REPORT ON FINANCIAL MARKET DEVELOPMENTS IN 2009

June 2010

CONTENTS

SUMMARY [1]

Economy

In the first half of 2009, the Czech economy experienced recession mainly induced by declining foreign demand. All components of aggregate expenditure with the exception of government spending and final expenditure of nonprofit institutions contributed to the decline in GDP by 4.2%. The average inflation rate measured by the consumer price index decelerated to 1.0%.

Funds for use in the financial market

The total volume of funds for use in the financial market increased by 5.8%. The decrease of collective investments volume (by 3.9%) relates to the overall development in the capital market.

Structure of household savings

On year-on-year basis, the household savings increased by 8.3%, amounting to CZK 2.2 trillion (*EUR 83.1 bn*) at the end of 2009. Czech households deposited more than 70% (CZK 1.6 trillion, *EUR 60.5 bn*) of the savings in banks and building societies. Czech households thus remain very conservative.

Financial market entities

The number of entities in the financial market has not changed significantly. The apparent decline in the number of investment intermediaries is related to legislative amendments.

Banking sector

The banking sector was not heavily affected by the financial crisis. Client deposits represent a stable source of financing – the ratio of deposits to loans amounted to almost 138%. Capital adequacy increased to 14.12% on year-on-year basis.

Interest rates

The Czech National Bank continued in the process of gradually loosening monetary policy. 2T repo rate decreased from the original 2.25% to 1%. The APR for consumption went up slightly, amounting to 15.4%; the APR for acquisition of residential property stagnated.

Deposit and loans

The total volume of deposits increased by 6.8% during 2009. On year-on-year basis, the highest absolute increase of deposits of CZK 110.3 bn (*EUR 4.2 bn*) was recorded within the household sector. The volume of loans increased by 2.0%. The total household indebtedness increased by 7.2% on year-on-year basis, amounting to CZK 1,101.3 bn (*EUR 41.6 bn*) at the end of 2009.

Building societies

On year-on-year basis, the number of newly arranged contracts fell by 18.5% during 2009. The total number of contracts in the saving stage decreased to nearly 4.9 million at the end of 2009. State building savings contribution was paid out in the total amount of CZK 13.3 bn (*EUR 0.5 bn*). On year-on-year basis, the total number of loans increased to 988 thousand and CZK 267.5 bn (*EUR 10.1 bn*) from the perspective of volume.

Mortgage market

The volume or mortgage loans provided to households amounted to CZK 554.4 bn (*EUR 20.9 bn*) at the end of 2009. Rates reported via HYPOINDEX indicator fluctuated near the 5.6% mark. The gap between the HYPOINDEX rate and the CNB 2T repo rate continued widen.

Credit unions

The sector recorded significant growth during 2009. The balance sheet total of credit unions increased by 48% to CZK 17.6 bn (*EUR 0.7 bn*). Deposits increased by 54% to nearly CZK 15.7 bn. Granted loans increased to CZK 8.8 bn.

Regulated markets

The PX Index increased by 30.2% (1,117.3 p.) in comparison to 2008. The volume of trades at the PSE fell by 29.8% to CZK 1,050 bn (*EUR 39.7 bn*), while the volume of trades at RM-S increased. Four stocks left the main market of the PSE. On 14 August 2009, the company Univyc acquired a license from CNB to act as a central securities depository. The company will commence its activities upon assuming records from the Prague Securities Center. This will result in changes to the clearing infrastructure and process as well as to the settlement of trades.

Investment firms and asset management

Banking investment firms dominate the volume of trades for own account, other than asset management transactions, and value of clients' assets. Nonbanking

[1] Selected values are converted from CZK to EUR using the year-end exchange rate for state variables and the average exchange rate (in the particular year) for flow variables.

investment firms together with investment companies operating in the area of assets management concentrate on the management of their clients' assets.

Insurance companies

The stability of the insurance sector is documented by a 3.1% increase of the written insurance premium. The increase can mainly be attributed to life insurance, as non-life insurance experienced a major slowdown of its momentum.

Supplementary pension insurance

The number of participants in supplementary pension insurance increased by almost 5% to 4.4 million. As at the end of 2009, participants deposited CZK 200.7 bn (*EUR 7.6 bn*) in pension funds – i.e. year-on-year increase of 7.5%. The number of participants, who received contribution to supplementary pension insurance from their employers, amounted to 20.6%.

Government sector

State budget recorded a deficit of CZK 192.4 bn (*EUR 7.3 bn*). The failure to meet the planned revenues mainly resulted from the outages on the part of all important categories of tax revenues. At the end of 2009, unconsolidated government debt amounted to CZK 1,178.2 bn (*EUR 44.5 bn*).

Foreign exchange market

Worsening economic situation of the Czech Republic in fourth quarter of 2008 resulted in a sharp depreciation of CZK in the first quarter of 2009. In the period from the late October 2008 to mid-February 2009, the Czech crown depreciated by 28% against euro and 61% against the dollar. However, the Czech currency compensated these losses, reporting a slight year-on-year appreciation against the two leading global currencies at the end of 2009.

Financial and economic crisis

The reactions of both the Czech economy and the financial sector to the crisis were less negative than majority of other countries of Central and Eastern Europe. This resulted from a number of factors: lower current account deficits in the previous years, lower dependence on the volatile cross-border debt financing, and lower volume of cyclical investments. The Czech Republic was not primarily hit by the financial crisis; it was affected by the economic crisis – implicitly due to the export dependence of the Czech Republic. However, problems of the real economy adversely affect the Czech financial sector. The decline of revenues and wages affects the ability of nonfinancial companies as well as individuals to repay their obligations.

Czech Presidency of the Council of the EU

The financial services sector became one of the key areas of interest of the EU in the first half of 2009. Politically-sensitive legislative and non-legislative proposals of the EC in reaction to the crisis induced expectations on the part of entities as well as member states. Members of the ECOFIN Council agreed on the main principals of the reform of the financial market supervision in the EU as well as the treatment of impaired assets. The Council adopted its conclusions in respect of banking capital, also addressing accounting standards of financial instruments. Active approach of the MoF in the legislative area resulted in a number of successful projects, such as the revision of the Capital Requirements Directive (CRD), Regulation on Credit Rating Agencies (CRA), and the Directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II).

Financial markets legislation

The legislative process was finalized with regard to the Act on Payments, Act on Insurance, Act implementing the Directive on reporting duties of issuers of listed securities, and the Act regulating certain aspects of the banking sector crisis. The MoF undertook to prepare the Consumer Credit Act, and prepared the Act implementing the Directive on insurance of bank deposits as well as the Act adapting the Regulation on Credit Rating Agencies. The MoF started to process the Act on Financial Assurance as well as the Act implementing the Directive on settlement finality in payment and securities settlement systems as well as the Electronic Money Directive. In spring of 2009, the MoF presented the Act on Pension Savings.

Consumer protection in the financial market

The key topic in this area was the harmonization of distributors´ expertise. As part of the review of the system of out-of-court resolution of consumer-related disputes, a proposal was presented for expanding the powers of the Financial Arbitrator and changes to financing of this office. The update process of the Financial Education Strategy commenced at the end of 2009.

1. MACROECONOMIC SITUATION

In the first half of 2009, the Czech economy experienced recession mainly induced by declining foreign demand. All components of aggregate expenditure with the exception of government spending and final expenditure of nonprofit institutions contributed to the decline in the gross domestic product (GDP) by 4.2% in 2009. The average inflation rate measured as the consumer price index decelerated to 1.0%. The household consumption has been decreasing since the second quarter of 2009 in reaction to significantly worsening situation on the labor market. The gross capital creation was the main driver behind the year-on-year decline in GDP. The creation of the gross fixed capital decreased and the inventory fell sharply, being the key factor affecting the year-on-year decline in the gross capital creation and consequently in GDP. The contribution of the foreign trade was positive in the fourth quarter already.

Table 1.1: GDP growth rates[2]

(annual,%)	2004	2005	2006	2007	2008	2009
Czech Republic	4.5	6.3	6.8	6.1	2.5	-4.2
EU-27	2.5	2.0	3.2	2.9	0.7	-4.2
Eurozone	0.8	2.2	1.7	3.0	0.6	-4.1
Japan	2.7	1.9	2.0	2.4	-1.2	-5.2
USA	3.6	3.1	2.7	2.1	0.4	-2.4

Source: Eurostat

The average inflation rate measured by the consumer price index (CPI) decelerated to 1.0% in 2009. On an average, the inflation rate was only driven by the so-called administrative measures, i.e. mainly the rising prices of regulated rent, electricity, and heating. On the other hand, the market fluctuation of prices did not increase the average inflation rate. One reason for this was a high comparison base (namely the prices of oil) from the previous year, and another reason was the negative production gap, which was characteristic for the economy in 2009.

Table 1.2: Macroeconomic indicators of the Czech economy

	2006	2007	2008	2009
GDP growth (%, constant prices)	6.8	6.1	2.5	-4.2
Household consumption (change,%, constant prices)	5.0	4.8	3.6	-0.3
Government consumption (change,%, constant prices)	1.2	0.7	1.0	4.4
Gross fixed capital formation (change,%, constant prices)	6.0	10.8	-1.5	-8.3
Inflation (CPI, average for period,%)	2.5	2.8	6.3	1.0
Unemployment rate (MLSA, average for period,%)	7.1	5.3	4.4	6.7
Current account balance for GDP (%, current prices)	-2.4	-3.2	-0.6	-1.0
Balance of trade for GDP (%, current prices)	2.0	3.4	2.8	5.0

Source: CZSO, CNB, MLSA

The unemployment rate according to VŠPS increased from 5.8% in the first quarter of 2009 to 7.2% in the fourth quarter of 2009. The decline in the foreign demand mainly after the production of the processing industry resulted in a severe shock for the labor market. With gradual year-on-year decline of the household consumption, this shock infiltrated other segments of the economy. Nevertheless, it seems that companies tried to retain at least their skeleton staff, at the expense of reducing work-loads and stagnating salaries.

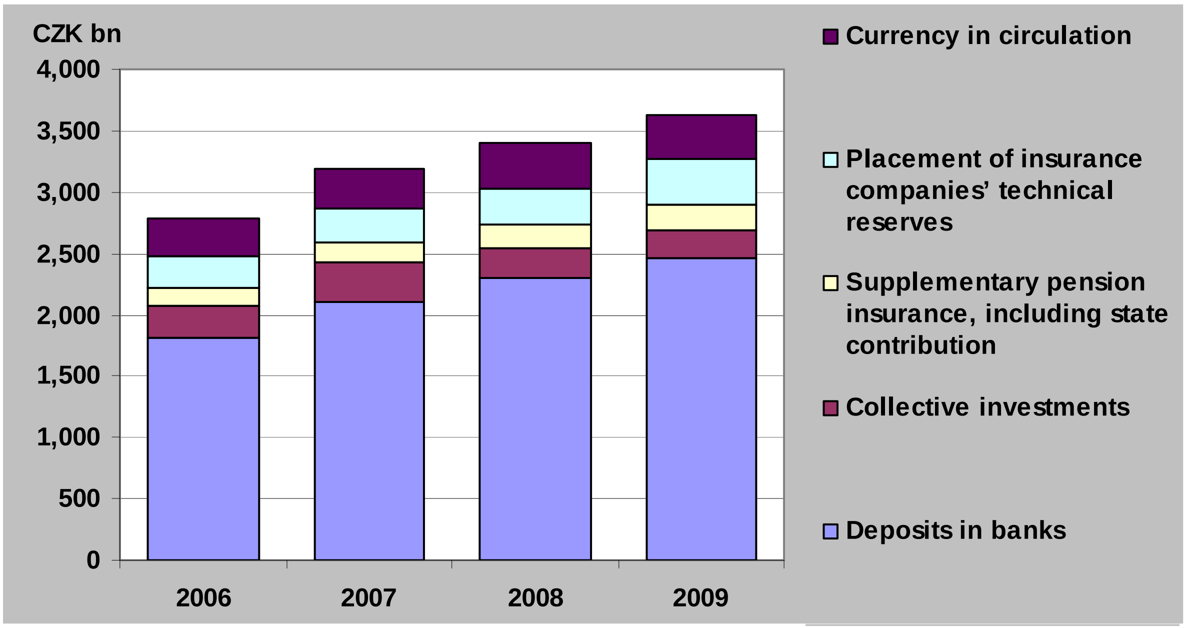
The share of the current account balance of the balance of trade in the nominal GDP amounted to -1.0% in 2009. Therefore, the Czech economy, similarly as in the previous years, acts as a debtor on the global financial market. Position of the Czech Republic has not changed much in comparison with 2008. The balance of trade surplus relative to GDP increased considerably, because nominal imports decreased more than nominal exports.

[2] Data published as at 11 April 2010.

2. FUNDS FOR USE IN THE FINANCIAL MARKET

In spite of the decline in GDP, three of the five items of funds for use in the financial market[3] recorded steady growth in 2009. The total volume of the funds increased by 5.8% and this rate does not vary significantly from the previous years. The fall in the volume of currency in circulation (by 3.3%) is associated with an exceptionally high comparison base. In the late 2008, when the consequences of the financial crisis were most severe, investors reduced their exposure to the capital market instruments, preferring cash. The lower volume of collective investments (by 3.9%) relates to the overall development in the capital market. The persisting increased volatility of the major stock markets resulted in uncertainty on the part of investors. This is why the redemptions of shares in the unit trusts exceeded new investments in this subsector of the financial market.

Graph 2.1: Funds for use in the financial market



Source: MoF, CNB, AKAT

Bank deposits, including deposits in building societies, represent the largest share of the total funds for use in the financial market – more than two thirds (68%), as a result of the traditionally conservative Czech population. A relatively significant increase in the insurance companies' technical reserves took place (by 28.4%); however, this results from the methodological change in the reporting of the reserves. Consequently, their share in the total volume of the funds increased to nearly 11%. The shares of other components did not change significantly.

[3] For the purpose of this report, we define the funds for use in the financial market as the sum of bank deposits, collective investments, supplementary pension insurance, placement of insurance companies' technical reserves and currency in circulation available for placement in the financial market. Therefore, they represent a particular segment of the total balance of financial resources formation and use.

Table 2.1: Funds for use in the financial market[4]

As at 31 Dec (CZK bn)	2008	2009	Year-on-year change	
			Abs.	**(%)**
Deposits in banks[5]	2,301.0	2,457.5	156.5	6.80
of which: building savings schemes	401.3	415.2	13.9	3.45
Collective investments	243.9	234.5	-9.4	-3.85
Supplementary pension insurance, including state contribution	186.7	200.6	13.9	7.45
Placement of insurance companies' technical reserves	296.8	381.9	85.1	28.66
Currency in circulation	365.5	353.6	-12.0	-3.28
Total	3,428.1 *€ 129.5*	3,628.0 *€ 137.1*	199.9	5.83

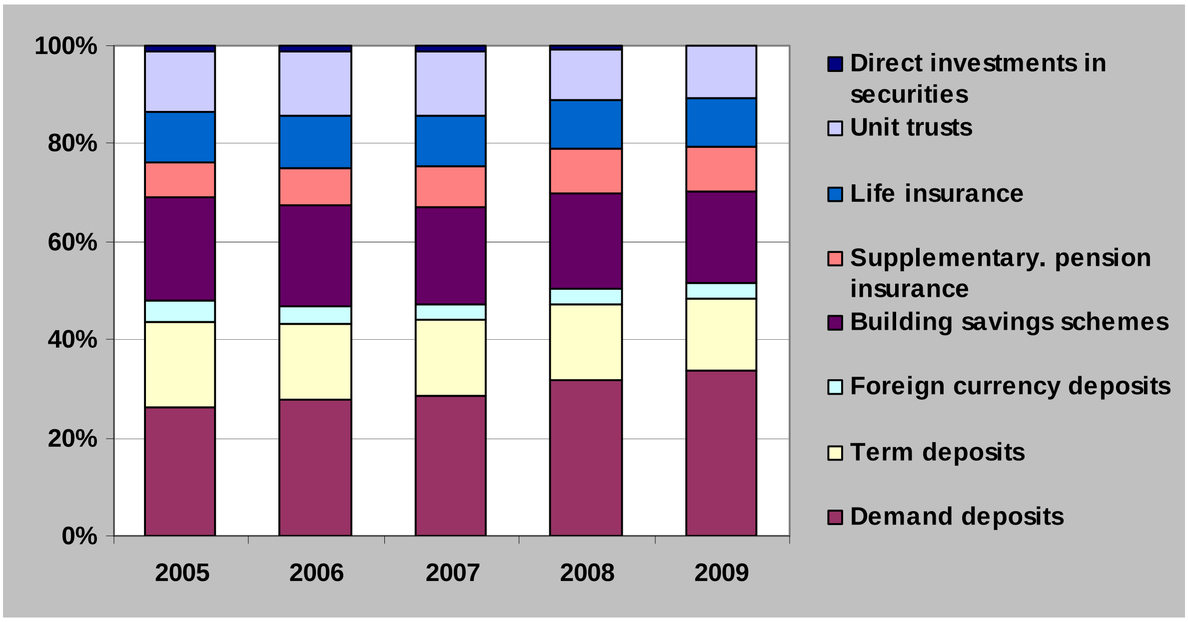
Source: MoF, CNB – ARAD, CNB, AKAT

[4] Data published as at 15 April 2010.
[5] Including CZK deposits of clients according to sector classification.

