by 0.5 years owing to

the higher uncertainty in global markets, while in 2011 the target band was narrowed to between 5.25 and 6.25 years. The average maturity of the government debt reached 5.8 years as at the end of 2011. As a consequence of the increased uncertainty in the capital markets and the resulting interest for short-term financial instruments among investors, the band of 5 - 6 years was set for 2012. Interest rate risk is the most important market risk in the government debt management. Since 2011, it has been the strategic objective to have the government debt average re-fixing time set between 4 and 5 years, which corresponds to the international practice of optimizing government debt expenses and the risks resulting from the re-fixing of rates. In 2012, the primary tool is the government bond issue activity. If the average government debt re-fixing time ranged outside the target interval, derivative transactions will be used. The average government debt re-fixing time was 4.6 years by the end of 2011. In terms of the interest-rate structure, 14.8 % of the long-term instruments were subject to variable interest rates in 2011. In 2012 and thereafter, the share of debt subject to variable rates should not exceed 17 %. Since 2011, the exchange rate risk has also been actively managed, i.e. the share of foreign currency debt must not exceed 15 % + 2 percentage points (except for short-term bridging of the sudden depreciations of the domestic currency). The average foreign-currency debt corresponded to 9.2 % by the end of 2011. The decrease compared to the end of 2010 is caused by the absence of any foreign issues (with the exception of the sale of a variable-rate bond from the portfolio of the Czech Ministry of Finance, in the amount of EUR 37.5 million). In the long-term horizon, no significant changes in the structure of foreign exchange exposure are expected.

**Graph 5.2: Government debt by creditor as at 31 December 2011**



Source: MoF

## 6. FOREIGN EXCHANGE MARKET

In 2011, the position of the Czech crown in comparison with the world's two major currencies differed. In the first half of the year, the crown kept a relatively stable rate to euro, while significantly strengthening the rate to US dollar, reaching near historic highs of 2008. During the summer, the exchange rate of the crown to both world's major currencies was stable; however, starting in September, the crown began to weaken against both currencies, and this trend continued until the end of 2011. Thus, the crown was down by 6.3 % against the US dollar year-on-year, to CZK 19.94/USD 1.00, and the CZK/EUR exchange rate was down by 3 %, i.e. CZK 25.80/EUR 1.00 as of 31 December 2011. The Strengthening of the US dollar against the euro in late 2011 was caused by the deepening European debt crisis. In the fourth quarter of 2011, the euro lost to all world's major currencies

**Graph 6.1: CZK exchange rates relative to major currencies in 2010 and 2011**



Source: CNB

The currencies in Central and Eastern Europe weakened due to the escalation of the European debt crisis, even more than euro itself. This was probably caused by the persistent problems of Hungary and the non-standard economic and political measures adopted by the Hungarian government. The Czech crown strengthened by 9 % against Hungarian forint to CZK 8.21/HUF 100, and by 8.2 % against Polish zloty, to CZK 5.79/PLN 1.00.

**Table 6.1: CZK exchange rates relative to major currencies**

	Average exchange rate					Year-on-year change (%)
	2007	2008	2009	2010	2011	
CZK/EUR	27,76	24,94	26,45	25,29	25,59	1,19
CZK/USD	20,31	17,04	19,06	19,11	17,70	-7,38
CZK/100HUF	10,39	9,86	9,54	9,07	8,39	-7,50
CZK/PLN	7,30	6,53	6,29	6,30	5,70	-9,52

Source: CNB, CZSO

The significantly different situation in the foreign exchange rate market of the first and second halves of 2011 caused a significant difference to the year-on-year change in the average CZK/USD exchange rate (the Czech crown strengthened by 7.4 %) and the exchange rate at the year-end (the Czech crown weakened by 6.3 % against US dollar).

**Table 6.2: CZK exchange rates relative to major currencies**

	Exchange rate as at the end of					Year-on-year change (%)
	2007	2008	2009	2010	2011	
CZK/EUR	26,62	26,93	26,47	25,06	25,80	2,95
CZK/USD	18,08	19,35	18,37	18,75	19,94	6,34
CZK/100HUF	10,49	10,11	9,79	9,02	8,21	-8,98
CZK/PLN	7,41	6,49	6,45	6,31	5,79	-8,24

Source: CNB, CZSO

As a result of changes in the methodology for the calculation of the payment balance, the Czech foreign trade data were revised. The changes particularly affected the trade balance, which was cleared of the branding effect on the basis of the new methodology (i.e. margin due to non-residents). The development of the current account deficit in 2011, was traditionally influenced by the strong income balance deficit, caused especially by the payment of dividends to foreign investors. However, the deficit of the income balance from direct investments was compensated, in comparison with previous years, by the growing trade surplus, traditionally influenced by the export of machinery and transport equipment. The trade surplus recorded the highest

increase year-on-year in the last quarter of 2011, thanks to the positive effects of the weakening exchange rate of the Czech crown). The sharp decline in the payment balance financial account surplus was especially caused by the decreasing direct foreign investments.

**Table 6.3: External financial relation**

Annual (CZK bn)	2007	2008	2009	2010	2011
Payment balance - current account	-156,9	-81,3	-89,3	-146,6	-109,1
Trade balance	46,9	25,7	87,3	53,8	94,0
Payment balance - capital account	21,6	27,1	51,2	32,5	14,7
Payment balance - financial account	125,3	92,2	143,2	174,3	87,9

Source: CNB - ARAD

The inflation rate of the last three months of 2011 in the Czech Republic was higher than planned by the Czech National Bank. This increase in consumer prices of the last quarter of 2011 was especially caused by the preliminary projection of the planned VAT changes (as of January 2012) in food prices, but also the increase in regulated prices and the weakening Czech crown. The inflation rate in the Euro area and the US was above the rate in the Czech Republic. However, as regards the Czech Republic and the USA, the growing inflation rate did not lead to changes in the major interest rates, because the inflation rate pressures was outweighed by the fears of slowing global economic growth. On the contrary, the change in the key interest rates of the European Central Bank was a matter of discussions. Towards the end of his term as the head of ECB, Jean-Claude Trichet twice raised the key interest rate, from 1% to 1.5%. The new ECB governor, Mario Draghi, decreased the major interest rate to the level of early 2010 immediately after his appointment. The main reason was the negative economic development of the second half of 2011. ECB played a very active role in 2011. In the bond markets, it purchased state bonds of the problematic countries, for a value of CZK 210 bn, to help reduce the high yields. In December, commercial banks in the Euro area were also provided with a three-year liquidity, of approximately EUR 490 bn.

**Table 6.4: Comparison of economic indicators**

2011	Inflation (year-on-year)			Key interest rate of central bank[1]		
	Czech Republic	Eurozone	USA	Czech Republic	Eurozone	USA
January	1,7	2,3	1,6	0,75	1,00	0,00-0,25
February	1,8	2,4	2,1	0,75	1,00	0,00-0,25
March	1,7	2,7	2,6	0,75	1,00	0,00-0,25
April	1,6	2,8	3,1	0,75	1,25	0,00-0,25
May	2,0	2,7	3,4	0,75	1,25	0,00-0,25
June	1,8	2,7	3,5	0,75	1,25	0,00-0,25
July	1,7	2,6	3,6	0,75	1,50	0,00-0,25
August	1,7	2,5	3,8	0,75	1,50	0,00-0,25
September	1,8	3,0	3,9	0,75	1,50	0,00-0,25
October	2,3	3,0	3,6	0,75	1,50	0,00-0,25
November	2,5	3,0	3,5	0,75	1,25	0,00-0,25
December	2,4	2,7	3,0	0,75	1,00	0,00-0,25

Source: CZSO, CNB, Eurostat, ECB, Fed

## 7. FINANCIAL MARKET ACTIVITIES OF THE MOF

### 7.1 Ministry of Finance's activities on an international level

#### **The Financial Services Committee (FSC) and the Economic and Financial Committee (EFC)**

The Financial Services Committee (FSC) and the Economic and Financial Committee (EFC) are two of the expert committees of the ECOFIN Council. The FSC is a forum for preliminary discussion of issues relating to financial services on an expert level and, together with the EFC, it takes part in the preparation of individual meetings of the ECOFIN Council. The FSC's work is carried out by representatives of the member states' finance ministries, the EU, EC, ECB, and European supervisory bodies EBA, ESMA, and EIOPA.

The EFC was established on the basis of Article 134 of the Treaty on the Functioning of the EU. It mainly handles the advisory and preparatory tasks set by this article of the Treaty or delegated directly by the Council. The core of the EFC's activity is monitoring the economic and financial situation in individual member states and the EU, presenting reports to the ECOFIN Council and the EC, and contributing to the preparation of the Council's activities within the economic and financial sector. The committee comprises representatives of the member states' finance ministries, the EU, EC and ECB, and national central banks. The MoF regularly attends meetings of both committees and plays an active role at these meetings. The MoF cooperates with the Czech National Bank when preparing standpoints for the committees' meetings.

The issues discussed in these committees included the IC initiative in the area of crisis management, stress tests of banks (and the related action), developments in financial markets, rating agencies, OTC derivatives, administration and management of financial institutions, SEPA, CBSG, shadow banking, regulatory dialogues with third countries, preparations of selected legislative proposals (such as MiFID, MAD, Transparency Directive, CSD), recapitalization of banks, issues related to the functioning of the new European supervisors, accounting of financial institutions, and the possible introduction of a Legal Entity Identifier (LEI). The committees also participated in preparing a common position on matters to be discussed by the FSB and at G20 meetings.

In 2012 the committees continue in discussing issues related to developments in financial markets, recapitalization of banks, a single identifier for legal entities and rating agencies. They also focus on the implementation of measures proposed by FSB, the financing of small and medium businesses, improved consumer protection in financial markets and the implementation of the Volcker rule.