3. STRUCTURE OF HOUSEHOLD SAVINGS

On year-on-year basis, the total household savings[6] increased by 7.3%, amounting to CZK 2.2 trillion (*EUR 83.1 bn*) at the end of 2009. The highest year-on-year increase (approximately 13%) was recorded in the category of demand deposits and funds invested in unit trusts. Due to the volume of demand deposits, their growth – taken in absolute numbers (by CZK 85.6 bn) - critically affects the overall balance of savings. Both supplementary pension insurance and funds invested in life insurance registered more than 7% growth rate. Not one of the monitored items registered decline in 2009.

Graph 3.1: Development of the structure of private savings in the Czech Republic [7]



Source: MoF, CNB

Due to the traditionally conservative behavior of Czech households, the structure of the savings virtually did not change in 2009. Over 70% (CZK 1.6 trillion, *EUR 60.5 bn*) of the savings were allocated to banks and building societies. Czech households thus remain very conservative. This attitude has certainly been supported by the recent experience with the financial crisis, which served as additional motivation for transferring some of the savings from riskier instruments to insured bank deposits.

[6] In comparison with the past, the calculation methodology changed in 2009 – for this reason, the data of the time series have also been recalculated for the years 2005 through 2008. Direct investments in securities are not included due to the difficulty associated with the estimate thereof. For the purpose of this report, the total household savings are defined as the sum of bank term and demand deposits, foreign-currency deposits, building savings schemes, supplementary pension insurance, life insurance, and unit trusts. It thus concerns funds, which the household use for their investments and/or savings.

[7] Unit trusts: The value of assets under management of open-ended unit trusts and investment funds, including foreign funds, for physical entities in the estimated amount of 85% of the funds' total assets. Life insurance: Based on the volume of insurance companies' technical reserves.

4. FINANCIAL MARKET ENTITIES

In spite of the complicated last year, the numbers of the financial market entities did not change significantly. A slight increase in the number of entities within the crucial sectors of the financial market is often realized in the form of a branch of a foreign parent company – either directly or indirectly via its foreign subsidiary. The operation of foreign entities in the financial market of the Czech Republic appears to be less demanding in terms of administration when executed in the form of a foreign branch.

Slight changes in the numbers of entities mainly occurred in the area of the capital market, as a result of the new legislative regulation, which facilitated the process of establishing namely the non-autonomous investment funds[8] and was fundamentally reflected in the declining number of investment intermediaries. The expiration of their registration took place by law (amendment to the Act on Capital market Undertakings).

Table 4.1: Numbers of selected entities providing services in the financial market[9]

As at 31 Dec	2005	2006	2007	2008	2009
Banks	36	37	37	37	39
of which: foreign banks branches	12	13	14	16	18
of which: building societies	6	6	6	5	5
Cooperative banks	20	20	19	17	17
Securities dealers	51	46	44	38	39
Investment funds	0	0	7	16	25
Investment companies	9	13	18	19	22
Open-ended unit trusts	65	77	121	142	139
of which: special OUT	41	51	83	101	103
standard OUT	24	26	38	41	36
Foreign funds /sub-funds	1,038	1,282	1,499	1,596	1,480
of which: based on common European license	1,025	1,271	1,479	1,569	1,453
of which: special funds	13	11	20	27	27
Investment intermediaries	8,400	10,600	13,370	12,870	9,100
Pension funds	11	11	11	10	10
Insurance companies	45	49	52	53	52
of which: branches of foreign insurance companies	12	16	18	17	16
Reinsurance companies	0	0	0	1	1
Insurance intermediaries	35,300	50,100	67,500	86,230	105,980

Source: CNB

Starting from the accession of the Czech Republic to the EU, the number of entities, which can enjoy the free movement of services on the basis of a single license (European Passport), has been growing each and every year. As these entities are not supervised by CNB and have no reporting duties to it, no detailed data on their production are available. However, it is safe to say their activities are rather smaller in scope or narrowly specialized – it thus rather supplements the production of domestic entities on the market or fills gaps of the existing portfolio.

Table 4.2: Number of entities operating in the Czech Republic under the single European passport

As at 31 Dec	Banks	Insurance companies	Funds	Investment companies	Providers of investment services
2007	198	478	1,479	37	518
2008	252	554	1,569	40	840
2009	275	614	1,457	49	958

Source: CNB

[8] Assets are managed by an investment company.
[9] Only active entities (not in liquidation) are included.

The headcount of financial institutions often decreased due to adopted saving measures. These measures also affected the profitability of the sector. The profit/loss for the whole year shows that the financial sector only incurred minimum losses from the turbulences on foreign markets. With the exception of investments companies, all other institutions increased their profits. The capital availability within the financial sector remains at required levels and shows a slightly upward trend. On the basis of the existing development of the fundamental economic indicators, we can assume that the financial sector is stabilized.

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

		Banking financial institutions	Non-banking financial institutions[10]	Insurance companies	Pension funds	Financial leasing companies	Investment companies[11]
Average headcount[12]	**as at 31 Dec 2008**	39,284	14,032	14,726	487	2,989	310
	as at 31 Dec 2009	38,278	14,102	14,559	486	2,687	348
	change (%)	-2.56	0.50	-1.13	-0.21	-10.10	12.26
Profit/loss before tax (CZK bn)	**as at 31 Dec 2008**	54.1	6.3	13.0	0.6	2.6	-18.5
	as at 31 Dec 2009	71.3	34.0	22.7	2.8	3.4	13.6
	change (%)	31.79	439.68	74.62	366.67	30.77	-173.51
Equity (CZK bn)[13]	**as at 31 Dec 2008**	73.6	279.1	18.1	1.1	43.0	146.4
	as at 31 Dec 2009	75.4	440.9	21.5	2.0	42.1	143.4
	change (%)	2.45	57.97	18.78	81.82	-2.09	-2.05

Source: CZSO

4.1. Banking sector

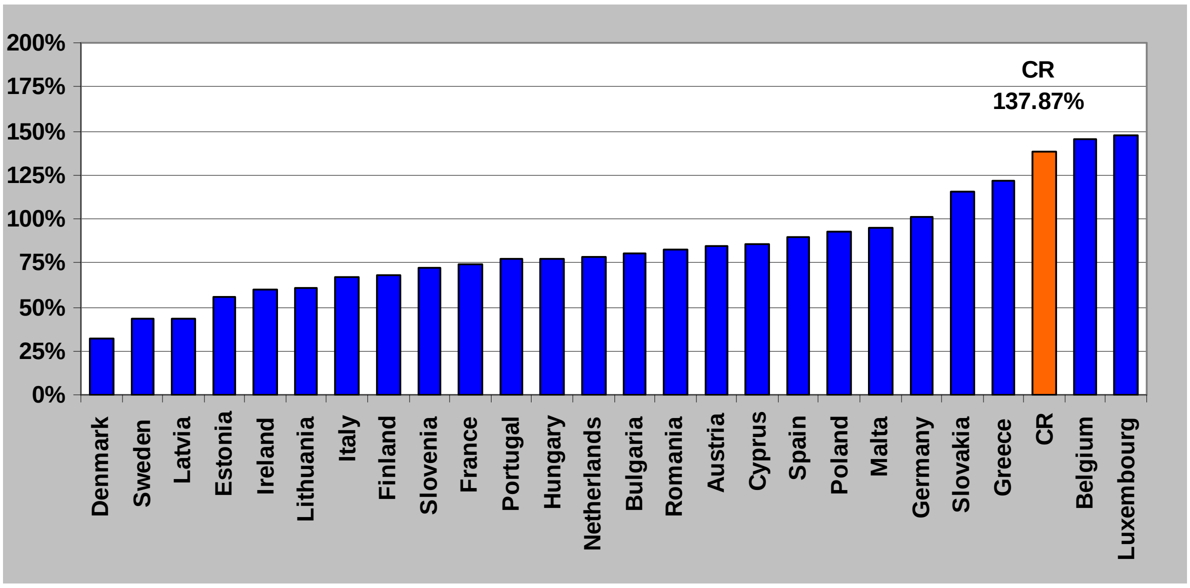
The banking sector was not significantly affected by the consequences of the financial crisis, which started to spread most intensively in the fall of 2008. The Czech banking sector could rely on the effect of a number of supporting factors. These factors included, among others, past successful restructuring of selected financial institutions, retail orientation of the sector, and low share of loans denominated in foreign currencies. Another positive factor was the relatively stable source of financing in the form of clients' deposits when the liquidity was "being drained" in the global interbank money markets. The ratio of deposits to loans amounted to nearly 138% at the end of 2009 (see Graph 4.1). Therefore, loans are more than financed through deposits. Separate section 7. Financial and economic crisis deals in detail with the analysis of impacts of the financial and economic crisis.

The balance sheet total of the Czech banking sector, including building societies, amounts to CZK 4,094.7 bn (*EUR 154.7 bn*) – i.e. a slight year-on-year increase of 1.2%. It is still true that several major entities play a key role within the industry. The group of the so-called large banks, which according to CNB includes 4 most important entities, accounts for 57.7% of the balance sheet total. In 2009, the profit of the banking sector before taxation amounted to CZK 71 bn.[14] This is a 32% increase in comparison with the previous year. However, in 2008, when the crisis fully unveiled, the financial sector recorded only a slight year-on-year decline in profitability (by 8.7%). The growth of received interest (by 4.7%) was one of the factors that contributed to the recovery of the upward trajectory of the banking sector results, in spite of an overall weakening of the credit activity. Another supporting factor of the banking sector profits remains the relatively stable revenue from fees.

[10] Institutions in categories 652 and 67 under the OKEČ methodology.
[11] Investment companies and the unit trusts and investment funds managed by those companies.
[12] Average headcount (full-time equivalent) of individual employees for the year ending on the stated date.
[13] Registered capital in banking financial institutions.
[14] CZSO data.

One of the signs of the banking sector stability is a reoccurring growth of the capital adequacy indicator – by 1.8 pp. to 14.12%. The quality of loans registered a slight impairment – mainly in connection with the general trend towards the decline of corporate revenues and household incomes. The rate of default in client loans increased, on year-on-year basis, from 3.2% to 5.2% as at the end of 2009. The share of non-performing loans increased from 1.7% to 2.1%. The data are very close to the EU27 average; however, they are significantly lower in comparison with certain new members of the EU.

Graph 4.1: Client deposits to loans ratio at the end of 2009[15]



Source: ECB

4.1.1. Interest rates development

In 2009, CNB continued in a gradual loosening of its monetary policy, lowering its rates four times. Therefore, 2T repo rate decreased from 2.25% to 1% in 2009.[16] The Czech central bank was one of the first monetary authorities in the world to take this step – already in mid-August of 2008, i.e. prior to the main wave of problems on American financial markets.

The rates in the Czech Republic thus gradually came close to the rates of major central banks of the world. The main rate of the CNB corresponds to the key rate of the ECB; however, it is higher than the rates of the Bank of England (0.5%) or the American Fed (0.0 – 0.25%).

Table 4.4: CNB interest rates

(%)	30 Jun 2007	31 Dec 2007	30 Jun 2008	31 Dec 2008	30 Jun 2009	31 Dec 2009
2T repo	2.75	3.50	3.75	2.25	1.50	1.00
Discount	1.75	2.50	2.75	1.25	0.50	0.25
Lombard	3.75	4.50	4.75	3.25	2.50	2.00

Source: CNB

The APR[17] rate for consumption continued to rise in 2009. It amounted to 15.4% at the end of 2009, i.e. year-on-year increase of 1.2 pp. These rates are increasing in spite of the lowering interest rates of the central bank.

[15] Data for Great Britain were not available at the moment of preparation of this report with regard to comparable indicators published by the ECB.

[16] In May of 2010, i.e. after the end of the period primarily covered by this report (2009), the CNB decided to carry out another reduction of its 2T repo rate by 0.25 pp to 0.75%.

[17] APR indicates the percentage share of the outstanding amount, which must be paid by a client for the period of one year in excess of the redemption of the outstanding amount – in connection with payments, administration, and other expenses associated with loans. It concerns an APR of CZK loans provided by banks in the Czech Republic (new transactions).

Higher risk aversion of credit institutions is apparent, mainly in connection with rising unemployment and declining dynamics of the household income growth.

Table 4.5: APR of CZK loans provided by banks in the CR

New loans (%)	I-09	II-09	III-09	IV-09	V-09	VI-09	VII-09	VIII-09	IX-09	X-09	XI-09	XII-09
Consumer credit	14.8	15.0	14.8	14.8	14.7	14.6	15.1	15.1	15.2	15.6	15.6	15.4
For residential real estate	5.8	5.8	5.8	5.7	5.7	5.7	5.8	5.8	5.8	5.8	5.8	5.8

Source: CNB

The APR rate for acquisition of residential property did not register almost any change in comparison with the previous year. It fluctuated near the 5.8% mark throughout the whole year.

4.1.2. Deposits and loans

The total volume of CZK deposits increased by 6.8% during 2009. The growth dynamics of CZK loans was somewhat lower and the volume of loans increased by 2.0% for the same period. In comparison with 2008, the rate of growth decreased both for deposits (by 2. 3 pp) and loans (by 12.8 pp).

The developments in the area of loans were very different for individual sectors. The household sector recorded the highest absolute growth (by CZK 88.9 bn). The highest relative growth was registered in the government sector (by 24.6%). The most important relative decline in loans was recorded by financial institutions (by 14.2%). On the other hand, the sector of non-financial companies recorded the highest absolute decline of loans – mainly in connection with the deceleration of economic activity.

Table 4.6: Breakdown of CZK deposits and loans with banks by sectors

As at 31 Dec, Sector[18]	Bank deposits (CZK bn)				Loan beneficiaries (CZK bn)			
	2008	2009	Change	Change (%)	2008	2009	Change	Change (%)
Non-financial companies	465.9	493.0	27.1	5.82	692.2	636.1	-56.1	-8.11
Households	1,373.8	1,484.2	110.3	8.03	850.7	939.5	88.9	10.45
Government institutions	287.0	298.0	11.0	3.84	48.1	59.9	11.8	24.57
Financial institutions	97.0	106.2	9.2	9.46	130.4	111.8	-18.5	-14.21
Other	77.3	76.2	-1.1	-1.45	62.5	72.7	10.2	16.30
Total	2,301.0 *€ 85.4*	2,457.5 *€ 92.9*	156.5	6.80	1,783.9 *€ 66.2*	1,820.1 *€ 68.8*	36.2	2.03

Source: CNB – ARAD

On year-on-year basis, the household sector also recorded the highest absolute growth of deposits (by CZK 110.3 bn) in this period. The highest growth momentum was recorded by the sector of financial institutions (by 9.5%). Deposits also increased in the sector of non-financial companies (by 5.8% - i.e. CZK 27.0 bn).

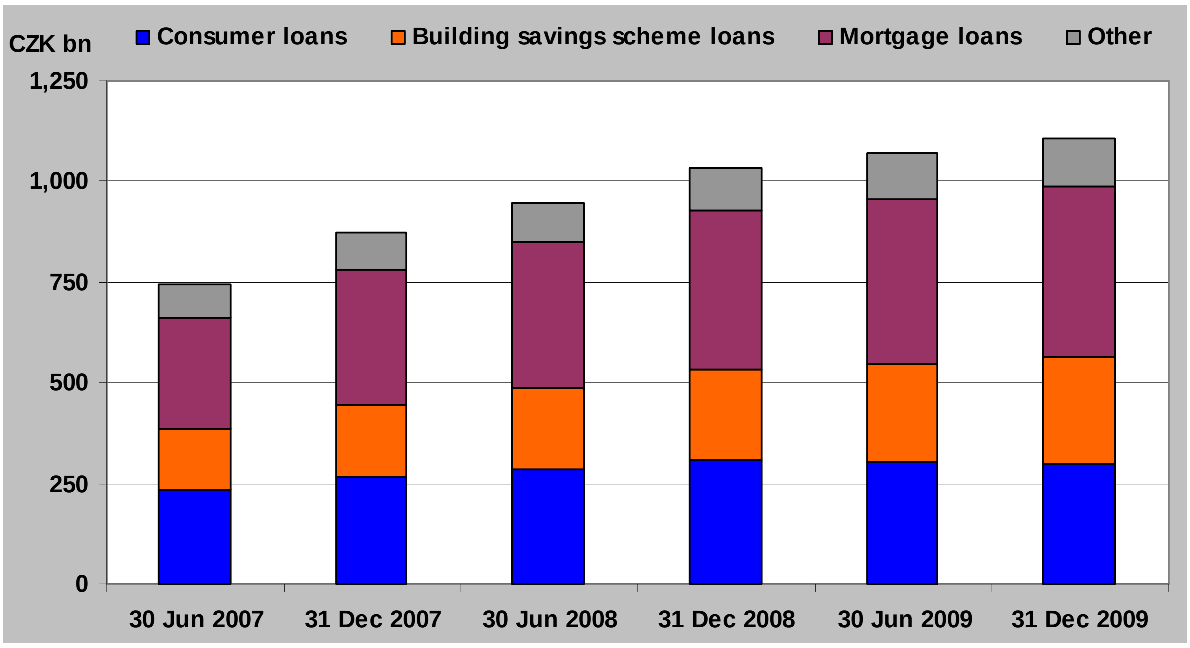
The total household indebtedness in banks and nonbanking financial institutions increased by 7.2% on year-on-year basis, amounting to CZK 1,101.3 bn (*EUR 41.6 bn*) at the end of 2009.[19] The fact that households continue to take out more loans – mainly in connection with resolving their housing needs – can be considered relatively

[18] Client CZK accounts and loans based on ARAD banking statistics, broken out by sectors and including both residents and non-residents.