#### **ECOFIN Council**

The Ecofin Council is one of ten configurations of the EU Council and is composed of finance ministers of EU Member States (budget ministers also attend meetings at which budgetary matters are discussed). Its authority covers the adoption of measures in areas such as the coordination of economic policies and supervision over these policies, monitoring budgetary policy and the state of public finances in Member States, the single Euro currency, taxes, financial markets, the free movement of capital and economic cooperation with third countries. In conjunction with the EP the Ecofin Council also prepares and adopts the EU budget every year. The chair of the Council rotates every half-year based on a pre-approved order (the Czech Republic chaired the Council in the first half of 2009). The Ecofin Council usually meets once a month. Every six months the economic and finance ministers also meet informally in the chair country. These informal meetings are attended by the governors of central banks.

The Ecofin Council's priority topics in 2011 mainly comprised stress testing on banks and the associated corrective actions, the issue of bank recapitalization, and the proposed regulation of short sales and some aspects of credit default swaps as well as the proposed directive on financial transaction tax.

In 2011 the ECOFIN Council:

- Took note of the work programme of the Hungarian presidency regarding economic and financial affairs; the Hungarian presidency reported on continuing progress of reforms in the financial sector

and stated their intention to continue the activities related to taxation of the financial sector (18 January 2011);

- Reached an agreement on general approach to the proposed regulation on short sales and credit default swaps implementing transparency requirements and harmonizing the powers that can be exercised by national regulators in exceptional cases; it took note of the progress report on taxation of the financial sector discussed by the high-level working group for taxation matters, and it requested the Commission to submit an impact assessment by the summer with respect to the individual options of financial sector taxation, and it requested the working group to further deal with this issue and as need may be submit reports; it approved a statement defining guidelines for emergency measures to support financial institutions whose vulnerability is proved by EU stress testing, and it agreed that all Member States shall have implemented credible emergency measures when the results are published, and it determined the dates for solution of possible vulnerability identified by stress testing, with a declared priority of solution in the private sector (17 May 2011);
- Requested the Committee of Permanent Representatives to supervise future work on the proposed regulation aimed to increase transparency and reduce risk on the OTC derivative market so the Council is able to reach an agreement on general approach as soon as possible; it reached an agreement on general approach to the proposed regulation aimed to define technical requirements for Euro payments and direct debits which is the key element of the Single Euro Payments Area (SEPA). This agreement allowed the Polish presidency to open discussions with the European Parliament on behalf of the Council (20 June 2011);
- Adopted a statement and endorsed the communication strategy for corrective and emergency measures planned by Member States to support vulnerable banks as related to the European stress testing in the banking sector; it took note of the work programme of the Polish presidency regarding economic and financial affairs; the goal of the Polish presidency with respect to financial services is to adopt proposals in the near future with the objective to improve the regulation and supervision of financial markets and to develop rules for crisis management. The Polish presidency also intends to deal with the issue of financial sector taxation (12 July 2011);
- Approved a general approach to the proposed regulation aimed to increase transparency and reduce risk on the OTC derivative market whereas this agreement allowed the Presidency to initiate discussions with the European Parliament on behalf of the Council with the aim to reach agreement at first reading; it endorsed the EU mandate for a session of G20 finance ministers and central bank governors held on 14 – 15 October 2011 in Paris that, amongst others, called for approximation of reforms in financial markets and policies aimed to ensure the fair and proper functioning of commodity markets (4 October 2011);
- Discussed activities following the decisions adopted at sessions of the heads of states and prime ministers in relation with the debt crisis and focused on measures to restore confidence in the banking sector; it took note of the EC proposed directive aimed to implement tax on financial transactions in the EU and requested the relevant working groups of the Council to review the proposal; it adopted a directive amending the financial conglomerates directive with the aim to eliminate legal gaps and provide suitable additional supervision of entities in financial conglomerates (8 November 2011);
- Reviewed results of the G20 summit held in Cannes on 3 – 4 November 2011 and dealing with, amongst others, a financial sector regulatory reform; it took note of the Presidency report on progress in proposals for the fourth amendment of EU rules applicable to capital requirements for banks and investment firms (CRD IV) aimed to change and replace the existing directives on capital requirements 2006/48/EC and 2006/49/EC (30 November 2011).

During its meetings, the ECOFIN Council also addressed preparations for European Council meetings and the preparation of common position for the G20 meeting.

There were two informal meetings of finance minister and central bank governors in 2011. The first of these took place in April 2011 during the Hungarian presidency and primarily discussed stress testing, financial stability, new supervision of financial markets and commodity derivatives. The second meeting was held in

September 2011 during the Polish presidency. Among the topics discussed was the evaluation of financial stability, stress testing and reforms in the financial sector.

At the start of 2012 the ECOFIN Council dealt with the proposed regulation on OTC derivatives, central counterparties and trade repositories (EMIR), the proposed regulation on financial transaction tax, crisis management and the amendment of the rating agency regulation. The revision of the Capital Requirements Directive (CRD IV) was also discussed.

#### Ecofin Council Working Party on Financial Services (WP D03)

The Ecofin Council Working Party on Financial Services is one of the preparatory bodies of the Council of the EU. It discusses the relevant legislative proposals of the EC regarding the financial markets before they are submitted to the ECOFIN Council. The working party thus deals with a broader range of topics; their specific number depends on the discussion stage the individual legislative proposals are currently in and whether any new proposals have been published. The working party's meetings are attended by experts from EU Member States; the working party is chaired by an expert from the EU presidency country.

The following was discussed by the Working Party on Financial Services during 2011:

- Proposed regulation aimed to establish technical requirements for credit transfers and direct debits in euro which is the key element of the Single Euro Payments Area (SEPA). The general approach was approved in June 2011;
- Proposed regulation on derivatives (EMIR). The general approach was achieved in October 2011;
- Proposed guarantee schemes for the banking sector (DGS) and capital markets (ICSD), i.e. newly proposed directive on deposit guarantee schemes and an amendment of the EU investor compensation directive. The general approach for DGS and ICSD was achieved in June and November 2011 respectively;
- Proposed regulation on OTC derivatives aimed to eliminate system risk when settling derivative transactions. The general approach was achieved in October 2011.
- Proposed directive amending the Prospectus Directive and the Solvency II Directive with a view to powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (ESMA) (Omnibus II). The general approach was achieved in September 2011.

Trialogues were initiated for the above proposals upon the approval of general approach (except of the Omnibus II Directive where dialogues were not started during 2011).

The Working Party on Financial Services also discussed proposals regarding capital adequacy of banks (CRDIV and CRR), housing loan agreements, financial tool markets (MiFID II and MiFIR). However, discussions did not reach the approval of a general approach until the end of 2011.

More information on each discussed proposal is provided in Chapter 7.2.1.

#### **European Council**

The European Council is the most important political body of the EU, comprising top-level officials of Member States (heads of states or prime ministers) and the EC President. The European Council meets at least four times a year, determining the general political direction of the EU.

At its meetings during 2011, the European Council focused on, amongst others, the issues related to bank stress testing. The European Council also called for the expedited adoption of important legislative proposals as regards OTC derivatives, deposit guarantee schemes and capital requirements of banks

## **Level 2 committees of the Lamfalussy process**

### European Insurance and Occupational Pensions Committee (EIOPC)

The EIOPC is an advisory body to the EC which deals with both expert and political issues linked to the insurance sector, including pension funds. It is composed of representatives of the Member States' governments at ministry level and EC representatives. Representatives of the supervisory body EIOPA and EEA countries attend as observers. Its mission is to review any issues relating to the application of EU laws on insurance and occupational pensions.

The committee mainly focused on the Solvency II Directive. It also dealt with the preparation of implementing regulations for the Solvency II Directive, with a special working group set up for this purpose. In relation to the Solvency II Directive the committee also discussed the preparation of the Omnibus II Directive that will revise Solvency II Directive in order to adapt it to the newly formed European supervisory authorities. During 2011, EIOPC was informed in detail on several occasions with respect to the progress of technical standards' (Level 3 guidelines) creation that will be drawn up by the European supervisory body EIOPA.

The EIOPC also deals with the revision of the Insurance Mediation Directive (IMD). At the same time it monitors the initiative in the area of retail investment products.

In the longer term the EIOPC's work should also cover the harmonisation of the introduction and modalities of insurance guarantee schemes and the new approach to the management of risk and capital requirements in connection with the Directive on institutions for occupational retirement provision (IORP) within the wider area of topics introduced by the EC in respect of pensions.

Last but not least, the committee discussed the impacts of the judgement of the European Court of Justice in the case of C-236/09 (published on 1 March 2011), which repeals Article 5 (2) of Directive 2004/113/EC with effect from 21 December 2012. This judgement will have a major impact on the insurance sector, because insurance companies will now lose their exemption from sex discrimination on that date and will thus not be able to include a gender factor into their calculations of insurance premiums and benefits. In that context, EIOPC also discussed the Commissions Instructions for impacts of said judgement (published in the EU Official Journal no. 2012/C 11/01).

### European Securities Committee (ESC) and Expert Group of the European Securities Committee (EGESC)

Four meetings of this Committee composed of representatives of the Member State ministries were held in 2011 (16 March, 13 April, 24 May and 15 November). The committee discussed, amongst others, the Markets in Financial Instruments Directive 2004/39/EC "MiFID II" which shall be revised by a new regulation on markets in financial instruments "MiFIR", a revision of the Transparency Directive 2004/109/EC, and a revision of Directive 2009/65/EC on co-ordination of legal and administrative procedures related to Undertakings for Collective Investment in Transferable Securities Directives "UCITS V".

Another topic for discussion of the Committee was the preparation of a proposal for Regulation on European Venture Capital Funds "EuVECA" that defines uniform rules for creation of EuVECA funds and provides for easier movement of venture capital using so-called Uniform European Passport, thus even access to investment resources for business of small and medium sized enterprises, and further discussion of a proposal for Regulation on European Social Entrepreneurship Funds "EuSEF" that defines uniform rules for creation of EuSEF funds owed to invest at least 70 % funds obtained from investors to support the function of enterprises pursuing a socially useful interest and provides for easier movement of venture capital to such enterprises within the EU using the European Passport.

In context of adoption of the Lisbon Treaty and the newly established European Supervisory Authorities (ESMA, EIOPA, EBA, ESRB), the role of the European Securities Committee has changed. Initially, it was an advisory body and now it shall act as an expert advisory body. Consequently, its name was changed to the Expert Group of the European Securities Committee (EGESC). The first session of the newly established group was held on 15 November 2011.



## OECD

### Committee on Financial Markets (CMF under OECD)

The CMF is the main OECD body dealing with issues in financial markets. It monitors and studies measures intended to improve the operation of national financial markets and the international financial and foreign exchange market and discusses conceptual and strategic trends. Its members are representatives of finance ministries, central banks and other regulatory and supervisory bodies of OECD member states. Discussions are also participated by representatives of the world's financial institutions such as the International Currency Fund and Bank for International Settlements in Basel as well as representatives of the affiliated fast-growing economies. Thus it covers a geographically broader platform for debate and exchange of experience than, for example, discussions between EU Member States. Specific aspects of the committee's work include meetings with representatives of the private financial sphere at which topics of common interest between the public and private sectors relating to development trends in the global financial market are discussed. The MoF representative attended both meetings of the Committee in 2011. The topics for discussion mainly included the current market developments in the Eurozone and experience attained in the financial sector reforms aimed to support long-term investments and environmental projects, systematically important financial institutions, deposit and government guarantees for the financial sector. In 2012, MoF attended the so far only meeting that discussed again the issues of development in the Eurozone and measures for long-term stabilization of financial markets.

### Insurance and Private Pensions Committee (IPPC under OECD)

The IPPC is the main OECD body dealing with the insurance market, supervision of the insurance sector and private pensions, i.e. the non-public sector of pension security (within the IPPC the issue of private pensions is dealt with by the Working Party for Private Pensions, or WPPP). The IPPC strives for international co-operation, co-ordination and greater consistency of the regulation of the said financial market sectors. Its members are representatives of finance ministries and those state authorities dealing with the insurance sector and private pensions; they are also attended by representatives of the supervisory authorities of OECD member states.

The key points on the 2011 agenda included the monitoring of developments of insurance markets and the pension fund sector in context of financial crisis impacts, clarification and co-operation in methodology and data collection, and defined-contribution pension schemes, and good practice for alternative investments and financial derivatives, and financial education and consumer protection in the insurance and pension fund sector, and catastrophic risk, or discussion over impacts of the changes in accounting regulation on long-term investment.

## G20

The G20 group composed of the finance ministers and governors of the central banks of 19 countries<sup>26</sup> and the EU (represented by the current presidency country and the ECB) was established in 1999 to provide a forum for exchange of opinions between the leading world economies on key questions affecting the global economy. In 2011 the group was chaired by France and within the November summit at Cannes the leaders:

- Adopted measures to ensure that no financial institution can be considered too big to fail while taxpayers should not carry any associated costs;
- Decided to exert regulation and supervision of the shadow banking system as well as extend the regulation of market integrity;
- Endorsed the principles of consumer protection in financial services;
- Committed to monitor the implementation of obligations with respect to banks, OTC markets and remuneration practices;

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<sup>26</sup> Member states: Argentine, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, Great Britain and the United States of America.

- Approved the reform of the Financial Stability Council that provides for better co-ordination and monitoring of the financial regulation agenda. This reform includes the granting of legal subjectivity and higher level of financial autonomy.

### **Other selected platforms of the European Commission**

#### European Financial Conglomerates Committee (EFCC)

The EFCC is a Level 2 committee mainly dealing with expert issues directly associated with financial conglomerates. It comprises representatives of Member States' governments at ministry level as well as EC representatives. Representatives of Level 3 committees –EIOPA, EBA and ESMA – attend the committee meetings as observers. During its 2 meetings, the committee dealt with the trend and contents of so-called fundamental revision of the Financial Conglomerates Directive (FICOD). That should focus on including as yet unregulated entities under the directive's regulatory scope, changing the definition of a financial conglomerate in the light of the disappearing boundaries between sectors, harmonizing regulatory capital across all the directives and revising powers of relevant supervisory bodies.

#### Government Expert Group on Retail Financial Services (GEGRFS)

GEGRFS is an expert group of the EC dealing with issues relating to retail financial services. The work of this group is mainly based on the Green Paper on Retail Financial Services in the Single Market published in May 2007. Both specific legislative/non-legislative proposals of the EC and topics in the expert discussion stage are presented during the Group's meetings. MoF representatives attend all meetings of this Group. In 2011 the Group did not meet and the topical issues (mainly referred to the implementation of the mediation system of consumer disputes, credit rate and loan restrictions, and access to a so-called basic payment account, or transparency and comparability of bank charges) were addressed in distance discussions between members.

#### Early Intervention Working Group (EIWG)

The European Commission's EIWG acts as an expert forum for discussing proposals relating to crisis management of banking institutions. In the Group, Member States may present their views of various aspects of the crisis management framework being prepared.

In January 2011, the European Commission published a public consultation on technical details of the framework being prepared. During September 2011, two meetings of the Working Group were held to discuss the basic topics related to the framework being prepared for crisis management in the banking sector that should reflect adverse experience of Member States in resolving bank failures. The entire framework should rest on three pillars: preventive measures reducing the likelihood of adverse developments in a specific institution; early intervention measures to be applied before a crisis situation arises; and the actual resolution of an existing crisis situation using a set of tools especially designed for the needs of financial institutions (bridge bank tool, sale of business tool, debt write-down tool etc.). The financing of these measures is a chapter unto itself. Initially, EC was promoting the concept of a special crisis fund financed by an ex ante levy imposed on selected bank liabilities. The framework's cross-border dimension was a highly sensitive topic given heed during EIWG's discussions (resolution colleges, decision-making power of the home/host bodies in the Group). The actual submission of a proposal for Directive is expected in June 2012 while the latest EIWG session took place on 13 April 2012.

#### Payments Committee (PC)

The Payments Committee is a standing advisory committee to the EC on legislative matters related to payment services. Meetings are held twice a year, chaired by the EC. The PC is staffed by representatives of all EU countries. Representatives of the EFTA and EEA countries, EU candidate countries and the European Central Bank are invited as observers. The PC agenda covers the issues related to the Directive on payment services in the internal market 2007/64/EC, Electronic Money Directive 2009/110/EC, Regulation (EC) no. 924/2009 on cross-border payments in euro, and Regulation no. 260/2012 establishing technical and business

requirements for credit transfers and direct debits in euro (published in the EU Official Journal on 30 March 2012).

#### Market Infrastructure Working Group - Central Securities Depositories (CSDWG)

CSDWG is an EC working group dealing with the preparation of regulation covering central securities depositories. The aim of regulation is two-fold: to increase certainty in the provision of central securities depository services and to create a framework for better cross-border operation. The regulation proposal was published by the EC on 7 March 2012.

#### Securities Law Directive Working Group (SLDWG)

SLDWG is a working group dealing with the finalization of the draft directive harmonizing the law on indirectly held securities. The Commission's proposal will be based on the work of the Legal Certainty Group (an EC advisory group). The aim of the draft directive is to harmonize material law concerning indirectly held securities which should lead to greater uniformity of the rules and thus increase the legal certainty of investors, make cross-border operations cheaper and reduce transaction costs. The EC proposal has not been published yet, however, it was expected before the end of 2011.

#### Close-out Netting Working Group (CoNWG)

CoNWG is an EC working group focusing on the unification of material law on close-out netting. An EC draft directive has not been published yet, however, it was expected before the end of 2011.

## 7.2 Financial Market Legislation

### 7.2.1 Law of the European Union

#### **DGS**

The main objective of the new draft Directive on Deposit Guarantee Schemes is to harmonize the working of national banking schemes and improve the protection of depositors. On 17 June 2011 the Committee of Permanent Representatives approved a general approach and consequently, dialogues were initiated with the European Parliament that continue in 2012.

#### **ICSD**

The draft amendment of Directive on Investor Compensation Schemes is primarily a response to new developments and conditions on the capital market since the original directive was promulgated in 1997, taking into account the need to close the loopholes that have emerged in the practice of investor protection. A general approach was approved by the Committee of Permanent Representatives on 23 November 2011. Dialogues with the European Parliament will mainly be held in 2012 to follow up the result of discussions of the above mentioned Directive on Investor Compensation Schemes.

#### **CRD IV/CRR**

During 2011, the European Commission continued to work on the revision of directives on capital requirements (Directive 2006/48/EC and 2006/49/EC) that will be jointly replaced by a Directive and Regulation (CRD IV/CRR). Negotiations on the EC proposals were conducted within the CRD Working Group (CRDWG) and MoF representatives were proactively involved in its work, preparing drafts and comments in collaboration with CNB. The discussion mainly covered the adjustment of regulatory capital, introducing capital cushions, introducing a leverage ratio, defining liquidity standards and tighter prudential rules for the banks' trading book (counterparty risk). The Commission also discussed a proposal putting restrictions on the discretion allowed for in CRD in order to unify the regulatory rules for banks within the EU ("Single Rule Book"). In the second half of the year, discussions were finished at the EC level. On 20 July 2011 the European Commission submitted the first legislative proposal for review of the Council and European Parliament.

On 29 September 2011, expert level discussions started at the EU Council. The progress can be characterized such that having discussed the entire EC proposal, discussions were limited to issues in some parts of the proposal considered the most disputable by Member States. Those areas were submitted by the Polish presidency for further discussion to reach a compromise legislative proposal. The questionable areas included maximum harmonization, liquidity (i.e. liquidity standards and supervision of branch liquidity), leverage ratio, capital definition, co-operation between the consolidated supervisory body and the national supervisory authority, penalty adjustment, company administration and management as well as anti-cyclical capital cushion, provisional measures, loan counterparty risk and the implementation of new technical EBA standards. As regards the Czech Republic, the principal areas of interest included the issues of liquidity and co-operation between the consolidated supervisory body and the national supervisory authority and the division of their powers. Beyond the scope of presenting opinions at meetings of the Council, MoF with the assistance of CNB took high efforts to provide written comments indicating the important areas of bank regulation in the EU.

The fifth comprise proposal of the Danish presidency has currently been presented. The Danish presidency submitted a general approach for approval of finance ministers at the extraordinary meeting of the ECOFIN Council on 2 May 2012. However, it was not approved before the next meeting of the ECOFIN Council held on 15 May 2012. The European Parliament first reading is scheduled on 12 June 2012.