[19] The data cover CZK/foreign currency loans to households (residents) and non-profit institutions serving households (NPISH) as well as funds provided by nonbanking institutions.

positive. The share of these loans gradually but slightly grows, exceeding 62% of the total household indebtedness at the end of 2009.

Graph 4.2: Total household indebtedness[20]



Source: CNB - ARAD

In absolute terms, housing-related loans increased by CZK 70.6 bn in 2009 – i.e. a decline of the year-on-year growth rate by 8.6 pp. to 11.5%. Consumption-related loans actually declined by CZK 9.5 bn (3.1%) on absolute terms in terms of a year-on-year comparison. The growth of the granted loans volume within the banking sector of CZK 16.5 bn was outweighed by the more significant decline in the volume of loans granted by nonbanking provider in the amount of approximately CZK 26 bn.

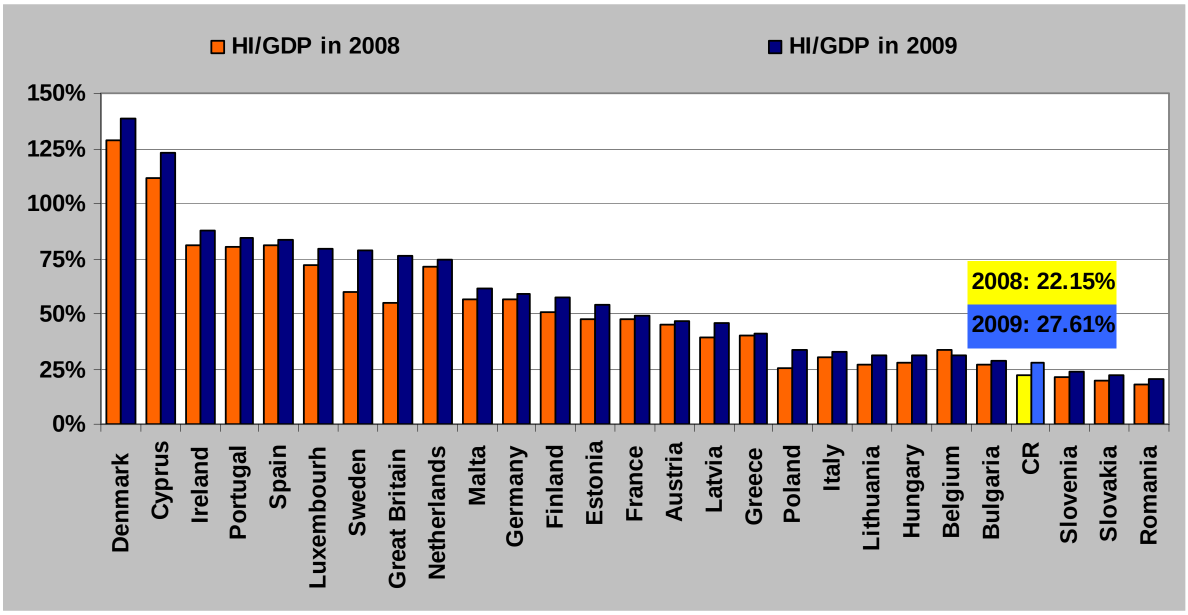
As shown in Graph 4.3, the household indebtedness level relative to the performance of the Czech economy remains relatively low in comparison with the rest of Europe (approximately 27.6% of GDP).[21] The costs of servicing household debt will thus not be a factor, which would limit their consumption insomuch as in countries with higher relative indebtedness level. It is also apparent from the graph, that other new Central European member states show a low level of indebtedness. The reason for this may lie in the relatively recent transformation of these economies to market economy, which did not allow for the long term accumulation of relative loan volumes prevailing in Western Europe.

However, it also applies that the total level of indebtedness to aggregate GDP ratio insufficiently considers certain microeconomic specificities (due to the macroeconomic nature of the ratio) – e.g. different situation of individual income groups of population or regional differences in indebtedness. At the same time, it generally applies that the most endangered groups are at risk of the most serious problems. These groups include low-income households, which must spend the highest relative share of their incomes to service their debts.

[20] In this case, loans granted by building societies represent the sum of volumes of bridging loans and standard building savings scheme loans.

[21] The year-on-year development of this indicator has a limited interpretability in respect of economies with their national currencies different from euro. In these cases, there is a risk of a year-on-year volatility of values due to the fluctuation of the national currency exchange rate against euro, which is subsequently used for expressing the household debts denominated in the national currency in the units of the common European currency euro.

Graph 4.3: Comparison of household indebtedness in the EU[22]



Source: ECB, Eurostat

4.1.3. Building societies

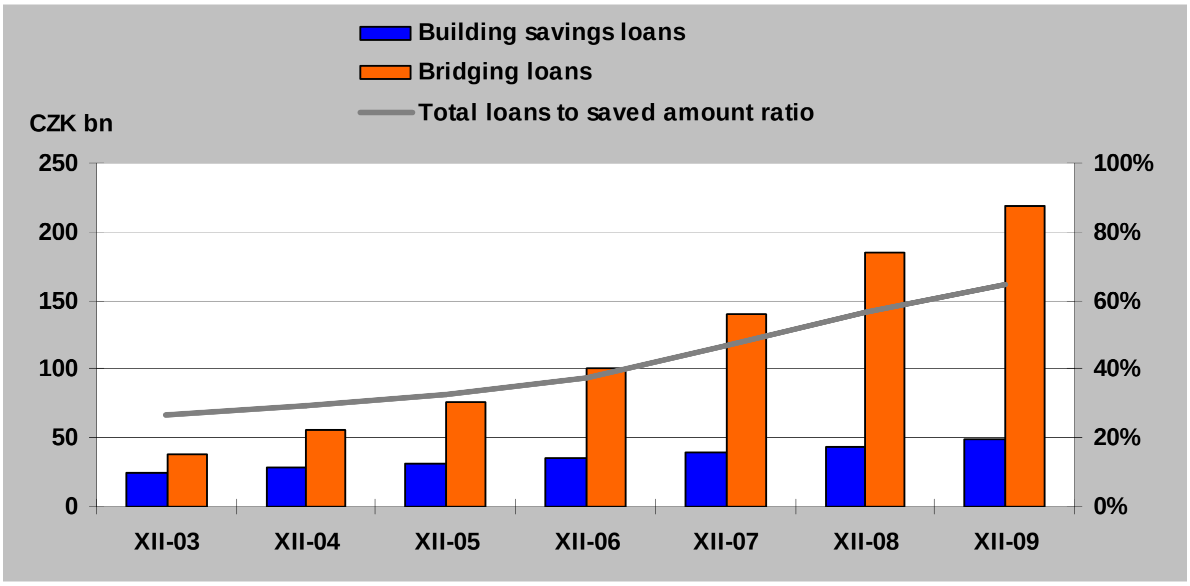
Over 575 thousand new building savings contracts were concluded in 2009, with a total target value of approximately CZK 183 bn (*EUR 6.9 bn*).[23] The number of newly negotiated contracts fell by 18.5% in comparison with the previous year, coming close to the level of 2007. Therefore, it is rather a certain correction of the development in 2008, when building savings were highly popular as a saving instrument, perceived by the population as relatively profitable and safe. The average target amount for individuals amounted to nearly CZK 309 thousand, i.e. approximately a 2% year-on-year increase.

The absolute number of terminated contracts was, once again in 2009, higher than the number of newly concluded contracts, resulting in another decline of their total number. The total number of contracts in the saving stage decreased by approximately 144 thousand contracts to nearly 4.9 million at the end of 2009. This represents a continuing trend, when the so-called old contracts[24] with the maximum state contribution of CZK 4,500 are mostly being terminated. The share of the so-called new contracts amounted to 48.2% of all contracts at the end of 2009, i.e. a year-on-year increase of 4.4 pp. There is a reason to expect that the ongoing change in the structure of building savings contracts will positively affect the amount of state contribution paid. In 2009, state building savings contribution was paid out in the total amount of CZK 13.3 bn. It is almost CZK 1 bn less than in 2008.

On year-on-year basis, the total number of loans increased by 17 thousand to 988 thousand, with a simultaneous increase in their total volume by CZK 40 bn to CZK 267.5 bn (*EUR 10.1 bn*). This fact was reflected in another increase in the total loans to saved amount ratio (64.4%), which increased by 7.7 pp. on year-on-year basis.

[22] MoF's own calculations based on data from ECB and Eurostat, which may differ from CNB and CZSO data.
[23] See Table 8.3 in Appendix 2.
[24] Contracts concluded within 31 December 2003.

Graph 4.4: Development of loans in building savings schemes sector



Source: MoF

As apparent from the above mentioned graph, the structure of loans within the building savings sector has been gradually changing since 2003. Even though building savings loans are growing on the year-on-year basis, they are nowhere near the growth dynamics of bridging loans, which are not associated with an obligation on the part of a loan beneficiary to first save up certain amount under the building savings scheme.

4.1.4. Mortgage market

The volume of mortgage loans provided to households (hereinafter the "mortgage loan volume") as at 31 December 2009 amounted to CZK 554.4 bn (*EUR 20.9 bn*). This represents a seeming increase of CZK 157.3 bn in comparison with 2008 (as shown in Table 4.7). However, the key factor, which contributed to such high increase in this indicator even during the period of broad economic slowdown and associated credit activity decline, consisted in the change of the reporting methodology.[25] The year-on-year change will therefore not be subject to any further analysis. Under the original methodology, the increase would be lower than in 2008.

Table 4.7: Balance of mortgage loans (ML) to households [26]

As at 31 Dec	2006	2007	2008	2009	Year-on-year change	
					Abs.	(%)
Number of mortgage loans (000s)	255.6	339.0	406.5	450.8	44.3	10.89
Agreed principal (CZK bn)	327.3	469.6	589.7	663.5	73.9	12.52
Volume of loans (CZK bn)	238.2 *€ 8.7*	333.6 *€ 12.5*	397.1 *€ 15.0*	554.4 *€ 20.9*	157.3	39.61

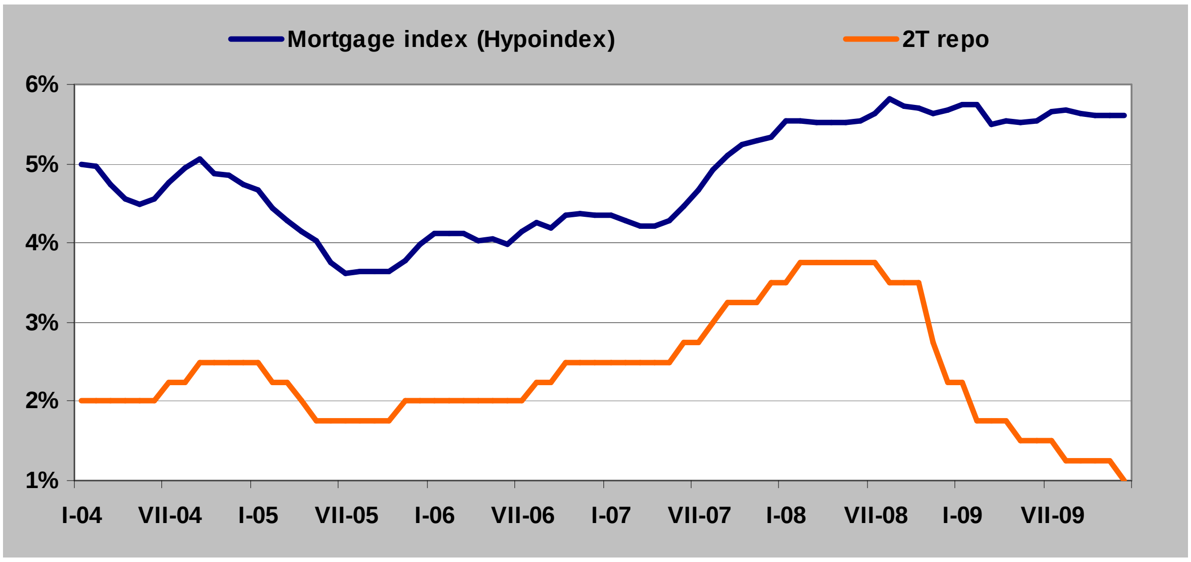
Source: MRD, CNB - ARAD

Factors, which can also affect the development of mortgage loans, include persisting uncertainty in respect of household incomes caused by higher employment rate, further development in the settings of loan conditions, as well as certain level of uncertainty relating to the future development of residential real-estate prices.

[25] In comparison with the past period, the classification of mortgage loans in the CNB statistics changed as follows: this category newly includes any loans secured from 50%, instead of the former requirement for 100% security. This change affected mortgage loans for residential and nonresidential real-estate. Therefore, the step change in values has primarily been caused by this administrative modification. This is also associated with the change in the volume of bridging loans reported under the CNB statistics (does not apply to data reported by the MoF). Some of the bridging loans are not 100% secured – they were previously reported as bridging loans under the CNB statistics, while today, they are registered as mortgage loans. However, it actually concerns the same bridging loan granted by a building society.

[26] Due to the change in methodology, the relative and absolute indicators of the year-on-change are misleading and have been intentionally omitted from the Table.

Graph 4.5: Selected interest rates' development[27]



Source: Fincentrum, CNB

In 2009, rates of the Czech mortgage loan market expressed as the Hypoindex (Mortgage Index) indicator recorded almost no change, fluctuating around the 5.6% mark. This interrupts the long-term growth trend, which was prevailing since mid-2005, when mortgage loans reached their lows of 3.6%.

When comparing the Hypoindex rate with the CNB 2T repo rate, we can see that the gap between the two rates further continued to widen in 2009 (widening started in 2008). At the end of 2007, the difference between the two rates only amounted to 1.8%. One year later, the difference amounted to 3.4% and even 4.6% at the end of 2009. The increasing difference between the Hypoindex rate and the CNB 2T repo rate has been affected by several factors. Two crucial factors include the widening gap between short-term and long-term interest rates as a result of the lowering monetary-political interest rates of CNB and increasing risk premium attributed to debtors by banks.

Table 4.8: Mortgage loan (ML) balances

As at 31 Dec		2007	2008	2009	Year-on-year change	
					Abs.	(%)
Individuals	total (000's)	339.0	406.5	450.8	44.3	10.89
	total agreed principal (CZK bn)	469.6	589.7	663.5	73.9	12.52
Business entities	total (000's)	9.8	11.9	12.8	0.9	7.83
	total agreed principal (CZK bn)	174.4	239.1	254.5	15.3	6.42
Municipalities	total (000's)	0.8	0.9	0.9	0.0	5.35
	total agreed principal (CZK bn)	8.3	8.5	9.0	0.6	6.56
Total	total (000's)	349.6	419.3	464.5	45.2	10.79
	total agreed principal (CZK bn)	652.3	837.3	927.0	89.7	10.72
Loans volume (CZK bn)		398.2 *€ 15.0*	468.1 *€ 17.4*	626.5 *€ 23.7*	158.4	33.83

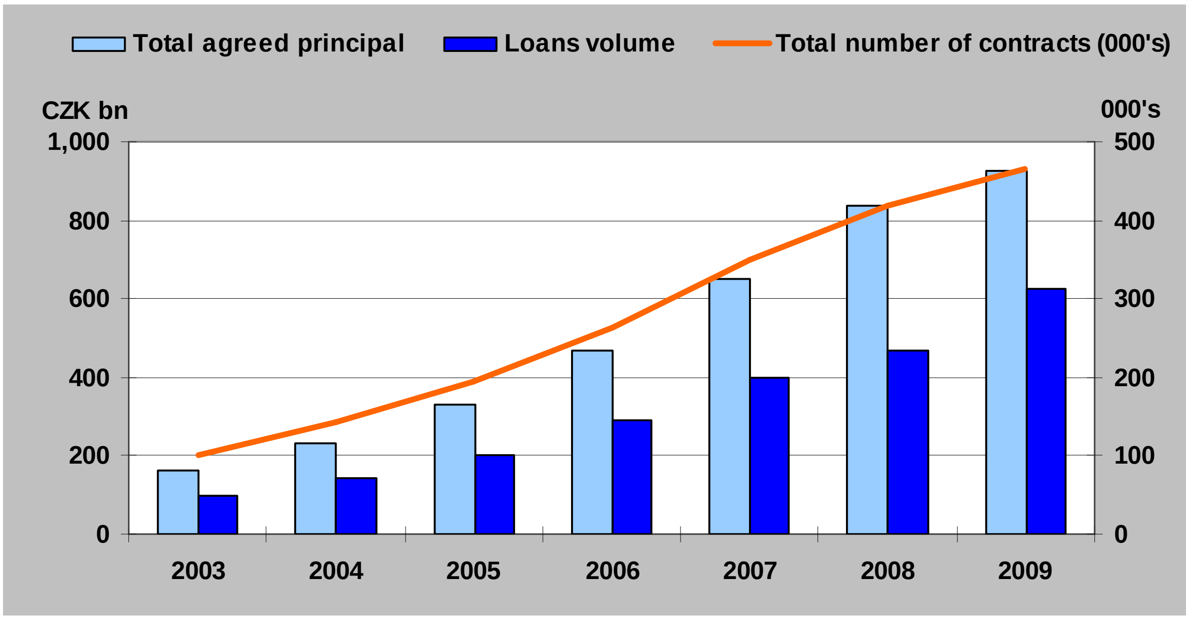
Source: MRD, CNB - ARAD

Table 4.8 illustrates, among others, the balances of mortgage loans granted to households, business entities, and municipalities. The total number of mortgage loans increased by more than 45 thousand, i.e. nearly 20 thousand less than a year ago. The compensation of trends between the segments of individuals and business entities resulted in the total number of loans and total agreed principal growing at a similar rate, i.e. by approximately 11% on year-on-year basis. The total reported volume of mortgage loans increased by CZK 158.4 bn (by

[27] The FINCENTRUM HYPOINDEX indicator is a weighted average interest rate applied to new mortgage loans to individuals in the given calendar month. The graph above depicts a time series of this interest rate.