#### **Basic payment account**

The European Commission adopted a Recommendation 2011/442/EU, on access to a basic payment account, on 18 July 2011. The Recommendation requires Member States, among others, to ensure that every consumer residing legally in the EU has the right to open and use a basic payment account maintained by a payment service provider operating in said territory given the consumer does not have a payment account yet in this territory to allow him/her using the payment services as defined in the Recommendation. Member States are called upon to take the necessary actions to enforce this Recommendation within six months from its publication and to notify the Commission of any actions taken in accordance with the Recommendation. If the European Commission concludes based on the evaluation of Member States' notifications that desired changes with respect to access to a basic payment account did not take place in Member States in accordance with goals of the Recommendation, it would move to take the necessary actions, legislative too. In view of relatively high competition in the Czech banking market, no regulatory steps are required to this end since the existing supply of products meeting the requirements of the Recommendation is sufficient.

#### **Consumer loan**

During 2011, several meetings of the comitology committee were held to discuss Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers and repealing Council Directive 87/102/EEC. At the meetings, the Commission and representatives of Member States discussed a possible revision of this Directive as regards the additional assumptions for the calculation of the annual percentage rate of charge. As a result of the discussions, Commission Directive 2011/90/EU of 14 November 2011, amending Part II of Annex I to Directive 2008/48/EC of the European Parliament and of the Council providing additional assumptions for the calculation of the annual percentage rate of charge, was adopted. At the same time, Commission guidance paper on application of Directive 2008/48/EC was developed as regards the consumer loan charge and the calculation of the annual percentage rate of charge. This document was officially published on 8 May 2012 as the Guidelines on the application of Directive 2008/48/EC (Consumer Credit Directive) in relation to costs and the Annual Percentage Rate of charge.

#### **Mortgage loan**

On 31 March 2011 the European Commission published the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property (COM(2011)142) aimed to unify and promote the internal market on mortgages. While the first meeting of the Working Group of the Council to discuss a proposed directive was held on 18 April, a total of 14 working group meetings took place until the end of 2011. During the Polish presidency, in particular in the autumn months of 2011, the work progress was highly expedited with respect to the proposed directive because of the intention of the Presidency to reach a common approach and submit a document to COREPER by the end of 2011 which, however, did not happen due to opposition from Member States. The cornerstones of a new Directive are the information duties (advertisement, pre-contract and the actual contract), annual percentage rate of charge,

assessment of consumer creditworthiness and credit suitability for a consumer, access to debtors databases, consulting services, early payment, requirements for supervision (single passport for intermediaries and supervision of non-bank providers), and requirements for qualifications of persons dealing with customers.

### **Transparency Directive**

On 26 October 2011 the European Commission published a proposal for revision of the Transparency Directive with the aim to enhance the level of investor confidence based on equal transparency in terms of security issuers and investors across the EU. The revision of the Transparency Directive based on the submitted proposal mainly repeals the obligation to make public interim management statements and deals with greater harmonization of reporting on holdings of proportions of voting rights, and clarification of rules for choice of home Member State for third country issuers, and introduction of a new obligation to report payments to the governments, or definition of a new framework for imposing financial penalties.

### **Credit rating agencies**

On 15 November 2011 the European Commission presented a proposal for amendment of the Regulation on credit rating agencies. The current version of the Regulation on credit rating agencies mainly included a uniform process of approval and supervision of credit rating agencies and issue of ratings used where the EU law requires reviewing quality of a specific financial tool based on rating. With the new proposal, the European Commission is ambitious to reduce dependency of so-called regulated financial institutions on external ratings, increase the transparency of credit rating agencies, introduce a specific interference element of the European Securities and Markets Authority (ESMA) into agency methodologies to develop ratings and lay down a rule of obligatory rotation of credit rating agencies.

### **Markets in financial instruments**

On 20 October 2011, the European Commission published on its website a proposed amendment of the Directive on markets in financial instruments (i.e. MiFID II) and the proposal for a Regulation implementing the Directive on markets in financial instruments (i.e. MiFIR II). These legislative proposals are expected, for example, to extend the regulatory framework by a new type of transfer point (organized trading facility - OTF), and strengthen the supervision of markets in commodity derivatives, and introduce a notification duty for "investment positions". In general terms, the requirements for customer property management, investment consulting and offering of so-called complex financial products should become more stringent.

### **Supervision of financial conglomerates**

On 16 November 2011, the Directive 2011/89/EU of the European Parliament and of the Council amending Directives 98/78/ES, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate was published in the Official Journal of the EU. It is so-called minor or technical amendment that mainly addresses the supervision at the top level of a financial conglomerate. In the next period, EC shall deal with so-called fundamental (complex) revision of the Financial Conglomerates Directive.

### **Insurance**

Since 2009 EC has actively worked on drafting extensive implementing measures (Level 2 Lamfalussy process) for the Solvency II Directive. The discussion of these measures that will take the form of an EC regulation is planned to be completed during 2013. At the same time, Level 3 draft regulations (technical standards) are being drawn up for the Solvency II Directive. Such regulations shall be binding but unlike Level 2 regulations, they suppose to be gradually discussed and adopted in a longer term. In 2011, the works on the Omnibus II Directive drafting continued as well. Similar to the Omnibus I, Omnibus II amends certain directives in connection with the empowerments of the European supervisory authorities, specifically the Prospectus Directive and most notably, the Solvency II Directive. In September 2011 the general approach was achieved by the EU Council and dialogues will be conducted during 2012.

### **Financial transaction tax**

In September 2011 the Commission submitted the Proposal for a Council Directive on a common system of financial transaction tax. According to the Commission, this proposal is aimed to ensure a fair contribution of the financial sector to crisis costs and reduce risk behaviour and the need for harmonization of the current transaction tax. The scope of the Directive is wide, including practically all financial transactions, i.e. shares,

bonds, derivatives both in organized markets and outside. Foreign exchange is excluded where taxation would be contrary to the EU law. Tax is neither imposed on transactions performed by ECB, central banks, etc. Nor the provision of loans, mortgages and other common financial operations and primary markets would be subject to taxation. The proposal is currently being discussed in the Council Working Group.

### **SEPA**

In December 2010 the Commission submitted the proposal for a regulation aimed to establish technical requirements for credit transfers and direct debits in euro which is the key element of the Single Euro Payments Area (SEPA). In the first half of 2011, the proposal for a regulation was discussed in the Working Group of the Financial Services Council. The Committee of Permanent Representatives approved a general approach on 8 June 2011 and the general approach was adopted by the ECOFIN Council on 20 June 2011. In September 2011 the Polish presidency began trialogues with the European Parliament and the Regulation was approved by EP on 14 February 2012. On 7 March 2012 the Regulation was published in the EU Official Journal as the 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 euro and amending Regulation (EC) No 924/2009. The main objective of the Regulation is to set dates for closure of the existing national payment schemes for credit transfers and direct debits in euro, and fully replace them by SEPA payment instruments, and define their technical requirements. The SEPA Regulation defines 1 February 2014 as the deadline on which the existing national schemes for credit transfers and direct debits in euro will cease to exist and will fully be replaced by SEPA-SEPA Credit Transfer (SCT) instruments for credit transfers and SEPA Direct Debit (SDD) for direct debits, and it defines their technical requirements. For non Euro-currency countries, these requirements shall be effective as of 31 October 2016.

### **EMIR – Regulation of OTC derivatives, central counterparties and trade repositories**

The Regulation of OTC (over the counter) derivatives, central counterparties and trade repositories is referred to as EMIR - European Market Infrastructure Regulation. The proposal was published by the European Commission in September 2010, and consequently discussed in the Working Group of the Financial Services Council. On 4 October 2011 the general approach of the Council was achieved and trialogues were initiated with the European Parliament. The Regulation was approved by the EP on 29 March 2012.

The main objective of the Regulation is to reduce, or eliminate system risk using several basic principles – higher standardization of OTC derivative instruments, settlement of trades through central counterparties, massive regulation of central counterparties, higher transparency, and information duty. The entities subject to regulation will include, except of central counterparties and trade repositories, both financial and non-financial institutions.

## **7.2.2 National Legislation**

The Ministry of Finance is the author of bills for the financial market.

### **Financial Market Supervision**

The amendment of Act No. 6/1993, on the Czech National Bank, took effect in March 2011. Its purpose was to adapt the Czech law to the regulation on the new regulatory framework in the EU.

The reform of the financial markets supervision in the EU made it necessary to transpose the so-called Omnibus I Directive through a bill amending certain acts in the context of the financial markets supervision reform in the EU. This act came into force in January 2012.

During 2011 work started on drafting a bill for supervision of the financial market aimed to unify and consolidate the legal form of supervision embodied in separate sector laws into a single legal document.

### **Guarantee schemes in the banking sector**

In late 2011 work started on amending the Act No. 21/1992, on banks, in context of the transposition of Directive of the European Parliament and of the Council on deposit-guarantee schemes. However, the final version of this Directive is not available yet and discussions continue at EU level in first six months of 2012.

### **Transposition of CRD II and CRD III**

The legislative process for an act amending certain acts in connection with the capital requirements and supervision of banks, building societies and credit unions, and investment firms was finalized early in the year. The Act 41/2011 amended the Act on banks, the Act on savings and credit unions and the Act on capital market undertakings. Both Directive 2009/111/EC of the European Parliament and of the Council amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds, large exposures, supervisory arrangements and crisis management (CRD II) and Directive 2010/76/EC of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitizations, and the supervisory review of remuneration policies (CRD III) were transposed into said law. Besides transposing these European directives, the Act also enables the transformation of credit unions into banks. The act came into force on 28 February 2011 and certain provisions on 31 December 2011.