33.8%). However, the change of this indicator once again results from the above mentioned change in the CNB reporting methodology for these loans.

Graph 4.6: Aggregate mortgage market indicators



Source: MRD, CNB - ARAD

Graph 4.6 shows the trend of aggregate mortgage market indicators. The data on total number of contracts and agreed principals used in this graph include not only households, but also business entities and municipalities. The volume of loans then includes mortgage loans for residential and nonresidential real-estate.

4.1.5. Credit unions

From the perspective of their size credit unions still represent the quantitatively least important segment of the Czech financial market. In 2009; however, similarly as during the previous period, this sector reported a significant growth of its balance sheet total. Following a decline in 2008, the number of credit union members increased by approximately 33% on year-on-year basis, amounting to almost 48 thousand. Clients are motivated by the interest rate and fee policy of certain credit unions as well as the fact that deposits in credit unions are subject to a deposit insurance scheme similarly as banking deposits.

On year-on-year basis, the number of credit unions operating within the sector did not change as at the end of 2009.[28] Seventeen credit unions reported the balance sheet total of CZK 17.6 bn (*EUR 0.7 bn*), which represents a dramatic year-on-year growth of 48%.

Deposits (liabilities to clients) increased considerably by more than one half (54%) to nearly CZK 15.7 bn. Granted loans (claims on clients) increased by approximately 32% to CZK 8.8 bn. The dynamic loan expansion of credit unions was thus supported by the financing of even faster growth of client deposits.

The reported quality of the credit unions' loan portfolio once again recorded a slight year-on-year impairment, as the share of standard claims in total claims fell by almost 1.2 pp. on year-on-year basis to 92.1%. On the other hand, the share of the riskiest category of claims (defaults) increased by 1.2 pp. to 3.0.

[28] On 15 March 2010 – i.e. after the end of the period covered by this Report – CNB announced that a license had been lawfully withdrawn from the credit union PDW (Prague). According to the Czech National Bank, this step resulted from the uncovered deficiencies, the nature and importance of which left no other choice but to revoke the credit union's license. It should be noted that from the perspective of size, the credit union PDW (Prague) was not one of the important credit unions. As at the end of 2009, this entity only had 367 members and its balance sheet total amounted to only CZK 62.8 mil.

Table 4.9: Credit unions – selected indicators

As at 31 Dec	2007	2008	2009
Number of members of credit unions	44,789	35,942	47,954
Total assets (CZK mn)	8,722.2 *€ 327.7*	11,879.4 *€ 441.1*	17,607.6 *€ 665.3*
Claims on clients (CZK mn)	5,077.2	6,569.6	8,781.5
Liabilities to clients (CZK mn)	6,847.9	10,155.6	15,651.9
Share of standard loans (%)	96.35	93.35	92.15

Source: CNB

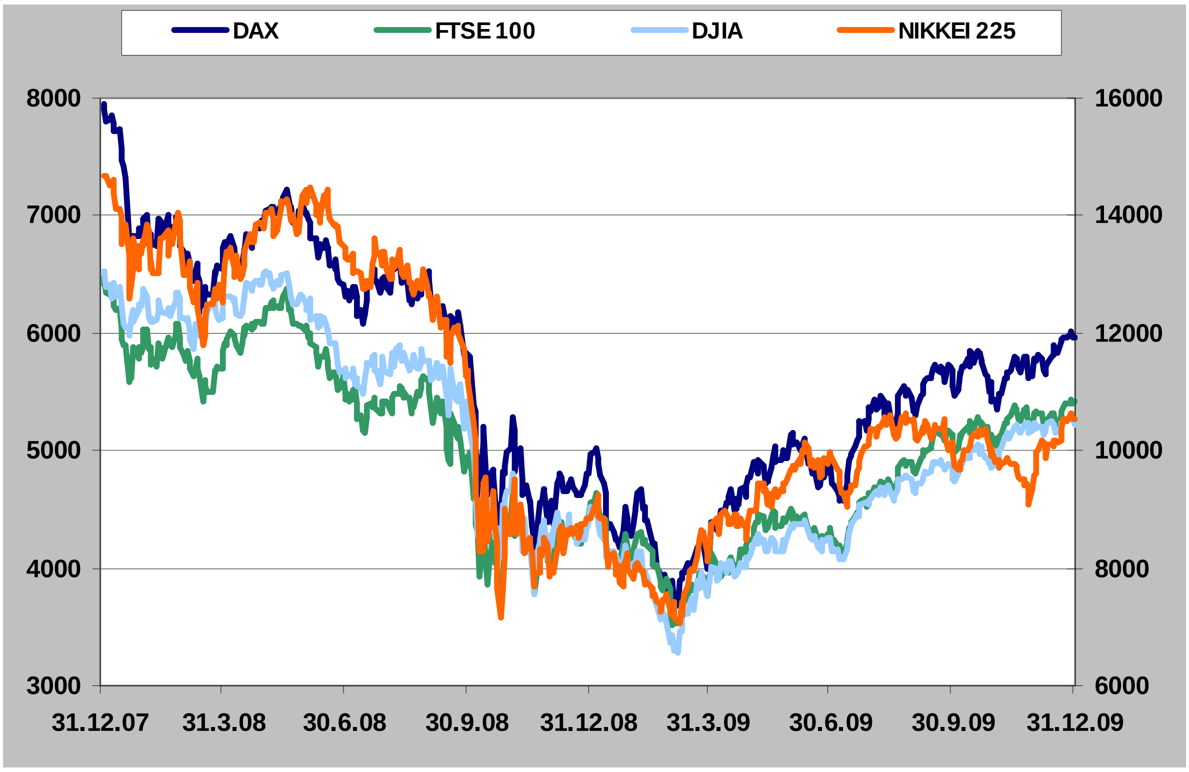
With regard to profit and profitability, certain trends of the year 2008 persisted. In spite of an increase in the credit unions' total assets their profits after taxation fell to CZK 22.0 mil (by 54.8%) in the period under review. This is also associated with the return on assets,[29] which fell from 0.51% in 2008 to 0.16% in 2009, while the banking sector reported a slight year-on-year increase in this indicator of 0.31 pp. to 1.47% in 2009.

Several major entities dominate this sector, in spite of the dynamic growth of the entire industry. Indicative indicators of concentration rates basically have not changed on year-on-year basis. More than 85% of the sector's total assets are controlled by 4 largest credit unions, with two most important entities controlling more than 62% of the balance sheet total.

4.2. Capital market

Similarly as in 2008, events on the capital markets were affected by the financial crisis in 2009, which transformed into an economic crisis during the year. Even though the stock market indexes erased some of their 2008 losses, their growth is significantly limited by the recession of economies and market uncertainty. The trade volumes continued to decline, unlike the share prices. As apparent from the following graph, the major global stock market indexes developed in a very similar manner in 2009.

Graph 4.7: Development of major global indexes



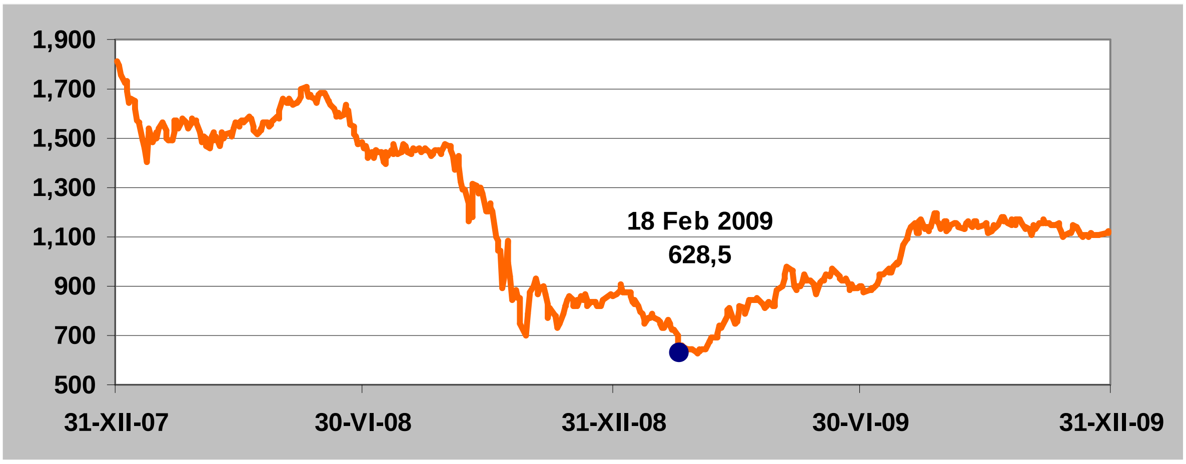
Source: Market organizers.

[29] The share of annual profit after taxation and average balance sheet total as at 31 December.

4.2.1. Regulated markets

Affected by the negative news on the situation of the global economy, the Prague exchange reported a loss in the first quarter, followed by the period of growth in the next two quarters and stagnation at the end of the year. Overall, it ended the year under review on a more positive note as the PX index rose by 30.2% on year-on-year basis to 1,117.3 points. The main driver of the stock prices was the news about the financial crisis progress and its impact on the national economy, with a subsequent nervousness of investors.

Graph 4.8: PX index development



Source: PSE

Negative reports on the worsening performance of the Czech economy naturally resulted in the decline in the stock prices in the first quarter of 2009. Decline in the PX index came to a standstill in mid-February at 628.5 points, writing off 26.8% year-to-date. Similar low levels of the index were last reported at the end of 2003. Investors' concerns about the ongoing crisis' impact on the Czech economy had proven as exaggerated and the stock exchange grew by 77.8% during remainder of the year.

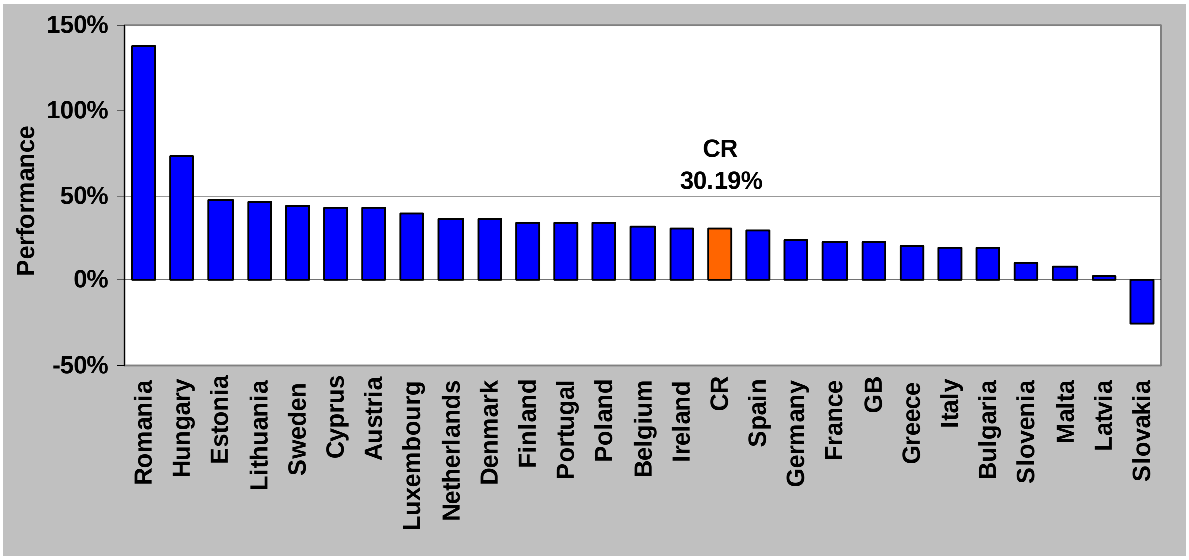
Table 4.10: PX index development

		2003	2004	2005	2006	2007	2008	2009
PX	as at 31 Dec	659.1	1,032.0	1,473.0	1,588.9	1,815.1	858.2	1,117.3
	Change (%)	43.06	56.58	42.73	7.87	14.24	-52.72	30.19

Source: PSE

In comparison with the major stock markets of other EU countries, PSE belongs to the numerous categories of exchanges where the major indexes reported a growth of 30 to 40% in 2009. If we take a look at the ranking of individual countries, the performance of the Prague Stock Exchange was only higher than the stock exchanges, the home countries of which were more severely hit by the crisis than the Czech Republic.

Graph 4.9: Performance of significant stock exchange indexes in EU Member States in 2009[30]



Source: FESE

The financial crisis also affected the trade value of all types of financial instruments. The total trading volume on the PSE fell by 29.8% in 2009, to CZK 1,050 bn (*EUR 39.7 bn*). It is apparent from the comparison with 2008 that bonds were worst off. This seems to have been supported by the Prague Stock Exchange mainly trades in government bonds, which are one of the least risky assets on the financial market and a financial crisis does not significantly affect their trading volumes.

While the trade value on the PSE plummeted, RM-S reported a growth as the year 2009 was the premier year for RM-S with the status of a standard exchange.[31]

Table 4.11: Trade value

Annual (CZK bn)			2006	2007	2008	2009	Year-on-year change (%)
PSE	Shares and units		848.9	1,013.0	852.0	463.9	-45.6
	Bonds		598.9	508.9	643.2	585.7	-8.9
	Derivatives	Futures	0.0	1.9	0.6	0.2	-66.0
		Certificates and warrants	0.0	1.2	0.5	0.3	-44.3
		Total	0.0	3.1	1.1	0.5	-56.4
	Total		1,447.9	1,525.0	1,496.2	1,050.0	-29.8
RM-S			3.9	7.7	6.9	7.9	14.6
Total			1,451.8 *€ 51.2*	1,532.6 *€ 55.2*	1,503.1 *€ 60.3*	1,057.9 *€ 40.0*	-29.6

Source: PSE, RM-S

On 14 August 2009, the company Univyc acquired a license from CNB to act as a central securities depository. The company ensured the transactions clearing and settlement on the PSE. Univyc later transformed to the company Centrální depozitář cenných papírů, a.s. (Central Securities Depository; hereinafter the "CD"). Following the takeover of the Středisko cenných papírů (Prague Securities Center), the CD should commence its activities at the beginning of July 2010. This should significantly change the infrastructure and process of the clearing and settlement of securities transactions in the Czech Republic. The register of securities changes from one-level to two-level register.

[30] Austria: ATX, Belgium: BEL 20, Bulgaria: SOFIX, Cyprus: FTSE/CySE 20, Czech Republic: PX, Denmark: OMXC 20, Estonia: OMXT, Finland: OMXH 25, France: CAC 40, Germany: DAX, Greece: FTSE/ATHEX 20, Hungary: BUX, Ireland: ISEQ, Italy: FTSE MIB, Latvia: OMXR, Lithuania: OMXV, Luxembourg: LuxX, Malta: MSE, Netherlands: AEX, Poland: WIG 20, Portugal: PSI 20, Romania: BET, Slovakia: SAX, Slovenia: SBI 20, Spain: IBEX-35, Sweden: OMXS 30, United Kingdom: FTSE 100.

[31] RM-Systém transformed from an off-exchange market to standard exchange as at 1 December 2008.

Table 4.12: Number of registered issues[32]

As at 31 Dec		2005	2006	2007	2008	2009
Shares	Main market	8	10	21	17	13
	Secondary market	19	11	-	-	-
	Free market	12	11	11	11	12
	Total	39	32	32	28	25
Bonds	Main market	27	28	41	38	36
	Secondary market	15	15	-	-	-
	Free market	54	67	91	83	80
	Total	96	110	132	121	116
Derivatives and other products	Futures	-	2	6	6	6
	Investment certificates	-	7	39	46	65
	Warrants	-	0	2	2	2
	Total	0	9	47	54	73
Total		135	151	211	203	214

Source: PSE

Owing to the adverse situation on the financial markets, it came as no surprise that no IPO took place on the PSE in 2009. On the contrary, the number of stocks traded on the main market of the PSE decreased by four. The shares of the companies Pražská energetika and RM-S Holding were transferred to the free market, while the companies Zentiva and Spolana withdrew their shares from trading.

4.2.2. Energy exchange

In 2009, the Prague energy exchange traded contracts in the total value of EUR 1.4 bn – i.e. a decline of 42.8%. Similarly as in 2008, the exchange mainly traded in futures. The spot market also froze in 2009, when the trade value sank by almost 98% to EUR 0.2 million. On the other hand, the number of products traded increased during the period under review.