### **Amendment of the act on building savings schemes**

The Act 348/2010 reduced the burden on the expenditure side of the state budget derived from the payment of state support for building savings, specifically by lowering the state support for building savings to 2000 CZK/year at maximum. This amendment also levelled the conditions for taxing interest revenues from building savings deposits to match the conditions for taxing equivalent revenues from other bank deposit products. This act was repealed by Constitutional Court finding (published in the Collection of Laws under no. 119/2011) on the grounds it was adopted in a state of legislative emergency. Legislators were set a deadline of 31 December 2011 to adopt new legislation by standard legislative process as the act repealed by the finding is repealed as of 1 January 2012. To that end, a further amendment of the act on building savings was submitted which is substantively identical to the repealed Act, with the exception of the special withholding tax of 50% on state support for building savings which the repealed act introduced and which the Constitutional Court found to be unconstitutional. This amendment was approved by the Czech Parliament and published under 353/2011 and it became effective as of 1 January 2012.

Further MoF prepared a conceptual amendment of building savings introducing the intended use with respect to state support for building savings. The state support for building savings can only be used for housing needs. As an alternative, the intended use of funds was proposed such as old age security where all participants' funds must be transferred to pension pillar III. This amendment further enhances the possibility of providing building savings. In future, building savings can be provided not only by specialized banks – savings banks but even by universal banks if they are granted a license. This bill was subject to the inter-ministerial comment procedure in July and August 2011. The government passed the bill on 18 April 2012 and submitted it for debate in the Parliament.

### **Amendment of the act on the Czech National Bank**

The preparation of an amendment of the Act No. 6/1993, on the Czech National Bank, as amended, was begun at the end of 2010 with a view to eliminating the shortcomings in the national legislation identified by the European Central Bank, thus bringing this act into line with the provisions of the Treaty on the Functioning of the EU and the Statute of the European System of Central Banks and of the European Central Bank. The bill also includes the elimination of certain shortcomings in the current version that CNB encountered in practice after the Czech Republic joined the European Union and the supervision of the financial market in the Czech Republic was integrated. The bill was further completed with provisions covering financial stability and macro-prudential policy in response to the Recommendation of the European Systemic Risk Board of 22 December 2011.

CNB largely co-operated in the preparation of the Act during 2011. The bill passed external comments on 4 January 2012 – 24 January 2012. On 23 March 2012 the bill was submitted to the European Central Bank for consultation. Its submission to the Government Legislative Council is expected by the end of June 2012

### **Amendment of the act on banks and certain other acts in connection with the change in approach to the branches of foreign banks domiciled in countries outside the EU/EEA**

In 2011 the amendment of the Act on banks and the Act on credit unions was prepared and submitted in cooperation with CNB, introducing new rules for the start-up and operation of branches of third-country domiciled banks in the territory of the Czech Republic. This amendment also includes the breach of banking secrecy towards intelligence services. This amendment was approved by the Government on 2 November 2011 and proceeded in the legislative process to the Czech Parliament.

### **Transposition of CRD IV**

In late 2011, MoF started preparation of law amending certain acts in context of the defined access to the activity of banks, credit unions and investment firms and their prudential supervision. The Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) as being prepared should have been transposed into said law. Further, this amendment shall adapt the Czech legal regulations to the Regulation on prudential rules for credit institutions and investment firms (CRR). This amendment should amend the Act on banks, the Act on savings and credit unions and the Act on capital market undertakings. The expected date for submission of the bill to the Government is October 2012.

### **Electronic money and clearing/settlement finality**

The Act 139/2011, amending the Act 284/2009, on payment, came into force on 27 May 2011. The amendment newly regulates the issue of electronic money and operation of payment systems with clearing finality and settlement systems with settlement finality.<sup>27</sup>

### **Circulation of banknotes and coins**

The Act 136/2011, on the circulation of banknotes and coins, came into force on 1 July 2011. It regulates the circulation and protection of legal tender (banknotes and coins), both the European single currency and the Czech koruna. The act takes up certain provisions hitherto contained in Decree 37/1994, on stipulating the procedure for accepting and handling money and providing compensation for incomplete and damaged banknotes and coins, which it repeals. The provisions regarding the circulation and protection of legal tender are to a certain degree loosened so there is a greater scope for agreement between the involved parties. The Act also introduces a completely new obligation for the registration of legal persons that handle cash for other entities.

### **Distribution of financial services**

MoF has begun to prepare a new Act on the distribution of financial services that unifies the rules for offering and mediating financial products and services and for the provision of financial consulting. MoF has also submitted an amendment of the Act on insurance intermediaries and loss adjusters to the Government. The discussions of the Government Legislative Council were suspended and the amendment of the Act is due for resubmission in mid-year 2012. The principal aim of both legislative initiatives is to boost consumer protection and to unify the system of business licenses in the financial market.

### **Insurance and pension issues**

The Act 260/2011, amending the Act 340/2006, on activities of institutions for occupational retirement provision from European Union member states or other states which are parties to the Agreement on the European Economic Area on the territory of the Czech Republic, and on the amendment of Act 48/1997, on public health insurance and on the amendment of some other relevant laws, as amended, was adopted and took effect in 2011, with a view to responding to the January 2010 judgement of the European Court of Justice reproaching the Czech Republic for insufficient transposition of the Directive on occupational pension insurance.

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<sup>27</sup> In connection with the transposition of Directive 2009/110/EC of the EP and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, and Directive 2009/44/EC amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims..



Further, the basic legal regulations for pension pillar II and III were adopted in 2011. Specifically, the Act 426/2011, on pension savings and the Act 427/2011, on supplementary pension savings, supplemented by the Act 428/2011, amending some acts in connection with the passage of the Act on pension savings and Act on supplementary pension savings. All the aforementioned acts will take effect on 1 January 2013.

During the year, work continued on the preparation of an amendment of the Act 277/2009, on insurance, in connection with the transposition of the Solvency II Directive.

### 7.3 Consumer protection in the financial market

#### **Financial education**

In 2011 the Working Group on Financial Education (WGFE) continued its work as an independent platform for the exchange of information and experience between representatives of the Ministry of Finance, the Ministry of Industry and Trade and the Ministry of Education, Youth and Sports, CNB, and professional associations operating in the financial market, providers of educational projects, consumer associations and education experts. The WGFE members discuss their projects and experience, trying to establish a joint approach to increase the financial literacy of the Czech population.

A conference on financial education for adults was held on 25 November 2011 under the auspices of MoF where the topics of the current situation and risk of financial illiteracy, and effective forms of financial education for adults, and what role is played by financial institutions in financial education for adults were discussed and best practices were shared.

#### **Financial arbitrator**

In 2011, significant changes were made in relation to the financial arbitrator, which is an authority called by the Act 229/2002, on financial arbitrator, as amended, for extrajudicial settlement of consumer disputes in the financial market. As of the Act 180/2011 taking effect from 1 July 2011, the competency of financial arbitrator has been extended to cover consumer loan and collective investment disputes. By the same token, the Office of the Czech Financial Arbitrator was established to perform tasks associated with professional, organizational and technical provisions for the activity of the financial arbitrator. On 16 September 2011 the financial arbitrator Dr. Ing. František Klufa delivered a written statement to the Prime Minister announcing his resignation. Consequently, the Government appointed a new financial arbitrator Mgr. Monika Nedelkova on 16 November 2011.

#### **Distribution of financial services**

One of the key legislative activities in the field of consumer protection in the financial market is to prepare the harmonisation of rules governing the distribution of financial products and services.

The conclusions on required qualifications completed the prior recommendations of the Working Group on Distribution in the Financial Market with respect to a suitable architecture of financial intermediaries, registration system and rules governing the dealings of distributors of financial services with customers. Having done that, the Working Group consisting of representatives of MoF, CNB, professional associations and consumer associations finished over two years of its operation. The outputs from its activities provided MoF a basic framework of the new legislation under preparation, i.e. the Act on the distribution of financial products and services, and for the amendment of Act 38/2004, on insurance intermediaries and loss adjusters, which will constitute the pilot implementation of the new regulatory framework for distribution in the insurance sector. The proposed amendment of the Act 38/2004 was submitted to the Government in the second half of 2011. However, the Government Legislative Council's discussions of this amendment were suspended and MoF was asked to incorporate comments of its members into the proposal. Resubmission of the proposed law and a continuation of discussions in the Government Legislative Council are expected in mid-year 2012. A draft act on the distribution of financial products and services will then be provided by MoF by the end of 2012.

The legislation being prepared respects the relevant legislative initiatives of the EC, in particular the new rules being drawn up for mortgage loans and the rules for "packaged retail investment products" (PRIPIs), which is coordinated with consultations on the revision of the IMD and the markets in financial instruments directive

(MiFID). As part of this agenda (IMD and PRIPs) the EC launched a public consultation at the end of 2010 with a view to outline the basic features of the future legislation. The key goal is to generally strengthen and unify consumer protection in the individual sectors of the financial market, and develop the single market in financial services and make the supervision more effective.

The PRIPs initiative is primarily a response to the need of unification of the degree of protection afforded to consumers in the case of investment products that are currently subject to differing degrees of regulation although they fulfil an identical economic function. According to the EC, the Directive is intended to create a single and adequate legal framework of rules governing dealings with customers and the provision of information on retail financial services with an investment component. The revision of the IMD should mainly focus on widening the Directive's scope to cover direct distribution of insurance products by insurance companies, making the provisions on cross-border provision of services more precise, improving consumers' awareness about the intermediary and the insurance product being negotiated and underlining the requirements for the distributor's expertise when entering and operating in the sector. Both legislative proposals should be published by the Commission before the end of 2011.

In addition to the above, the proposal for a new directive regulating the provision and mediation of mortgage loans was published by the Commission in March 2011. Even in case of this regulation, the main purpose is to strengthen consumer protection. Seeing as this significant part of the credit market remained uncovered by regulation after the transposition of Directive 2008/48/EC on consumer credit agreements, the MoF welcomes and supports this initiative.

## 7.4 Other activities of the Ministry of Finance

### **Closing of Prague Securities Centre**

The Prague Securities Centre, a semi-budgetary organization established by the Ministry of Finance, transferred all its activities relating to maintenance of the register of book-entered and dematerialized securities to the Central Securities Depository as of 2 July 2010 and its function was cancelled by the decision of the Minister of Finance as of 31 December 2011 and deleted from the Commercial Register. All rights and obligations of the Prague Securities Centre, with the exception of maintenance of the register of book-entered and dematerialized securities and the provision of associated services, were assigned to MoF as the owner of the ceased organization under the Act on the Property of the Czech Republic and its Representation in Legal Relations as of 1 January 2012. The register of securities has been maintained by the Central Securities Depository as of 2 July 2010.

### **Anti-debt Alliance (ADA)**

MoF participates in the ADA activity. The establishment of ADA was initiated by the Department of Crime Prevention of the Ministry of Interior, Probation and Mediation Service and Association for Probation and Mediation in Justice in May 2011. It provides a professional platform composed of the representatives of governmental institutions and non-governmental non-profit organizations. The goal of the Alliance is to find solutions of problems associated with insolvency of persons that may result in repeated criminal activity. The purpose of the Alliance is to follow up similar activities, experience and analyses of all partners, including foreign, who deal with said issues and come up with proposals leading to minimize insolvency and its associated risk.

Ten essential goals of the Alliance are expressed in the Basic Declaration of ADA. Four working groups are established to meet the goals: Consumer Loans, Debt Recovery, Financial Education and Alternative Methods of Debt Relief. The members of working groups have regular meetings. Experts are invited to participate in so-called round tables.

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## LIST OF ABBREVIATIONS

abs.	Absolute
AKAT	Asociace pro kapitálový trh (Czech Capital Market Association)
APF CR	Asociace penzijních fondů ČR (Association of Pension Funds of the Czech Republic)
ARAD	Time series database - Czech National Bank
BRICS	Joint economic grouping of Brazil, Russia, India, China and South Africa
CESR	Committee of European Securities Regulators
CMF	Committee for Financial Markets
COREPER	Committee of Permanent Representatives
CPI	Consumer price index
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CZK	International code for Czech koruna
CIA	Czech Insurance Association
CNB	Czech National Bank
CR	Czech Republic
ČS	Česká spořitelna, a. s. (Czech Savings Bank)
ČSOB	Československá obchodní banka, a. s. (Czechoslovak Business Bank)
CZSO	Czech Statistical Office
VAT	Value added tax
DGS	Deposit Guarantee Schemes
EBA	European Banking Authority
PXE	Prague Energy Exchange
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EFC	Economic and Financial Committee
EFCC	European Financial Conglomerates Committee
EGAP	Exportní garanční a pojišťovací společnost, a.s. (Czech Export Credit Agency)
EEA	European economic area
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EIOPC	European Insurance and Occupational Pensions Committee
EIWG	Early Intervention Working Group
EC	European Commission
EMD	Electronic Money Directive
EMIR	European Market Infrastructure Regulation
ESC	European Securities Committee
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	International code for euro
Fed	Federal Reserve System
FESE	Federation of European Securities Exchanges
FICOD	Financial Conglomerates Directive
FSB	Financial Stability Board
FSC	Financial Services Committee
GEGRFS	Government Expert Group on Retail Financial Services
GDP	Gross domestic product
HUF	International code for Hungarian forint
IBRD	International Bank for Reconstruction and Development
ICSD	Investor Compensation Schemes Directive
IF	Investment firms
IMD	Insurance Mediation Directive
IORP	Directive on the activities and supervision of Institutions for Occupational Retirement Provisions
IPPC	Insurance and Private Pensions Committee

KB	Komerční banka, a. s. (Commercial Bank)
MEYS	Ministry of Education, Youth and Sports of the Czech Republic
MiFID	Markets in Financial Instruments Directive
MIT	Ministry of Industry and Trade of the Czech Republic
ML	Mortgage loan
MoF	Ministry of Finance of the Czech Republic
MRD	Ministry of Regional Development of the Czech Republic
OECD	Organization for Economic Co-operation and Development
OPF	Open-ended pension fund
p.b.	Percentage point
PC	Payment Committee
PF	Pension funds
PLN	International code for Polish zloty
PRIPs	Packaged Retail Investment Products
PSE	Prague Stock Exchange
RM-S	RM System
APR	Annual percentage rate of charge
SEPA	Single Euro Payments Area
SIFIs	Systemically Important Financial Institutions
SLDWG	Securities Law Directive Working Group
SLFS	Selective labour force survey
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
UNIDROIT	Convention on harmonized substantive rules regarding securities held with an intermediary
USA	United States of America
USD	International code for US dollar
WPPP	Working Party on Private Pensions

## APPENDIX 1: FINANCIAL MARKET LEGISLATION

In 2011, the following changes were made in the legislation of the Czech Republic and European Communities in the financial market sphere:

### P1.1. Cross-sectoral regulations in the sphere of financial markets

#### 1) European legislation and other initiatives published in 2011:

- Directive 2011/89/EU of the European Parliament and of the Council 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.
- Commission Directive 2011/90/EU of 14 November 2011 amending Part II of Annex I to Directive 2008/48/EC of the European Parliament and of the Council providing additional assumptions for the calculation of the Annual Percentage Rate of Charge.

#### 2) Pending European legislation (including legislation published after 31 December 2011) and other initiatives of the European Commission:

- Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC.
- Preparation of fundamental revision of the Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 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 of the European Parliament and of the Council.
- Guidelines on the application of Directive 2008/48/EC (Consumer Credit Directive) in relation to costs and the Annual Percentage Rate of Charge.
- Regulation on structured retail investment products (PRIIPs).

#### 3) Acts that took effect in 2011:

- Act No. 180/2011 Coll., amending Act No. 229/2002 Coll., on Financial Arbitrator and other related acts. This Act to extend the scope of the Financial Arbiter and the dispute resolution of consumer credit and collective investment schemes. At the same time with effect from 1 July 2011 state branch office of the Financial Arbiter was established (with effect from 1 July 2011) to perform the tasks associated with professional, organizational and technical support activities of the Financial Arbiter.

#### 4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2011):

- Act No. 37/2012 amending certain acts in connection with the the reform of the financial market supervision in the EU (Act No. 21/0992, on banks, Act No. 87/1995, on credit unions, Act No. 15/1998, on supervision in the capital market area, Act No. 256/2004, on capital market undertakings, Act No. 189/2004, on collective investment, Act No. 377/2005, on financial conglomerates, Act No. 284/2009, on payment system. This Act implements the Directive 2010/78/EU of the EP and of the Council (the Omnibus Directive).
- Proposal for amendment of Financial Conglomerate Act No. 377/2005 Coll.
- Draft Act on the financial market supervision. The main aim of this act is to unify and consolidate the sectoral legislation in the area of the financial market supervision.

#### 5) Secondary legislation:

- None

## P1.2. Legislation in the sphere of capital markets

### 1) European legislation and other initiatives published in 2011:

- Proposal 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.
- Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative Investment fund managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010
- Regulation (EU) No. 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies.
- ESMA update of the CESR recommendations - the consistent implementation of Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive (23 March 2011).
- ESMA Guidelines for competent authorities and UCITS management companies – Guidelines on risk measurement and the calculation of global exposure for certain types of structured UCITS (14 April 2011).
- ESMA Guidelines on the application of the endorsement regime under Article 4 (3) of the credit rating agencies regulation No. 1060/2009 (17 May 2011).
- ESMA Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities (22 December 2011).

### 2) Pending European legislation (including legislation published after 31 December 2011) and other initiatives of the European Commission:

- 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.
- Proposal 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.
- Proposal 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 repositioriem.
- Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation.
- Proposal for Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse).
- Proposal 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.
- Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencye.
- Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/ES on 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 terms of excessive reliance on ratings.
- Proposal for a Regulation of the European Parliament and of the Council on European Venture Capital Funds.
- Proposal for a Regulation of the European Parliament and of the Council on European Social Entrepreneurship Funds.
- ESMA Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities.

### 3) Acts that took effect in 2011:

- Act No. 199/2010 Coll. Amending Act No. 586/1992 Coll. on income tax, as amended, and Act No. 218/2000 Coll. on budgetary rules and amending certain related Acts (budgetary rules), as amended, and certain other laws (with effect from 1 January 2011, except as provided in part One, Article I,



paragraphs 1 to 6, 8 and 9 and part Two, Article II, which become effective on 16 June 2010, and part five of Article V, sections 3, 8 and 11, which become effective on 1 January 2012).

- Act No. 408/2010 Coll. on financial collateral arrangements (effective from 1 January 2011).
- Act No. 409/2010 Coll., amending certain laws in relation to the act on financial collateral arrangements (effective from 1 January 2011).
- Law No. 41/2011 Coll. amending certain laws in relation to the determination of capital requirements and supervisory practices of banks, credit unions and investment firms (with effect from 28 February 2011), with the exception of § 16a paragraph 8, § 136, paragraph 2, point f) i), which become effective on December 31, 2011.
- Act No. 139/2011 Coll. of 27 April 2011, effective from 27 May 2011 – amending Act No. 284/2009 Coll. , on payment systém.
- Act No. 188/2011 amending Act No. 189/2004 Coll. Collective Investment Act, as amended, and other related laws. Transposition of the Directive of the European Parliament and Council Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS IV"), European legislative acts performed UCITS IV, the prospect and the Directive on transparency (with effect from 15 July 2011).

#### **4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2011):**

- Act No. 420/2011 Coll., amending certain laws in relation to the act on the criminal liability of legal persons and proceedings against them (with effect from 1 January 2012)
- Act No. 37/2012 Coll. amending certain laws in relation to the reform of financial supervision in the EU. The reason for the amendment changes the level of the EU with regard to the division of supervisory powers between the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (with effect from 31 January 2012).
- Draft Act amending Act No. 190/2004 Coll. on bonds, as amended, Act No. 256/2004 Coll., The Capital Market Undertakings Act, as amended, Act No. 634/2004 Coll., on administrative fees, as amended, and Act No. 97/1963 Coll. on International private and procedural law, as amended. The main objective is to remove the bill from the current legislation, administrative requirements, as well as producing the desired legislative clarification (with effect from 1 July 2012, with certain provisions become effective on the first day of the third calendar month following the date of publication of the Act).