Table 4.13: Main indicators of trading on PXE

Indicator	Market	2008	2009	Change	
				Abs.	(%)
Trade value (EUR mn)	Futures	2,441.0	1,396.1	-1,044.9	-42.80
	Spot[33]	7.1	0.2	-6.9	-97.17
	Total	2,448.0	1,396.3	-1,051.7	-42.96
Number of products (at the end of period)	Futures	54	58	4	7.41

Source: PXE

4.2.1. Investment firms and asset management

The roles of individual entities within the sector of investment firms continued to be clearly divided in 2009. Banking investment firms significantly dominate the trade volume for own account, relatively distinctly control other than asset management transactions and value of clients' assets. On the other hand, nonbanking investment firms together with investment companies operating in the area of assets management concentrate on the management of their clients' assets. This is the reason behind their marked dominance in the value of management and procurement transactions. As a result of the economic crisis, all three categories of entities registered a significant fall in all types of trades with the exception of trades for own account of banking

[32] On 1 July 2007, the main and the secondary markets merged.
[33] Trading on the spot market was launched in February 2008.

investment firms. The significant changes in the number of clients of banking IF result from the new methodology in use since 2009.[34]

Table 4.14: Selected indicators of investment firm sector (by segment)[35]

As at 31 Dec (excl. derivatives, CZK bn)	2009			Change (%)		
	Banking IF	Non-banking IF	Investment companies[36]	Banking IF	Non-banking IF	Investment companies
Total number of licensed entities	25	32	6	0.00	6.67	0.00
Total transactions value[37]	24,289.5 *€ 918.5*	2,474.8 *€ 93.58*	156.5 *€ 5.9*	24.78	-33.44	-65.05
of which: for own account	20,797.4	946.1	0.0	42.49	-34.97	#DIV/0!
management	40.3	615.6	156.5	-28.99	-13.49	-65.04
procurement	3,451.7	913.1	0.0	-28.29	-41.16	-100.00
Value of managed funds	45.7 *€ 1.7*	378.8 *€ 14.3*	96.8 *€ 3.7*	-17.13	8.04	13.93
Value of clients' assets	1,031.7	471.2	186.4	3.68	12.60	8.25
Number of clients (according to contracts, 000s)	696.4	140.8	1.4	-45.31	23.02	-31.16

Source: CNB

Asset management

The value of assets under management increased in 2009 once again – by 4.2% to the final amount of CZK 753.2 bn (*EUR 28.4 bn*). The asset management sector is still dominated by 3 financial groups, the market share of which increased by 0.7 pp. year-on-year to 63.6%. The market share of 5 largest asset managers increased by 1.4 pp. to 86.9%, while the share of 10 largest assets managers increased by 3 pp. to 98%.

Table 4.15: Financial groups by value of assets under management

As at 31 Dec (CZK bn)	Value of assets under management		
	2008	2009	Change (%)
Generali PPF Asset Management + ČP Invest	166.0	185.5	11.72
ČSOB (Group)	156.3	154.4	-1.17
Česká spořitelna (Group)	132.4	139.3	5.18
ING (Group)	85.8	95.4	11.15
Komerční banka (Group)	77.5	80.0	3.22
AXA investiční společnost	38.2	43.0	12.52
UniCredit Bank + Pioneer Investments	14.9	16.0	7.75
Conseq Investment Management	10.5	12.5	18.97
WOOD & Company investiční společnost	-	8.3	-
Raiffeisenbank	6.1	7.0	15.48
Others	35.1	11.9	-66.19
Total	722.7 *€ 26.8*	753.2 *€ 28.4*	4.22

Source: AKAT

[34] As from 2009, the data on the number of clients (for banking IF) only contain customers with securities registered with IF at the end of the period under review. With regard to periods prior to 2009, this indicator also includes clients, who only had derivatives or financial funds at the end of the period under review / traded during the period under review and registered no securities at the end of the period.

[35] Because a derivatives contract's value is available only at the underlying asset value, derivatives are not included in the table.

[36] Investment companies managing customer assets.

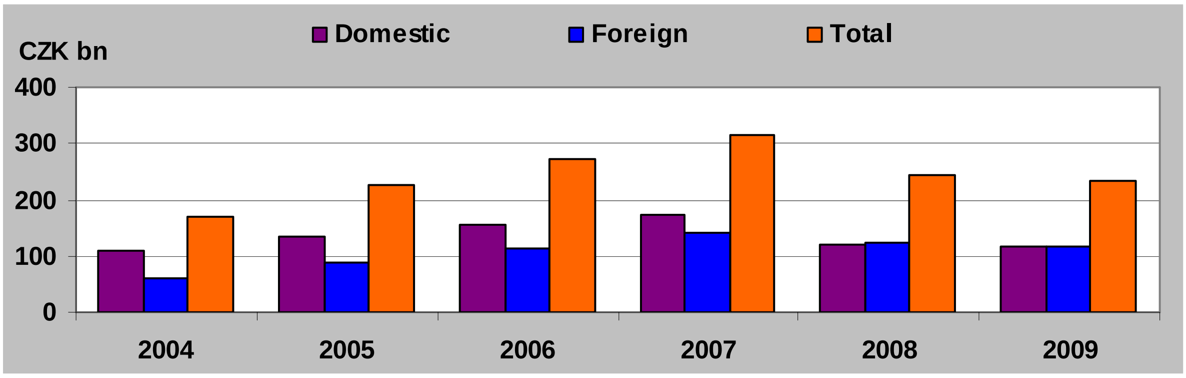
[37] All trades (purchase and sale) concluded at PSE, RM-S, foreign markets and direct trading; accumulated for shares, unit certificates and bonds; excl. derivatives trading.

Investment intermediaries
The decline in the number of investment intermediaries continued in 2009. There were 9,055 investment intermediaries registered at the end of 2009 – 3,738 less than at the beginning of the year. This development resulted from an amendment to the Act on the Capital Market Undertakings, which transformed level 2 investment intermediaries to controlled representatives. These controlled representatives are no longer listed in the registry of investment intermediaries, as they are recorded in a separate registry instead. CNB thus maintains 2 separate registries.

4.2.1. Collective investments

Similarly as in 2008, the value of funds under management decreased in 2009. However, the decline was less severe, amounting to 3.8%. Total investments in unit trusts amounted to CZK 234.5 bn (*EUR 8.9 bn*) at the end of 2009. The total share of domestic and foreign unit trusts almost evened out, as both groups managed assets in the value slightly exceeding CZK 117 bn (*EUR 4.4 bn*).

Graph 4.10: Development of investments in unit trusts



Source: AKAT

Only equity funds registered a significant increase in assets in 2009. Sharp declines in stock prices recorded in 2008 brought about attractive investment opportunities in 2009. On the other hand, the most assets were drained from conservative funds – i.e. bond and money market funds. The newest category of unit trusts, i.e. the real-estate funds, recorded a great setback in 2009, writing off almost 25% of their assets.

Table 4.16: Assets in individual types of unit trusts by domicile

As at 31 Dec (CZK bn)	2008			2009			Year-on-year change (%)		
Unit trust type	Domestic	Foreign	Total	Domestic	Foreign	Total	Domestic	Foreign	Total
Money market	55.9	32.2	88.1	46.9	30.9	77.8	-16.1	-4.1	-11.7
Bond	14.0	12.5	26.5	14.4	6.2	20.5	2.8	-50.9	-22.6
Equity	7.3	16.1	23.5	13.5	20.0	33.5	84.7	23.7	42.7
Mixed	19.4	6.7	26.1	20.1	6.6	26.7	3.7	-0.8	2.6
Funds of funds	12.7	0.2	12.9	12.7	0.4	13.0	-0.1	53.8	0.8
Guaranteed	9.9	55.2	65.1	8.3	53.3	61.6	-16.1	-3.4	-5.3
Real estate	1.8	0.0	1.8	1.3	0.0	1.3	-24.2	-	-24.1
Total	120.9 *€ 4.5*	123.0 *€ 4.6*	243.9 *€ 9.1*	117.2 *€ 4.4*	117.4 *€ 4.4*	234.5 *€ 8.9*	-3.1	-4.6	-3.8

Source: AKAT

The changes in the above mentioned assets under management are affected by two factors – valuation achieved by the funds and net sales. The net sales of shares represent the change of assets of unit trusts resulting from the subscriptions and redemptions of shares; such change does not affect the unit trust performance, only total assets. It is apparent from Table 4.17 that nearly one half (49%) of the decline in the total assets of domestic money market funds resulted from the client withdrawals, because the redemptions of shares were higher than the subscriptions, i.e. net sales were negative (CZK -4.4 bn). Other categories of unit trusts recorded negative net sales as well. Equity funds were the only exception to this development, as they reported a significant growth of their total assets as a result of the positive trend on stock markets.

Table 4.17: Subscriptions and redemptions of shares of domestic unit trusts in 2009

Subscriptions and redemptions of shares (CZK bn)	Equity	Bond	Money market	Funds of funds	Mixed	Real estate	Total
Subscription	2.8	2.4	15.5	1.9	1.6	0.2	24.4
Redemptions	2.1	3.4	19.9	4.8	2.8	0.4	33.4
Net sales	0.8	-1.0	-4.4	-2.9	-1.2	-0.2	-9.0
Change in the asset value (year-on-year)	6.2	0.4	-9.0	0.0	0.7	-0.4	-3.7
Change adjusted for net sales	5.4 *€ 0.20*	1.4 *€ 0.05*	-4.6 *€ -0.17*	2.9 *€ 0.11*	1.9 *€ 0.07*	-0.2 *€ -0.01*	5.3 *€ 0.20*

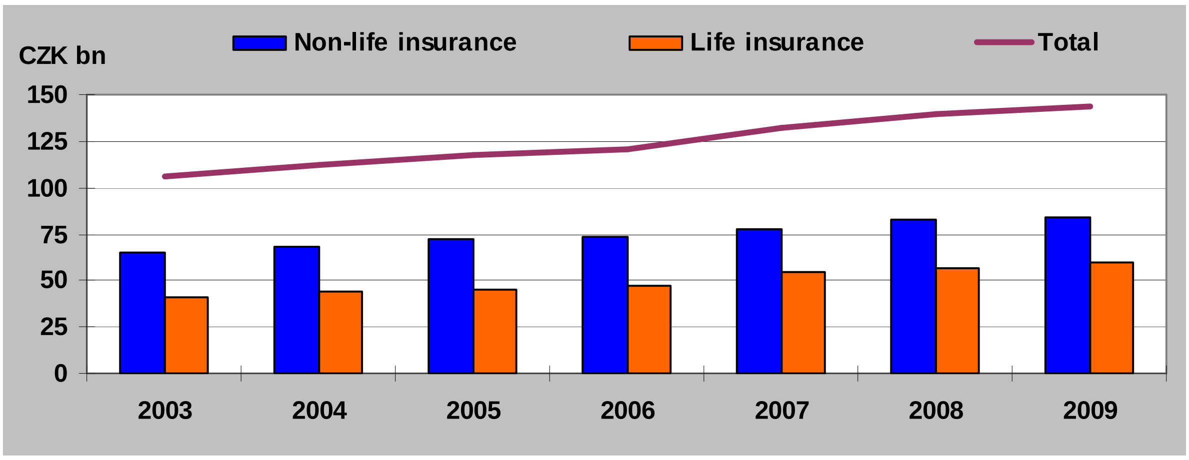
Source: AKAT

4.3. Insurance companies

In June of 2009, the Czech Republic as a whole was hit by floods which; however, were not as destructive as in the past. The hardest hit regions were the Moravian-Silesian Region and the territory of Southern Bohemia. Most property damages in the Central Bohemian Region and Hradec Králové Region can be attributed to windstorms (damages exceeding CZK 2 bn). Furthermore, insurance companies were dealing with standard property damages resulting mainly from local spring flooding, excessive snowfall, and strong wind.

In spite of the continuing difficult situation on the financial market, the insurance industry reported rather respectable results in 2009. Even though the economic crisis slowed down dynamics of the sector, insurance companies retained a slight upward trend for their key economic indicators. The sector stability is documented by an increase in the total gross premiums written of 3.1% to CZK 144.1 bn (*EUR 5.4 bn*). The total insurance penetration indicator (total written premiums to GDP ratio) slightly increased to nearly 4%, as a result of not only the hike in the written premiums but also the GDP decline. Due to the expected economic development, no significant changes in the slight upward trend are foreseen for 2010.

Graph 4.11: Development of gross premiums written



Source: CNB

The life and non-life insurance contributed to the increase of the total gross premiums written indicator from 78% and 22%, respectively.

The gross premiums written for life insurance amounted to CZK 60.2 bn (*EUR 2.3 bn*), corresponding to a growth rate of 5.8%. This increase was mainly driven by one-off payments of gross premiums written. On the other hand, standard premium payments recorded a slight decline.

The dynamics of the non-life insurance sector experienced a significant slowdown. While the gross premium written grew by more than 5% annually in the previous years, it only increased by 1.2% in 2009, amounting to CZK 83.9 bn (*EUR 3.2 bn*). The overall stagnation of the non-life insurance was mainly affected by the decline in total premiums in the car insurance category, which is associated with the setback in car sales in 2009. On the other hand, the category of business insurance acts as the stabilization factor of the non-life insurance base and points at the cautious approach of business entities in respect of potential also arising from imminent dangers.

The Czech insurance market is still dominated by Česká pojišťovna and Kooperativa pojišťovna, which together account for nearly a half of the market share (49.4%) based on the total gross premiums written.

Table 4.18: Results of insurance companies[38]

As at 31 Dec	2007	2008	2009	Year-on-year change	
				Abs.	(%)
Number of policies (000's)	26,387	28,254	27,701	-553	-1.96
of which: non-life insurance	16,268	18,150	18,351	201	1.11
life insurance	10,119	10,104	9,350	-754	-7.46
Number of newly concluded policies (000's)	9,276	10,670	10,470	-200	-1.87
of which: non-life insurance	8,053	9,429	9,336	-93	-0.99
life insurance	1,223	1,241	1,134	-107	-8.62
Total gross premiums written (CZK bn)	131.9 *€ 4.8*	139.8 *€ 5.3*	144.1 *€ 5.4*	4.3	3.08
of which: non-life insurance	77.8	82.9	83.9	1.0	1.21
life insurance	54.1	56.9	60.2	3.3	5.80
Total insurance penetration (%)	3.70	3.77	3.97	0.20	-

Source: CNB

In spite of the decline in the number of life insurance policies (by 7.5%), no mass cancelation of policies is taking place. In respect of significant financial market fluctuations, the dynamics of the unit linked insurance slowed down; however, its growth rate amounted to 11.7%. The so-called family policies are the new trend on the market – several family members can be insured under one insurance policy.

On the other hand, the non-life insurance sector registered a slight increase in the total number of negotiated insurance policies – by 1.1%. In comparison with the year-on-year increase recorded in the previous period (11.6%), we can see a significant setback of the sector dynamics. From the perspective of products, the non-life insurance is characterized by efforts to expand its complexity, namely with the use of assistance services. Insurance companies try to reinforce their respective market positions by increasing the overall scope and quality of insurance products rather than by competing in the area of insurance premium level.

The trend of a wider use of direct communication channels continues in the insurance industry. Consequently, insurance companies are able to provide online requested current information on the liquidation process of specific insurance events. Furthermore, the remote negotiation of insurance (via internet) is becoming more common for certain products (e.g. travel insurance and motor-vehicle liability insurance).

In 2009, the number of detected insurance frauds - or cases when insurance companies suspended indemnification payments due to suspected insurance frauds - increased. This new phenomenon can be linked to not only more efficient methods of fraud detection but also to the economic recession, as some insurance companies' clients want to resolve their adverse financial situation at the expense of unjustified insurance claims.

[38] IP = insurance policy; the number of life insurance policies does not include supplementary insurance policies. Data excluding the Czech Insurers' Bureau (professional organization of insurers, who were granted a license to operate motor-vehicle liability insurance). The data for 2007 and 2008 have been recalculated only for entities active in 2009.

52 insurance companies and 1 reinsurance company operated on the Czech insurance market at the end of 2009. There were 35 domestic entities, 17 foreign branches (of which 16 from EU/EEA countries). From the perspective of performed activities, there were 7 life insurance companies, 29 non-life insurance companies, and 16 insurance companies, which offered both life and non-life insurance. Under the so-called European Passport, 614 entities (of which 152 branches of insurance companies from EU/EEA countries) offered their insurance services on the Czech market.