#### **5) Secondary legislation:**

- Government Regulation No. 189/2011 Coll. key investor information document of the undertaking for collective investment. Regulations implementing the Act No. 189/2004 Coll. Collective Investment Act, in terms of the requirements document containing key information for investors. Key investor information document replaces the existing institute of simplified collective investment fund rules. The reason for the change is that the Directive of the European Parliament and Council Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) introduces the communication of key information for the standard funds, that is, funds, whose regulation is the subject of harmonization at EU level (with effect from 15 July 2011).
- Government Regulation No. 190/2011 Coll. setting the limits of certain amounts in euro, as regards the adjustment of public offers of investment securities, prospectus and information obligations of the issuer of certain investment securities and others. Regulations implementing the Act No. 256/2004 Coll. The Capital Market Undertakings Act.in terms of transposition of the European Parliament and Council Directive 2010/73/EU of 24 October 2010 amending Directive 2003/71/EC on the prospectus , to be published in the public or admitted to trading and 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (as of 15/07/2011 ).
- Decree No. 191/2011 Coll. amending Decree No. 234/2009 Coll. on the protection against market abuse and on the transparency (with effect from 15 July 2011).

- Decree No. 192/2011 Coll. amending Decree No. 233/2009 Coll. on applications, approval of persons and the manner of proving professional qualifications, trustworthiness and experience of persons, and on the minimum amount of funds to be provided by a foreign bank to its branch (with effect from 15 July 2011).
- Decree No. 193/2011 Coll. on the minimum requisites of the statute and on the conditions for the use of the name short-Term money market fund and money market fund (with effect from 15 July 2011).
- Decree No. 194/2011 Coll. on more detailed regulation of certain rules in collective investment (with effect from 15 July 2011).
- Decree No. 195/2011 Coll. on the activities of a depository of a collective investment fund and on the particulars of a depository contract of a standard fund (with effect from 15 July 2011).

### **P1.3. Legislation in the sphere of banking, building savings schemes and credit unions**

#### **1) European legislation and other initiatives published in 2011:**

- None

#### **2) Pending European legislation (including legislation published after 31 December 2011) and other initiatives of the European Commission:**

- Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. The legislative proposal was published by the EC in July 2011.
- Proposal 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. The legislative proposal was published by the EC in July 2011.
- Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property (Mortgage Credit Directive - MCD) KOM(2011) 142, 2011/0062(COD).

#### **3) Acts that took effect in 2011:**

- Act No. 41/2011 Coll. amending certain laws in connection with the determination of capital requirements and supervisory practices of banks, credit unions and investment firms (amendment to the Act on banks, Act on credit unions and the Act on capital market undertakings).
- Act No. 188/2011 Coll., amending Act No. 189/2004 Coll., on collective investment, as amended and other related laws (this Act amended also Act on banks).
- Act No. 353/2011 Coll. amending Act No. 96/1993 Coll., on building savings schemes and state contribution for building savings and supplementing Act of the Czech National Council No. 586/1992 Coll. on income tax, as amended by Czech National Council No. 35/1993 Coll., as amended, and Act No. 586/1992 Coll. on Income tax, as amended. The law has been adopted in order to reduce the burden on the state budget expenditure in connection with the payment of state support for building savings, which does not fully support the financing of housing needs and draws on resources of all taxpayers in only certain parts of the population, and with the aim to set similar terms for the taxation of interest income of savings deposits in building the conditions for a similar type of income tax from other bank deposit products.

#### **4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2011):**

- Draft Act amending Act No. 21/1992, on banks. This act is intended to transpose the proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes. The main aim of the proposal is to harmonize the guarantee schemes at EU level as regards the coverage level, time limit for repayment, the scope of covered products and depositors, information provided to the depositors and cross-border cooperation.

- Draft Act amending Law No. 96/1993 Coll., on building savings schemes and state contribution for building savings and supplementing Act of the Czech National Council No. 586/1992 Coll. On Income Tax, as amended by Czech National Council No. 35/1993 Coll., as amended, and other related laws. This Act is both to modify the rules for setting up their own activities and branches of foreign banks from countries outside the EU / EEA in the Czech Republic and also to remove some material deficiencies, irregularities or unjustifiable differences in the Act on banks and the act on credit unions;
- Draft Act amending some acts in connection with a change in the Act on building savings schemes. This bill will deliver some conceptual changes.
- Draft Act amending Law No. 6/1993 Coll. on the Czech National Bank, as amended, and other related laws of the Czech National Bank. The purpose of this amendment is to eliminate gaps in the national legislation identified by the European Central Bank and thus bring it into conformity with the provisions of the Treaty on the Functioning of the EU and the Statute of the European System of Central Banks and the European Central Bank.

#### **5) Secondary legislation:**

- The Decree of the Czech National Bank No. 89/2011 Coll. amending Decree No. 123/2007 Coll. on prudential rules for banks, credit unions and investment firms, as amended.
- The Decree of the Czech National Bank No. 192/2011 Coll. amending Decree No. 233/2009 Coll. on requests approval of persons and how to demonstrate professional competence, trustworthiness and experience of persons and the minimum amount of funding provided to branches of foreign banks.
- Provision of the Czech National Bank No. 2 dated 18 November 2011, on the reporting of banks and branches of foreign banks to the Czech National Bank.
- Provision of the Czech National Bank No. 1 dated 21 November 2011, amending Provision No. 1 of 19 October 2010, on the reporting by credit unions to the Czech National Bank.

### **P1.4. Legislation in the sphere of payments and market infrastructure**

#### **1) European legislation and other initiatives published in 2011:**

- Commission Recommendation of 18 July 2011 on access to a basic payment account (2011/442/EU).

#### **2) Pending European legislation (including legislation published after 31 December 2011) and other initiatives of the European Commission:**

- 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 euro and amending Regulation (EC) No. 924/2009. The general objective is creation of an integrated market for electronic payments in euro with no distinction between national and cross-border payments.
- Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (EMIR). The general objective of the regulation is to reduce systemic risk of the OTC derivatives settlement.
- Proposal for a Regulation of the European Parliament and of the Council on improving securities settlement in the EU and on central securities depositories (CSDs) and amending Directive 98/26/EC. The legislative proposal was published by the European Commission in March 2012. This Regulation introduces an obligation to represent all transferable securities in book entry form and to record these in CSDs before trading them on regulated venues.
- Other initiatives of the European Commission are expected to unify the substantive securities law (the European Commission's proposal - autumn 2012).

#### **3) Acts that took effect in 2011:**

- Act No. 139/2011 Coll., amending Act No. 284/2009 Coll., on payments and certain other acts. The transposition of the Electronic Money Directive and amendment of Directive on settlement finality in payment and securities settlement systems (with effect from 27 May 2011).
- Act No. 136/2011 Coll. on the circulation of banknotes and coins (with effect from 1 July 2011).
- Act No. 206/2011 Col., amending Act 219/1995 Col., the Foreign Exchange Act, as amended. Section 17, containing restrictive rules on the acquisition of real estate property, including agricultural land, in

the Czech Republic by foreign nationals, was cancelled. The Czech Republic fulfils the obligation under the Treaty of Accession to the EU, in which it committed itself to cancel these limitations after a seven-year transitional period (with effect from 19 July 2011).

**4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2011):**

- Proposal for an Act on restriction of cash payments, replacing Act No. 254/2004 Coll., on restriction of cash payments and amending Act No. 337/1992 Coll., on taxes and fees, as amended. The Act is expected to be in effect in the first half of 2013.
- Proposal for an Act on foreign exchange activities, replacing Act No. 219/1995 Coll., the Foreign Exchange Act, as amended. The Act is expected to be in effect in the first half of 2013.

**5) Secondary legislation:**

- Decree No. 169/2011 Coll., on the rules for the creation of account numbers for making payments (with effect from 28 June 2011).
- Decree No. 140/2011 Coll. on payment systems with settlement finality (with effect from 27 May 2011).
- Decree No. 141/2011 Coll., on the pursuit of business of payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers (with effect from 27 May 2011).
- Decree No. 142/2011 Coll., on reporting by payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers to the Czech National Bank (with effect from 27 May 2011).
- Decree No. 274/2011 Coll., on the implementation of certain provisions of the Act on the circulation of banknotes and coins (with effect from 23 September 2011).

## **P1.5. Legislation in the sphere of insurance and supplementary pension insurance**

**1) European legislation and other initiatives published in 2011:**

- 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).

**2) Pending European legislation (including legislation published after 31 December 2011) and other initiatives of the European Commission:**

- Preparation of level 2 implementing measures to the Directive 2009/138/EC (Solvency II).
- Preparation of level 3 technical standards to the Directive 2009/138/EC (Solvency II).
- Preparation of revision of the Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision.
- Preparation of revision of the Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.
- Preparation of a directive on insurance guarantees schemes.

**3) Acts that took effect in 2011:**

- Act No. 260/2011 Coll., amending Act No. 340/2006 Coll., on the activities of institutions for occupational retirement provision from member states of the European Union and other states that are contracting parties in Agreement on European Economic Area, in the territory of the Czech Republic and on amendments to Act No. 48/1997 Coll., on public health insurance and on amendments and additions some related laws, as amended by later laws, as amended by later laws (with effect from 31 August 2011).

**4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2011):**

- Act No. 426/2011 Coll., on retirement savings (with effect from 1 January 2013.).

- Act No. 427/2011 Coll., on supplementary pension savings (with effect from 1 January 2013.).
- Act No. 428/2011 Coll., amending certain laws in relation to the adoption of the law on retirement savings and supplementary pension savings (with effect from 1 January 2013.).
- The proposal for amendment of Insurance Act No. 277/2009 Coll.
- The proposal for amendment of certain laws in relation to the adoption of the law that amends the Insurance Act No. 277/2009 Coll, on insurance.
- The proposal for amendment of Act on insurance intermediaries and on independent loss adjusters (38/2004 Coll.) and of other related laws.