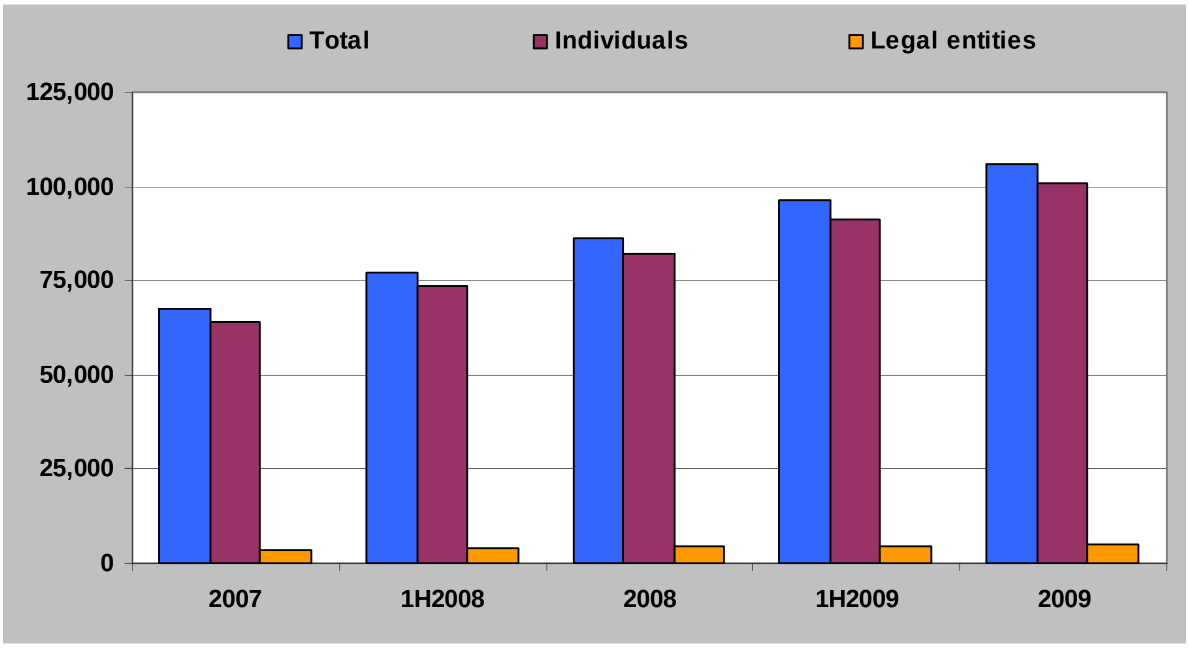
In 2009, insurance companies reported record-high profits of CZK 13 bn (according to CZSO data) in spite of the problems on the global financial markets. This represents an increase of 74.6% in comparison with the previous year. The profitability improvements result from higher revenues as well as cost savings.

The capital availability of insurance companies was at a decent level – considering the volume and risk of executed transactions – and it was supported by the year-on-year increase in equity by 18.8% (according to CZSO data).

In 2008, the solvency rate[39] of non-life insurance exceeded the required solvency more than four times (460%) and the same indicator for life insurance exceeded the required threshold approximately two and a half times (248%). The correctness of the solvency calculation and the assessment of the overall caution during the process of providing insurance products, namely the adequacy of creation of technical reserves, are verified by actuaries. In total, 49 actuaries were registered on the list maintained by CNB at the end of 2009. Insurance companies pay more attention to the conservative component of the financial allocation of their assets originating in the technical reserves.

The maximum acceptable technical interest rate (i.e. guaranteed share in the earnings from financial allocations under life insurance) did not change in 2009, remaining at 2.4%.[40]

Graph 4.12: Development of the number of insurance intermediaries



Source: CNB

The intermediation of insurance is ensured by nearly 100 thousand registered entities (106 thousand entities registered in total; however, 9 thousand entities had their license revoked). The largest category of issued registrations is the subordinated insurance intermediaries (54.8%) and exclusive insurance brokers (24.5%). It is possible to deduce from the continuously increasing number of insurance intermediaries that the rate of their active involvement in the insurance market cannot be optimal. In spite of the declining growth rate of their increments, which nevertheless amounted to nearly 23% in 2009, the share of mediated premium per one

[39] The yearlong delay of the data on solvency complies with Decree no. 433/2009 Coll., on the presentation, form, and required content of financial statements of insurance and reinsurance companies.
[40] In February of 2010, CNB decided to increase the technical interest rate to 2.5%.

intermediary declines. It is estimated that the involvement of a substantial part of these entities in intermediation activities is only formal, with no or minimum production. Some distortion of the data also results from the so-called multiple registration of one person. This situation is not optimal from the perspective of the market and/or consumer, and it will be necessary to regulate this system legislatively. Furthermore, this situation makes a systematic supervision of this market segment difficult in view of the existing capacities.

Table 4.19: Insurance intermediaries by position (category)[41]

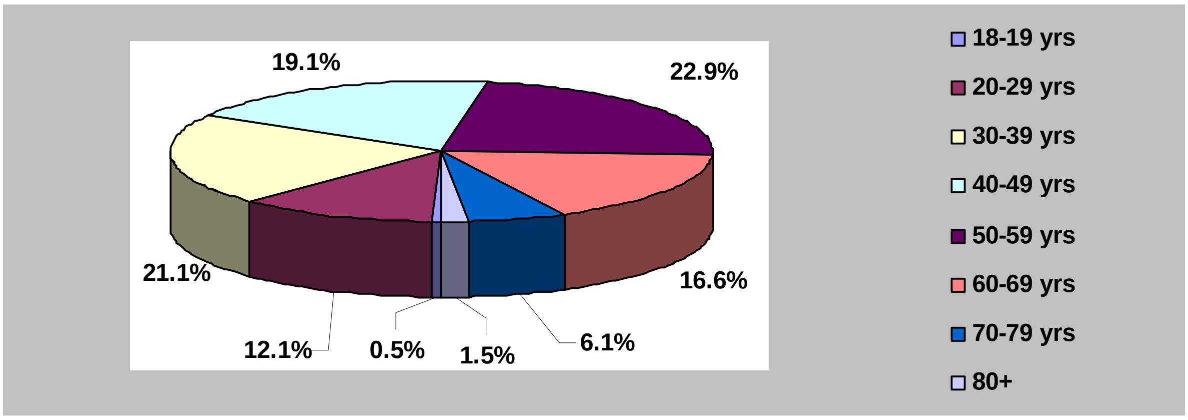
Entity registered as at 31 Dec	2008			2009			Year-on-year change (%)		
	IN	LE	Total	IN	LE	Total	IN	LE	Total
TIE	10,201	264	10,465	11,480	287	11,767	12.54	8.71	12.44
SII	44,692	1,375	46,067	56,384	1,652	58,036	26.16	20.15	25.98
EIA	20,477	124	20,601	25,850	161	26,011	26.24	29.84	26.26
IA	509	649	1,158	531	755	1,286	4.32	16.33	11.05
IB	161	497	658	167	538	705	3.73	8.25	7.14
ILA	62	103	165	64	108	172	3.23	4.85	4.24
FII	5,819	1,299	7,118	6,345	1,658	8,003	9.04	27.64	12.43
Total	81,921	4,311	86,232	100,821	5,159	105,980[42]	23.07	19.67	22.90

Source: CNB

4.1. Supplementary pension insurance

In spite of the ongoing crisis and low revenues, the number of participants in supplementary pension insurance increased by nearly 5% to 4.4 mil in 2009. In total, participants deposited CZK 200.7 bn (*EUR 7.6 bn*) in pension funds – i.e. a year-on-year increase of 7.5%.

Graph 4.13: Age structure of participants in supplementary pension insurance



Source: MoF

The highest absolute increase in the number of participants was traditionally reported for the age group of 30-39 years, while the age group of 80+ years came in first in respect of relative increments. However, above-average growth has been recorded in other categories of pension age. It thus confirms the trend of an increasing share of participants over 60 years of age, which increased from 20.1% in 2005 to 24.2% in 2009. The substantial part of the increase in participants relative to these categories results from the mere transfer of participants to higher categories (aging). Nevertheless, the number of participants, who take part in this scheme even at the age of 60+, is relatively high. It relates to the product settings. After turning 60, supplementary pension insurance becomes a secure short-term to mid-term saving product with state contribution. Similarly as in the preceding year, only the category of thirty-year-olds reported any distinct growth with regard to participants in productive age.

[41] Explanation: TII = tied insurance intermediary, SII = subordinated insurance intermediary, EIA = exclusive insurance agent, IA = insurance agent, IB = insurance broker, ILA = independent loss adjuster, FII= foreign insurance intermediary, IN = individual and LE = legal entity.

[42] License was revoked from 9,023 entities.

Table 4.20: Participants in supplementary pension insurance by age

As at 30 Dec	2005	2006	2007	2008	2009	Year-on-year change	
						Abs.	(%)
18-19 yrs	12,522	16,513	21,461	22,526	23,433	907	4.03
20-29 yrs	368,952	420,387	475,887	512,496	530,382	17,886	3.49
30-39 yrs	601,614	686,156	786,781	867,574	927,964	60,390	6.96
40-49 yrs	705,074	735,250	777,167	807,665	839,614	31,949	3.96
50-59 yrs	931,001	966,952	996,474	1,010,509	1,008,265	-2,244	-0.22
60-69 yrs	452,878	530,932	610,778	682,601	729,339	46,738	6.85
70-79 yrs	173,965	196,484	218,919	245,558	267,966	22,408	9.13
80+	33,721	40,971	48,890	58,307	67,559	9,252	15.87
Total	3,279,727	3,593,645	3,936,357	4,207,236	4,394,522	187,286	4.45

Source: MoF

The number of participants, who received employer's contributions toward their supplementary pension insurance policies, slightly decreased slightly. Their number thus accounts for one fifth (20.6%) of all participants only. Employers, probably under pressure of growing crisis, limited employee benefits including contributions to supplementary pension insurance. This was especially apparent in the categories 20-29 years and 50 -59 years.

Table 4.21: Share of policies with employer's contribution by age group and gender[43]

Age	2006	2007	2008	2009	Year-on-year change	
					Abs.	(%)
18-19	344	459	461	292	-169	-36.66
20-29	81,412	83,203	86,224	80,770	-5,454	-6.33
30-39	200,425	218,108	238,090	240,473	2,383	1.00
40-49	230,051	242,993	257,048	260,305	3,257	1.27
50-59	267,726	279,464	290,310	280,546	-9,764	-3.36
60-69	29,757	37,468	43,315	43,558	243	0.56
70-79	658	756	907	973	66	7.28
80+	22	28	43	35	-8	-18.60
Total	810,395	862,479	916,398	906,952	-9,446	-1.03

Source: MoF

In spite of the persisting crisis, the so-called acquisition costs – i.e. costs incurred in connection with acquiring new supplementary pension insurance policies – increased significantly in 2009 – by almost two thirds to CZK 3,365 (*EUR 127*). These costs exceed the costs of 2006 almost three times. Such high increase may result from the market saturation – the number of participants corresponds to 83.1% of workforce of the Czech Republic and it is quickly losing its dynamics. Unlike in the past when pension funds could grow by attracting new participants in the system, they must now mainly concentrate on the retention of their existing participants and expand by acquiring clients of their competitors.

Table 4.22: Costs incurred in connection with new policies

CZK/average	2006	2007	2008	2009	Year-on-year change	
					Abs.	(%)
Costs incurred in connection with a new policy	1,283 *€ 45*	1,592 *€ 57*	2,033 *€ 77*	3,365 *€ 127*	1,332	65.53
Deferred expenses to a number of existing supplementary pension insurance policies	799	876	959	883	-76	-7.94

Source: MoF, CNB

[43] Data as at 31 December of the given year.

On the other hand, deferred expenses (DE) slightly decreased in 2009 – by 4.7% to CZK 3.9 bn (*EUR 140 mn*). Therefore, the amount of CZK 883 was attributable to each supplementary pension insurance policy – i.e. 7,9% less than in 2008. Deferred expenses represent cumulated costs of new policies, which have not been written off. Pension funds thus write costs associated with new policies off faster than in the past, because not even the record-breaking acquisition costs reported in 2009 did not lead to an increase in deferred expenses.

Impaired economic situation of households affected the amount of average monthly contributions. The average participant's contribution decreased for the second consecutive year. This was also reflected in the average state contribution amount, which did not increase for the first time since the inception of supplementary pension insurance.

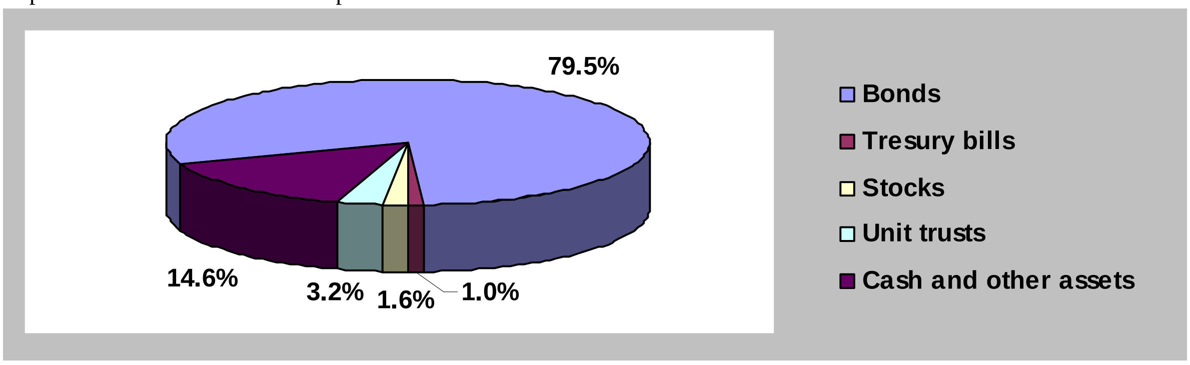
Table 4.23: Breakdown of average monthly contributions amount

CZK/month	2005	2006	2007	2008	2009	Year-on-year change	
						Abs.	(%)
Participant's contribution	459.1 *€ 15.4*	474.8 *€ 16.8*	495.9 *€ 17.9*	488.0 *€ 19.6*	475.5 *€ 18.0*	-12.4	-2.5
State contribution	100.8	103.6	104.0	105.4	105.2	-0.1	-0.1

Source: MoF

Investment portfolio of pension funds became even more conservative than in the past. The share of bonds amounted to nearly 80%, while the share of stocks decreased by almost a half to 1.6% - even though stocks did offer some interesting valuations in 2009. However, high volatility and persisting uncertainty on the markets discouraged pension funds from investing in this asset class, as they are obligated to generate a non-negative economic result for each fiscal year.

Graph 4.14: Allocation of assets of pension funds as at 31 December 2009[44]



Source: APF CR

[44] See table 8.6 in Appendix 2.

5. RELATION OF THE GOVERNMENT SECTOR TO THE FINANCIAL MARKET

5.1. General government balance

The share of the government sector balance to GDP will decrease to -5.3% in 2010 (CZK -197.2 bn, E*UR 7.5 bn*). There will thus be a year-on-year decline in the government deficit to GDP ratio by 0.6 pp. In order to comply with the consolidation strategy specified under the Convergence Program, it will be necessary to adopt saving measures in excess of originally expected steps. The development of the government sector is based on very fragile economic growth and relatively high unemployment rate, which is also associated with an adverse development of household consumption. On the other hand, the gradual recovery in the economies of our key business partners should have a positive impact. These factors are directly reflected in the development of the government sector revenues and expenditures. The impacts of anti-crisis government measures are slowly fading away, and active measures aimed at the deficit reduction are becoming apparent within the government economy.

When taking a closer look at the **balance structure of government institutions sector,** we find out that all its subsectors reported a deficit in 2009. The highest deficit was recorded within the subsector of central government institutions (CZK -180.3 bn – i.e. -5.0% of GDP), followed by the subsector of local government institutions (CZK -24.0 bn, i.e. -0.7% of GDP) and social security funds (namely health insurance companies) (CZK -10.7 bn, i.e. -0.3% of GDP). At the end of 2009, government debt amounted to CZK 1,282.3 bn (*EUR 48.5 bn*, i.e. 35.4% of GDP).

It is apparent from the 2010 government deficit structure that the deficit economy of all subsectors still continues. The majority of adopted consolidation measures is reflected in the balance of the central government institutions subsector, which reports a year-on-year improvement of approximately CZK 7 bn (0.3 pp. of GDP) and the deficit of this sector amounts to CZK -173.3 bn (-4.7% of GDP). Deficit of CZK -15.9 bn (-0.4% of GDP) is expected for the local government institutions subsector – i.e. a year-on-year improvement by CZK 5.3 bn (0.3 pp. of GDP). A year-on-year improvement is also expected for the social security funds subsector, which should improve its deficit by CZK 2.7 bn (0.1 pp. of GDP), amounting to CZK -8.0 bn (-0.2% of GDP). It is apparent from the above mentioned that the public finance consolidation is namely taking place on the central government level, the economy of which falls within the direct of the government.

In addition to a significant setback of economic growth, the **revenue side** of the government sector balance in was affected by the so-called anti-crisis measures in 2009. The most important anti-crisis measures included the possibility to postpone income tax advance payments (only affects cash-flow), acceleration of depreciation for depreciation categories 1 and 2, lower VAT rate on selected services, and social security insurance premium discounts for employers. Therefore, the revenue side of the government sector will reflect impacts of the so-called saving measures in 2010. These measures include, for example, annulment of tax exemption for constitutional officials' benefits, reduction of flat-rate expenditures for entrepreneurs in the area of the so-called freelance activities and copyright, double real-estate tax rate, and hike in both VAT rates by 1 pp. At the same time, excise taxes on fuels, spirits, beer, and tobacco products have been increased. The main contributions in respect of social security and health insurance premiums consist in the postponement of the reduction in the sickness insurance premium rate by 0.9 pp., higher limit for an assessment base relating to social security and health insurance, and annulment of insurance premium discounts. Total government sector revenues are expected at approximately CZK 1,496.4 bn (*EUR 56.6 bn*), i.e. a year-on-year increase of CZK 36.4 bn.

The **expenditure side** was also affected by the so-called anti-crisis measures, which were mainly aimed at increasing expenditures for the development of transportation infrastructure and serviceability, support of research and development, increase in the capital of ČEB and insurance coverage of EGAP. The preparation of the so-called saving measures started in the second half of the year, which included new regulation of an assessment base for the state payments in favor of the public health insurance system. Changes of parameters in respect of financial aid during maternity, compensation allowance during pregnancy, and sickness benefits payments have been proposed in the area of sickness insurance. However, these measures did not gather sufficient political support. In the area of wages and salaries, functional positions will be terminated in 2010, some of the expenses in the area will be limited. Furthermore, the government decided not to valorize pensions as at the beginning of the year. In spite of the aforementioned saving measures, the existing developments – e.g. in comparison with assumptions included in the state budget proposal – indicate worse fiscal results of the government sector, mainly as a result of outages in the area of corporate income tax and social security/health insurance premiums. In order to comply with the fiscal target specified in the Convergence Program, the government decided to compensate these outages by limiting expenditures of individual state budget chapters, which should sum up to approximately CZK 11.5 bn. Furthermore, payments will be cut down this year for removing the so-called old environmental damages from the privatization proceeds, and – in spite of original assumptions – the original conservative dividend payment of the company ČEZ has been increased. The total government sector expenditures are expected at approximately CZK 1,693.6 bn (*EUR 64.0 bn*), i.e. a year-on-year decline of approximately CZK 18.6 bn.

Privatization proceeds (i.e. proceeds from the sale of shares and other property participations) were, or actually are expected to be insignificant in 2009 and 2010. The main source of income of the so-called privatization account includes dividend payments amounting to (or being planned at) CZK 16 bn and CZK 17.4. The dividend payments mainly come from the following companies: ČEZ, ČEPRO, and MERO ČR. Privatization proceeds, similarly as in 2009, will mainly be used to finance the removal of environmental damages/coal-mining damages, flood control, and contributions to the State Fund for Transport Infrastructure.

Government sector debt will amount to CZK 1,403.7 (*EUR 53.0 bn*) in 2010 – i.e. 38.0% of GDP. It is expected to grow significantly on year-on-year basis (by CZK 121.4 bn, i.e. 3.5 pp of GDP). Even though its growth dynamics will decline on year-on-year basis, it still remains very high (decline from 16.1% to 9.5%). In addition to this, the government debt growth dynamics is partially decelerated by an integration of the so-called debt reserves issued in previous years. Within the consolidated government debt, contribution to the central government institutions accounts for CZK 1,317.9 bn – of which the government debt amounts to CZK 1,308.2 bn, i.e. almost 99.3% of the total contributions of individual subsectors; contribution to the local government institutions debt is predicated at CZK 95.3 bn. Contribution to the social security funds debt (health insurance companies) amounts to CZK 0.1 bn. Of the total government debt, the amount of CZK 25.6 bn (i.e. 1.8% of the total consolidated government debt) corresponds to imputed loans, i.e. it is not factually covered by existing debt instruments in government entities' balance sheets (imputed state guarantees, lease of military fighter planes Grippen, etc.). The largest part of the government debt is in the form of debt securities, whereas the process of the debt securitization still continues. Therefore, the share of loans in the government debt has been steadily declining since 2001.

5.2. State budget

The 2009 state budget was approved with a deficit of CZK 38.1 bn. Total expenditures were expected at CZK 1,152.1 bn, while foreseen revenues amounted to CZK 1,114.0 bn. Actual expenditures and revenues amounted to CZK 1,167.0 bn (*EUR 44.1 bn*) and CZK 974.6 bn (*EUR 36.9 bn*) respectively. Therefore, the state budget ended with a deficit of CZK 192.4 bn (*EUR 7.3 bn*).

The failure to comply with planned **revenues** was namely caused by outages on the part of all major tax revenue categories, which decreased by CZK 59.0 bn on year-on-year basis. The approved tax revenue budget was not fulfilled by CZK 110.2 bn. Collection of legal entities income tax was the worst off (64.0% of the budget), followed by physical entities income tax (79.9% of the budget). The first mentioned collection was mainly affected by the above described measures in the area administration of this tax (temporary cancellation of the obligation to pay advance payments). Significant setbacks are also apparent in respect of value added tax revenues (91.0% of the budget) and excise taxes (86.1% of the budget). Substantial year-on-year decline of CZK 37.6 bn was recorded for social security premium revenues. The increase in indirect taxes continues to grow within the tax revenue structure. On the other hand, nontax and capital revenues and received transfers recorded a year-on-year increase of CZK 7.3 bn. In this regard, it is appropriate to mention the utilization of the so-called reserve funds of the state organizational units in the amount of CZK 38.0 bn intended for financing of the state budget deficit. A surplus of the pension insurance system of 2008 in the amount of CZK 2.6 bn was transferred to a special reserve account for the pension reform. However, such transactions are not regarded as revenues – with the exception of the state budget composition methodology. These transactions were regarded as revenues in the past; however, any such transactions executed now are only regarded as mere internal transfers. Another negative news is the low fulfillment of transfers accepted from the EU (including the National Account), which only reached 54% of the budget after adjustments (i.e. CZK 59,6 bn).

Total expenditures of the state budget increased by CZK 83.1 bn year-on-year, whereas current expenditures amounted to CZK 1,033.8 bn (88.6%) and capital expenditures amounted to CZK 133.2 bn (11.4%). State budget expenditures were mostly routed to social area (36.8%), whereas expenditures in connection with social allowances amounted to CZK 429.3 bn, increasing by CZK 24.8 bn year-on-year. The share of the so-called mandatory expenditures in the total expenditures amounts to 53.3% (i.e. CZK 622.0 bn). Even though this category recorded a year-on-year increase of 6.9%, there share in the total expenditures is declining. The year-on-year growth is mainly affected by increasing expenditure for pension insurance allowances (by CZK 27.3 bn), debt service (by CZK 8.3 bn – including fees) and unemployment benefits (by CZK 8 bn). This state budget segment represents the biggest threat to the future development of public budgets, because it will immediately reflect impact of aging population and existing unsustainable nature of public policies. The pension insurance system reported a deficit of CZK 36.8 bn in 2008. The balance of the so-called special reserve account for the pension reform in government financial assets, generated from the surpluses of this system in the past, amounts to CZK 19.5 bn. The development of the state budget expenditures in 2009 was also affected by the fact that the transfers of unused budget expenditure funds to reserve funds, which were heavily criticized in the past, were cancelled. The former procedure was replaced by an establishment of the so-called claims for unspent expenditures (i.e. receivables from the budgets of future periods). These funds amounted to approximately CZK 72.5 bn as at 1 January 2009, whereas the expenditure budget was exceeded by CZK 41.7 during the year and new claims for unspent expenditures arose during the year of approximately CZK 62,2 bn (the claims balance amounts to approximately CZK 90 bn at the beginning of 2010). The majority of such claims are associated with the relatively slow execution of projects co-financed from the EU funds.

Upon adjustments for internal transfers, **the total state budget balance** amounted to CZK 234.0 bn (CZK 192.4 bn without these adjustments). The settlement of this deficit took place through an issue of government bonds (CZK 185.8 bn), acceptance of long-term loans (CZK 11.9 bn), and changes in statuses within the state financial assets accounts (CZK 5.4 bn).

Proposal of the state budget for the **year 2010** was presented to the Chamber of Deputies with a deficit of CZK 162.7 bn (i.e. CZK 124.6 bn more than foreseen by the budget approved for 2009). The budget is foreseen with total revenues of CZK 1,022.2 bn (i.e. 8.2% less in comparison with the budget approved for the previous year) and total expenditures of CZK 1,184.9 bn (i.e. year-on-year increase of 2.8%). The state budget revenues and expenditures were designed in a manner that would enable a to a government sector balance (ESA 95 methodology) of 5.3% of GDP.

Table 5.1: Development of state budget revenues, expenditures and balance[45]

As at 31 Dec (CZK bn)	2005	2006	2007	2008	2009	2010	Year-on-year change (%)
Revenues incl. repayments	808.7	858.0	959.0	985.7	921.8	991.8	7.59
Expenditures incl. gross borrowings	874.5	965.1	1,007.3	1,066.2	1,155.8	1,164.6	0.76
Balance	-65.8 *€ -2.2*	-107.2 *€ -3.8*	-48.3 *€ -1.7*	-80.5 *€ -3.2*	-234.0 *€ -8.8*	-172.8 *€ -6.5*	-26.17

Source: MoF

5.3. Government debt and state guarantees

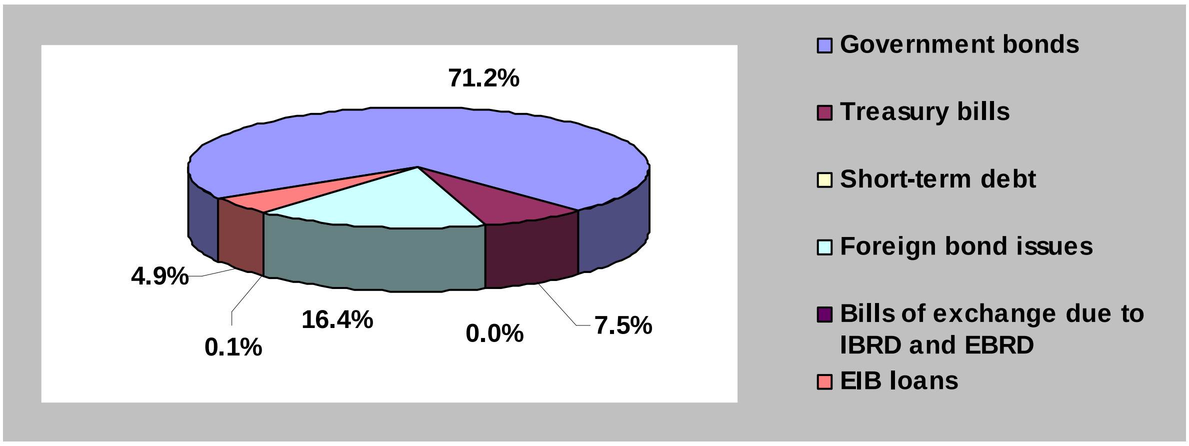
At the end of **2009**, unconsolidated government debt was reported in the amount of CZK 1,178.2 bn (*EUR 44.5 bn*) and it is expected to increase to CZK 1,298.0 bn (*EUR 49.0 bn*) by the end of 2010. The government debt to GDP ratio will amount to 35.2%. The internal government debt amount will increase to CZK 1,005.1 bn (77.4%), while the extern government debt amount will reach CZK 292.9 bn (22.6%).

The government debt growth mainly results from the deficit-oriented state budget - the growth dynamics of the debt had been slowly decelerating since 2003. However, the growth rate has once again been picking up since 2009.

[45] The methodology of revenues and expenditures specified in Table 5.1 does not correspond to the data presented on the State final account, which are commented in the wording of the Report. GFSM 2001 methodology is used for the specification thereof. The main methodological differences consist in the fact that revenues and expenditures are reduced by received interest and premiums on government debt (i.e. consolidation of costs of debt service), granted loans reduced by their installments are not part of revenues and expenditures, expenditures for an execution of risky state guarantees with uncertain recoverability are included in expenditure capital transfers (their potential payments are classified as incomes/revenue). Furthermore, revenues and expenditures are adjusted in the time series for the so-called internal transfers (to and from reserve funds and state guarantees fund).

Three tranches of EIB loans were drawn upon in the first quarter of the year, amounting to CZK 2.4 bn in total (i.e. 19.3% of this type of financing approved by the State Budget Act). In terms of domestic issue activities, medium and long-term bonds were issued in the nominal value of CZK 40.2 bn, of which CZK 3.5 bn was sold on the secondary market (CZK 2,0 bn by EIB). The net issue of government bonds thus amounted to CZK 40.2 bn in the first quarter. No redemptions took place during the first quarter.

Graph 5.1: Government debt by type of instrument as at 31 December 2009



Source: MoF

The average government debt maturity decreased at the end of the first quarter to 6.3 years. The net costs of the government debt servicing amounted to CZK 2.6 bn at the end of the first quarter.

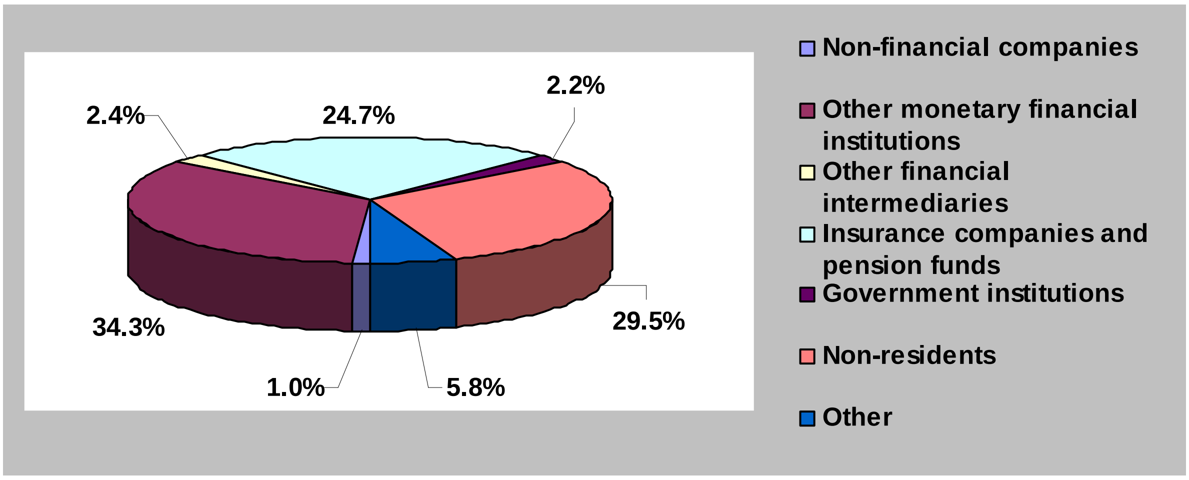
Of the total government debt amount, CZK 1,156.1 bn (*EUR 43.7 bn*) is in the form of negotiable debt and CZK 60.7 bn (*EUR 2.3 bn*) in the form of nonnegotiable debt at the end of the first quarter. The share of foreign-currency debt amounts to 8.1%. The share of short-term government debt increased by 0.5 pp to 14.2% in comparison with the end of the previous year.

The year 2010 has seen another decline in the value of the portfolio of risky state guarantees, which are being refinanced within the state budget expenditures. Their importance relative to government debt amount fell under 6% and their structure thus cannot significantly affect monitored quantitative criteria from announced target amounts.

The planned government loan need according to the Strategy for the government debt financing and management in 2010 without the net change in financial instruments revolving will amount to CZK 280.0 bn (*EUR 10.6 bn*) in 2010. This amount consists of the planned state budget deficit in the amount of CZK 162.7 bn, refinancing of payable medium-term and long-term government bonds in the amount of CZK 83.0 bn, refinancing of government bonds redemptions in the amount of CZK 10.0 bn, and installments on EIB loans in the amount of CZK 1.1 bn. At the same time, the gross government loan need has been increased by the planned increase in the balance of the accounts of government financial assets in the amount of CZK 3.2 bn and creation of a financing reserve of CZK 20.0 bn.

MoF plans to perform at least one benchmark issue of Eurobonds in 2010.

Graph 5.2: Government debt by creditor as at 31 December 2009

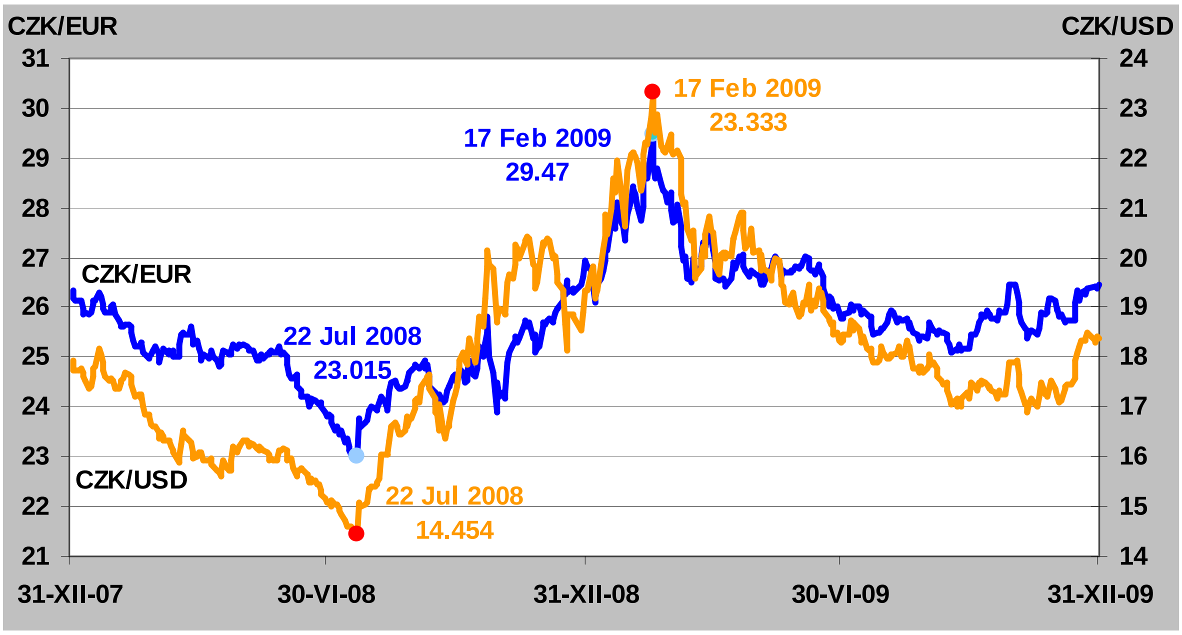


Source: MoF

6. FOREIGN EXCHANGE MARKET

At the end of 2009, the Czech currency slightly appreciated against the two leading global currencies. With regard to euro, it gained 1.8% to close at 26.47 CZK/EUR, while gaining 5.1% against the dollar to close at 18.37 CZK/USD. However, on average it was weaker throughout the year than in 2008. This was mainly caused by the economic crisis consequences.