**5) Secondary legislation:**

- None

## APPENDIX 2: SUPPLEMENTARY TABLES

**Table P2.1: Average interest rate**

As at 31 Dec (%)		2007	2008	2009	2010	2011
Deposits	households and small entrepreneurs	1,34	1,55	1,38	1,25	1,20
	non-financial businesses	1,17	1,80	0,87	0,56	0,52
Loans	to households and small entrepreneurs	8,06	6,81	7,00	7,00	6,83
	for consumption	14,99	13,40	13,93	14,28	14,56
	for real estate	6,11	5,05	5,22	5,26	5,08
	to non-financial enterprises	4,57	5,59	4,58	4,10	3,94

Source: CNB – ARAD

Note: Data related to new deposits and loans in CZK

**Table P2.2: Loans by type**

As at 31 Dec (CZK bn)	2009	2010	2011	Year-on-year change	
				Abs.	(%)
Overdrafts and debit balances of current accounts	148,3	141,1	143,3	2,3	1,60
Consumer loans (excl. overdrafts and debit balances of current accounts)	177,8	190,2	186,7	-3,5	-1,82
Housing loans excl. mortgages	161,0	149,1	143,8	-5,3	-3,56
Mortgage loans for residential properties	634,7	682,7	710,1	27,4	4,01
Mortgage loans for non-residential properties	79,0	82,5	114,8	32,3	39,16
Other loans	369,0	393,0	415,6	22,6	5,74
Investment loans	492,0	501,2	554,3	53,1	10,60
Bridge loans	4,3	2,2	4,0	1,7	77,92
Trade receivables	36,1	32,8	31,9	-0,9	-2,69
<b>Total</b>	<b>2 102,1</b>	<b>2 174,8</b>	<b>2 304,5</b>	<b>129,7</b>	<b>5,96</b>

Source: CNB – ARAD

**Table P2.3: Basic indicators of building savings development in the Czech Republic**

As at 31 Dec		2006	2007	2008	2009	2010	2011
New building savings contracts	number	516 385	579 730	705 463	575 292	532 765	410 461
	change (%)	20,0	12,3	21,7	-18,5	-7,4	-23,0
Average target value for new building savings contracts with private individuals	value (CZK 000s)	235,8	284,9	302,8	308,7	300,5	346,2
	change (%)	3,5	20,8	6,3	1,9	-2,7	15,2
Building savings contracts in savings phase <sup>28</sup>	number	5 297 522,0	5 132 595,0	5 070 510,0	4 926 183,0	4 845 319,0	4 550 468,0
	change (%)	-5,0	-3,1	-1,2	-2,8	-1,6	-6,1
Paid state contribution	value (CZK bn)	15,8	15,0	14,2	13,3	11,7	10,7
	change (%)	-2,0	-5,0	-5,0	-6,7	-11,5	-8,6
Average state contribution paid per building savings contract for the relevant year	value (CZK)	3 173,0	3 090,0	2 927,0	2 776,0	2 631,0	n/a
	change (%)	-2,1	-2,6	-5,3	-5,2	-17,1	n/a
Saved amount <sup>30</sup>	value (CZK bn)	359,8	384,8	401,1	415,2	430,1	433,4
	change (%)	9,4	6,9	4,2	3,5	3,6	0,8
Loans total <sup>30</sup> of which: building saving schemes bridging <sup>29</sup>	number	900 653	942 944	971 176	988 353	993 357	956 659
	number	587 501	580 352	569 870	565 485	564 633	552 999
	number	313 152	362 592	401 306	422 868	428 724	403 660
	change (%)	5,0	4,7	3,0	1,8	0,5	-3,7
Loans total <sup>30</sup> of which: building saving schemes bridging <sup>31</sup>	value (CZK bn)	135,5	179,3	227,4	267,5	293,4	293,1
	value (CZK bn)	35,1	38,9	42,9	48,9	53,1	55,8
	value (CZK bn)	100,4	140,4	184,5	218,6	240,3	237,3
	change (%)	25,3	32,4	26,8	17,6	9,7	-0,1
Loans total/saved amount	ratio (%)	37,6	46,6	56,7	64,4	68,2	67,6

Source: MoF

<sup>28</sup> Status at the end of period.

<sup>29</sup> Loans according to Section 5 Para. 5 of the Act 96/1993, on building savings and state support for building savings, as amended.

**Table P2.4: Net assets in trusts domiciled abroad, by distributors**

As at 31 Dec 2011	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
ČSOB investiční společnost	62,7	54,14	-8,26
ING Investment Management (C.R.)	14,0	12,11	-13,91
Česká spořitelna	13,0	11,21	-14,34
Conseq Investment Management	8,1	7,02	3,64
Komerční banka	4,9	4,26	-14,93
Raiffeisenbank	5,6	4,81	18,89
Pioneer Asset Management	1,9	1,67	3,38
UniCredit Bank Czech Republic	2,3	2,00	32,16
Citibank Europe	0,9	0,74	-2,90
HSBC Bank	1,8	1,56	137,80
Other	0,5	0,47	-67,85
<b>Total</b>	<b>115,8</b>	<b>100,00</b>	<b>-7,41</b>

Source: AKAT

**Table P2.5: Net assets of domestic trusts, by management companies**

As at 31 Dec 2011	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
Investiční společnost České spořitelny	49,3	45,59	-11,32
Investiční kapitálová společnost KB	22,2	20,47	-22,94
ČP INVEST investiční společnost	10,9	10,05	6,85
Pioneer investiční společnost	8,2	7,59	-12,50
ČSOB investiční společnost	6,8	6,28	-7,37
AXA investiční společnost a.s.	5,1	4,73	5,64
REICO investiční společnost ČS, a.s.	1,8	1,69	2,70
J&T ASSET MANAGEMENT, IS	1,9	1,73	10,80
PROSPERITA investiční společnost, a.s.	0,9	0,82	-14,69
AKRO investiční společnost	0,5	0,48	-19,44
Other	1,1	1,06	-33,06
<b>Total</b>	<b>108,2</b>	<b>100,00</b>	<b>-11,54</b>

Source: AKAT

**Table P2.6: Allocation of assets of pension funds**

As at 31 Dec (market prices, CZK bn)	2007	2008	2009	2010	2011	Share in 2011 (%)
Bonds	119,4	144,8	171,6	195,3	214,2	86,55
Treasury bills	7,4	6,4	2,2	1,1	0,6	0,24
Shares	9,8	5,7	3,5	1,9	1,0	0,41
Unit certificates	7,6	6,2	6,9	8,7	5,7	2,30
Money and other assets	22,8	28,4	31,5	25,2	26,0	10,50
<b>Total</b>	<b>167,0</b>	<b>191,5</b>	<b>215,7</b>	<b>232,1</b>	<b>247,5</b>	<b>100,00</b>

Source: CNB

**Table P2.7: Placement of technical reserves**

As at 31 Dec (CZK bn)	2010			2011			Abs. Change			Year-on-year change (%)		
	LI	NLI	total	LI	NLI	total	LI	NLI	total	LI	NLI	total
Debt securities	150,9	63,7	237,7	159,8	65,8	247,0	8,8	2,1	9,3	5,86	3,24	3,89
Of which: bonds issued by the Member State or its national central bank	98,4	44,0	152,0	102,9	48,8	158,7	4,5	4,8	6,7	4,58	10,81	4,42
Bonds issued by banks of Member States	15,2	3,4	20,3	15,0	4,5	21,3	-0,2	1,0	0,9	-1,13	29,98	4,51
Listed bonds issued by corporations	10,6	3,3	20,8	10,9	4,6	20,8	0,4	1,3	-0,1	3,49	39,11	-0,47
Treasury bills	2,1	3,2	5,4	1,6	0,5	3,1	-0,5	-2,6	-2,3	-23,13	-82,99	-42,10
Listed municipal bonds	2,6	0,9	3,4	2,3	0,6	3,0	-0,2	-0,2	-0,5	-9,19	-28,61	-13,64
Mortgage bonds	11,6	7,0	19,9	11,7	3,8	18,3	0,2	-3,1	-1,6	1,55	-45,04	-7,89
Bonds issued by EIB, ECB, EBRD or IBRD	6,0	0,9	7,6	6,6	0,9	7,7	0,6	0,0	0,1	10,06	-4,38	0,95
Foreign debt securities traded on any regulated market of OECD Member States	4,6	1,0	7,7	6,7	1,6	10,5	2,1	0,6	2,8	45,26	63,99	36,42
Equities	31,3	5,2	52,3	40,6	5,1	65,5	9,2	-0,1	13,2	29,38	-2,57	25,31
Of which: listed shares	4,5	0,2	4,9	5,1	0,1	5,4	0,6	0,0	0,4	13,08	-28,21	9,04
Securities by unit trusts complying with EC regulations	20,6	2,1	23,9	25,7	3,1	31,1	5,1	1,0	7,2	24,98	44,93	30,24
Credits, loans and other receivables	0,0	0,0	0,6	0,0	0,1	0,6	0,0	0,1	0,0	-	27 372,53	-1,19
Other receivables	0,0	0,0	0,5	0,5	1,2	2,6	0,5	1,2	2,0	7 123,66	-	390,06
Bills	0,0	0,1	0,2	0,0	0,1	0,3	0,0	-0,1	0,1	-100,00	-57,29	70,46
Real estate	0,4	2,3	4,8	0,4	2,3	4,9	0,0	0,0	0,1	-12,19	-0,45	2,19
Deposits and certificates of deposits or depository bonds	9,1	6,5	26,8	10,9	5,1	27,8	1,7	-1,4	1,0	19,15	-21,12	3,60
Items and works of artistic/cultural value	0,0	0,1	0,3	0,0	0,1	0,3	0,0	0,0	0,0	-	-3,88	10,50
Receivables from reinsurance companies	0,7	13,1	20,3	0,6	14,2	22,9	-0,1	1,1	2,6	-8,45	8,40	12,70
Derivatives	0,0	0,0	-0,6	0,1	0,0	-0,1	0,1	0,0	0,5	-1 334,95	-	-91,16
Other financial placement	0,6	0,0	2,3	2,5	0,0	2,5	1,9	0,0	0,3	334,44	-	11,70
Financial placements total	193,1	91,0	345,2	215,3	93,9	374,3	22,2	2,9	29,1	11,52	3,24	8,44

Source: CNB



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