Graph 6.1: CZK exchange rates relative to major currencies



Source: CNB

Table 6.1: CZK exchange rates relative to major currencies

Average exchange rate						
	2005	2006	2007	2008	2009	Year-on-year change (%)
CZK/EUR	29.78	28.34	27.76	24.94	26.45	6.03
CZK/USD	23.95	22.61	20.31	17.04	19.06	11.87
Exchange rate as at the end of						
	2005	2006	2007	2008	2009	Year-on-year change (%)
CZK/EUR	29.01	27.50	26.62	26.93	26.47	-1.73
CZK/USD	24.59	20.88	18.08	19.35	18.37	-5.06

Source: CNB, CZSO

The significant worsening in the economic situation of the Czech Republic in the fourth quarter of 2008 resulted in a sharp depreciation of CZK in the first quarter of 2009 – to reach levels from October 2005. During the period from late October of 2008 to mid-February of 2009, the Czech crown depreciated by 28% against euro and by 61% against the dollar. This depreciation arose from the change in the manner investors perceived the Czech Republic. Until October of 2008, it seemed the Czech Republic would undergo the crisis with less damage than other countries, and the Czech crown thus appreciated. However, economic statistics published during the fourth quarter revealed that not even the Czech Republic would be immune to a substantial recession. With more and more data coming in during the first quarter of 2009, it was possible to estimate the situation of the Czech economy better, and, following a short correction, the exchange rate stabilized and the Czech crown started to appreciate slightly.

Table 6.2: External financial relations

Annual (CZK bn)	2005	2006	2007	2008	2009
Payment balance - current account	-39.8	-77.2	-113.1	-22.9	-37.0
Trade balance	59.4	65.1	120.6	102.7	180.6

Payment balance - capital account	4.7	8.5	19.6	30.4	41.0
Payment balance - financial account	154.8	92.4	125.8	59.0	95.1

Source: CNB - ARAD

CZK transactions were mainly affected by the news on the situation of the economy and public finance in the USA and the Eurozone. Economic indicators mainly put a pressure on CZK depreciation. The interest differential decreased during the year, GDP was dropping faster than in the Eurozone and the USA, and the inflation in the Czech Republic was higher. On the other hand, record-breaking surpluses of the payment balance mitigated the pressure on the Czech currency depreciation induced by an adverse development of other indicators.

Table 6.3: Comparison of economic indicators

(%)	Inflation (year-on-year)			Key interest rate of central bank[46]		
	Czech Republic	**Eurozone**	**USA**	**Czech Republic**	**Eurozone**	**USA**
January 09	2.2	1.1	0.0	2.25	2.50	0,00-0,25
February 09	2.0	1.2	0.2	1.75	2.00	0,00-0,25
March 09	2.3	0.6	-0.4	1.75	1.50	0,00-0,25
April 09	1.8	0.6	-0.7	1.75	1.25	0,00-0,25
May 09	1.3	0.0	-1.3	1.50	1.00	0,00-0,25
June 09	1.2	-0.1	-1.4	1.50	1.00	0,00-0,25
July 09	0.3	-0.7	-2.1	1.50	1.00	0,00-0,25
August 09	0.2	-0.2	-1.5	1.25	1.00	0,00-0,25
September 09	0.0	-0.3	-1.3	1.25	1.00	0,00-0,25
October 09	-0.2	-0.1	-0.2	1.25	1.00	0,00-0,25
November 09	0.5	0.5	1.8	1.25	1.00	0,00-0,25
December 09	1.0	0.9	2.7	1.00	1.00	0,00-0,25

Source: CZSO, CNB, Eurostat, ECB, Fed

[46] CR: 2T repo rate of CNB, Eurozone: ECB's main refinancing operations (minimum bid rate, or fixed rate), and USA: the Fed's intended federal funds rate.

7. FINANCIAL AND ECONOMIC CRISIS

Looking back at the financial and economic crisis, it can be observed that both the Czech economy and financial sector reacted to the crisis less negatively than the majority of other countries of Central and Eastern Europe. A number of factors contributed to this outcome: lower current account deficits in the previous years, lower dependence on volatile cross-border debt financing and subsequently a lower volume of cyclical investments dependent/driven by foreign capital inflow.

The acute phase of financial crisis, the signs of which on the global markets in the fall of 2008 were associated with an increasing uncertainty, asset sell-offs, and risk of the entire financial sector collapse, was successfully averted by unprecedented measures of central banks and other public institutions. These measures included, for example, fierce and coordinated lowering of interest rates, increase in liquidity provision, programs aimed at the purchases of impaired assets, state guarantees on bank debt and other assets, and capital injections into the affected financial market institutions. In some cases, the funds raised through these measures were already paid back by the relevant global financial institutions.

Due to its nature, the Czech financial sector was not significantly hit by the financial crisis. The reason for this was the fact that the Czech Republic was not primarily hit by the financial crisis. Instead, it suffered from the economic crisis and only in an indirect way, as a result of the export dependence of the Czech Republic, mainly on the markets of Western Europe. However, the problems of real economy tend to have some adverse implications for the Czech financial sector. The decline of revenues and wages will affect the ability of nonfinancial companies as well as individuals to repay their financial obligations, and thus may negatively influence the quality of banks’ credit portfolios’.

Entities of the banking sector, which dominate the Czech financial market, are mostly subsidiaries of major European financial groups. The Czech financial (and banking) sectors did not report losses from impaired assets similar to the level of some major European banks. Credit institutions in the Czech Republic concentrate on retail activities rather than on investment banking. Therefore, Czech credit institutions could rely on financing from relatively steady client deposits during the period of potential uncertainty on the interbank market. The deposits-to-loans ratio exceeded 130% in 2008, rising even further to 138% a year later (see Graph 4.1) – ranking among the highest in whole Europe. In October of 2008, CNB commenced preventive liquidity provision; however, this was met with only minimal interest among banks. Moreover, CNB has been removing liquidity from the market for many years.

Much lower exposure of Czech households and non-financial companies to foreign-currency loans in comparison with other countries in the Central and Eastern Europe region, is another factor, which was in favor of the Czech banking sector. Therefore, the exchange rate fluctuation of the national currency does not have negative impact on their ability of debtors to service and repay the loans. This situation results from the development of CZK interest rates during the past years. The interest rate differential between the Czech crown and some foreign currencies was significantly lower in the Czech Republic in comparison to for example Poland, Hungary or Romania. For this reason, there was not much of an advantage for domestic entities to accept loans in foreign currencies. The share of household foreign-currency loans on household total loans nearly equals to zero. They are mainly used by nonfinancial companies as a practical hedging instrument to offset cash flows from foreign-currency export revenues.

In addition to worsening macroeconomic situation with an impact on the quality of banking loan portfolios, other negative impulses mainly involved news coming from abroad rather than domestic instability. Even though panic resulted in plummeting share prices just like in foreign markets, the spring of 2009 was characterized by growth on the Prague Stock Exchange. This growth compensated for larger part of previously incurred losses and was a result of growing optimism supported by the loosening policy of central banks.

In 2009, gradually calming situation could be observed in the financial markets. However, after the end of the period covered by this Report it was becoming more apparent that the future market developments will be significantly affected by other adverse impulses. Tension started to pick up again in the financial markets – mainly in connection with the fiscal situation of certain countries of the Eurozone and subsequent problems with the financing of their debt. This process culminated in May of 2010, with a rapid depreciation of euro, temporary decline of stock exchange indexes, and subsequent assurance of state and international support to fiscally challenged countries in the amount of up to EUR 750 bn.

The Czech Republic, which is outside of the Eurozone, was not immediately affected by these events. Even though the rising tension in the financial markets led to a temporary depreciation of Central European currencies (including the Czech crown) against euro, the depreciation was followed by an appreciation as investors reacted to an announcement of ECB on further loosening of its monetary policy, including the purchases of government bonds of Eurozone countries. The yields of Czech government bonds also reacted very moderately to the rising tension in the Eurozone and they remain on low levels. Negative effects of the current development may thus have an indirect effect via declining demand after Czech exports in connection of a potential adverse impact of the financial market developments on the real economy of Eurozone. However, the depreciation of euro could support German exports and consequenty the Czech industry.

8. FINANCIAL MARKET ACTIVITIES OF MOF

8.1. Ministry of Finance's activities on an international level

8.1.1. Czech Presidency of the Council of the European Union[47]

The financial services sector became one of the key interest areas of the EU during the Czech Presidency, namely in respect to the financial and economic crisis prevailing at the time, which was associated with significant number of legislative and non-legislative activities. These often politically-sensitive proposals of the EC evoked high expectations on the part of entities operating in the financial market as well as individual member states. In addition to that, negotiations took place under time pressure caused by ending electoral term of the EP and term of office of the EC, as well as the effort to react to the financial crisis as soon as possible.

Legislative acts

The financial services industry represented one of the important areas on the agenda of the Czech Presidency defined as Competitive and Open Europe. European initiatives in this area were aimed at creating open and secure internal market for retail consumers, further integration of certain nonretail financial services, and establishment of a proper regulatory framework. In this context, the Czech Republic strived, on European level, to finalize the discussion of those legislative acts, which were urgent in the Pan-European context, namely in respect of then topical financial and economic crisis.

The main objective of the first half of the Czech Presidency in the legislative area was to find an agreement between the Council and the EP in the following three priority areas: Regulation on Credit Rating Agencies (CRA), Directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II), and the revision of the Capital Requirements Directive (CRD).

Regulation on Credit Rating Agencies represented the most complex problem – with both European and global impact. Our objective as the Presidency country was to contribute to legal regulation, which would properly work in connection with the global nature of this industry. The Regulation mainly contains terms and conditions for the registration of rating agencies in the EU, rules for issuing ratings, prevention of conflicts of interest and higher transparency. It newly introduces rules for rating agencies outside of the EU, which issue ratings used by financial institutions in the EU. A breakthrough novelty is the supervision of rating agencies' activities within the EU – councils of supervision authorities will be created, which should facilitate better coordination. The regulation will contribute to higher quality and objectivity of ratings, which are used by investors for their decision-making.

Solvency II Directive represented an obvious challenge as well as a massive opportunity to set up international standards in the insurance sector regulation. The Czech Presidency succeeded in completing demanding and difficult negotiations, both in the Council of the European Union as well as in the EP, which had been conducted in respect of this Directive for the last 2 years. During the revision process, 13 Directives regulation life and non-life insurance and reinsurance included in a single legislative act. The Directive intensifies integration of the EU insurance and reinsurance market, improves the protection of policy holders and beneficiaries, and increases international competitiveness of EU insurers and reinsurers.

One of the top priorities of the Czech Presidency was the revision of the CRD Directives, which is a good example of a specific legislative reaction to the crisis. The amendment of the aforementioned Directive represents the first major contribution to a thorough revision of the banking regulation system aimed at removing its key deficiencies, which became apparent during the financial crisis. The main changes consist in the establishment of councils of supervision authorities for the cooperation in the course of supervision over transnational credit institution groups as well as institutions operating in another member state through their branches. It introduces stricter rules for large exposures (limits for receivables from one client), higher harmonization of hybrid capital instruments, and fundamentally revises the regulatory framework in the area of

[47] In 2008, the preparations for the Czech Presidency of the Council of the European Union were carried out, culminating in the Presidency during the first half of 2009. With respect to the importance of the topic, this document discusses the preparation phase as well as the actual course of the Presidency and the results it has achieved to date.

securitization. The achieved compromise in respect of this text may also be regarded as a major success of the Czech Presidency.

Another important legal regulation discussed during the Czech Presidency was an amendment to the Electronic Money Directive (EMD), which regulates issuing of electronic money and supervision over electronic money institutions. During negotiations on the EMD Directive, the Czech Presidency mainly strived to remove high regulatory barriers, which prevent development of the electronic money market in the European Union, and to set adequate terms and conditions for undertaking of electronic money institutions. By way of example, the Directive liberalizes prudential requirements imposed on electronic money institutions, specifies the electronic money definition as well as the specification of the Directive’s scope of application. It also enables introduction of the so-called hybrid electronic money institutions, which will issue electronic money as only one of several business activities. Overall, the Directive strives to bring the regulatory and supervisory framework of electronic money institutions closer to the supervision of payment institutions, whose products are very similar to electronic money.

New regulation on cross-border euro payments guarantees that the costs of cross-border payments (transfers, ATM withdrawals, and electronic payments) are the same for consumers as in case of a corresponding euro payment carried out within their own member state. The amendment represents an important step in the execution of the project Single Euro Payments Area (SEPA) within the EU, reinforcing consumer rights protection and supporting development of modern and effective payment system in the EU. The amendment also expands the scope of application to direct debits, which were officially launched under the SEPA project on 2 November 2009.

In January of 2010, a proposal was presented to the EC for an introduction of a Community program for the support of specific activities in the area of financial services, accounting reporting and audits, the objective of which is to support EU policies in the given areas. The main objective of this decision is to ensure better functioning of the internal market by improving effectiveness of the process of creating and applying Community rules. With regard to preserving independence of institutions in the area of accounting and auditing standards and ensuring adequate funds for their activities, a mechanism has been introduced for their co-financing from the EU budget.

Non-legislative initiatives

In the non-legislative area, the main focus at the beginning of the Czech Presidency was on following measures adopted during the year 2008 in respect of the recovery of proper functioning of the financial systems and confidence of economic entities. A pressing task of the Czech Presidency was the execution of other measures aimed at reinforcing transparency and stability of financial markets. During the first meeting of the ECOFIN Council, which took place under the Czech Presidency, it succeeded in adoption of conclusions in respect of banking capital. The Council thereby confirmed that the funds, which banks received in connection with the recapitalization activity of member states’ governments, should not be interpreted as an increasing requirement for the banking capital adequacy, because the main objective of the measures is the support of loans to companies and households. Ministers also addressed the issue of accounting standards relating to financial instruments in order to support application of similar rules in the USA and in Europe.

The entire EU worked actively on adopting coordinated reaction to the financial crisis. As part of the strategy for ensuring financial stability, which was agreed in October of 2008, common approach to impaired assets was discussed on EU level. Due to its complexity, this issue required close cooperation of the EC and ECB in order to find an optimum approach for assessing impaired assets and authorization of institutions to take part in rescue schemes. In all above mentioned cases, the Czech Presidency tried to facilitate and accelerate ongoing debates in order to achieve maximum consistency for the stabilization of the economic and financial situation and in order to prevent any negative side effects. The ECOFIN Council agreed on the common principles for impaired assets treatment in February of 2009.

The main priority of the second half of the Czech Presidency within the financial services sector was the reform of the financial market supervision structure. The first discussion, on the level of ministers of finance and central bank governors of all 27 member states, took place in early April, during informal meetings of the ECOFIN Council in Prague. During the meeting, the ministers and governors agreed on the key principles of the EU financial market supervision reform, namely on the necessity to reinforce supervision over the macro-financial stability on the EU level. For this reason, they supported the creation of a new authority – the European Systemic Risk Board (ESRB). As regards the reform of supervision over individual financial market institutions, the ministers and governors confirmed the necessity to harmonize the European supervision framework. During its June meeting, the European Council confirmed the direction that the EC took in the preparation of other legislative proposals. It concerns the harmonization of rules, standards, and sanction powers between member states, as well as the reinforcement and transformation of the Level 3 Lamfalussy Committee (CEBS, CESR, and CEIOPS)[48] into new agencies with legal identity, and the establishment of the European System of Financial Supervisors (ESFS), whose task would be to harmonize the European supervisory framework as well as the consistent application of rules in EU member states.

International coordination

The Czech Presidency attempted to find a common position of all member states of the EU for negotiations within G20 – for all negotiation levels. The meetings of the ECOFIN Council dated 10 March 2009 as well as of the European Council dated 19 March 2009, which approved the European mandate for the London summit of G20 countries, were crucial for the negotiation of a common position of the EU.

8.1.1. European and other international institutions

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

The Financial Services Committee (FSC) and the Economic and Financial Committee (EFC) belong among the expert committees of the ECOFIN Council. FSC is a forum for preliminary discussion of issues relating to financial services on an expert level and, together with EFC, it takes part in the preparation of individual meetings of the ECOFIN Council. Activities of FSC are carried out by representatives of the member states' ministries of finance, EU, EC, ECB, and Level 2 and Level 3 Lamfalussy Committees.

The EFC has been established on the basis of Article 134 of the Treaty on the functioning of the EU. It mainly handles advisory and preparatory tasks set by this Article of the Treaty or delegated directly by the Council. The subject matter of the EFC' activity is to mainly monitor economic and financial situation of individual member states and the EU, present reports to the ECOFIN Council and the EC, and contribute to the preparation of activities of the Council within the economic and financial sector. The Committee comprises representatives of the member states' ministries of finance, EU, EC, ECB, as well as national central banks. MoF regularly attends meetings of both Committees and is actively involved. When preparing standpoints and communications for the meetings of both Committees, MoF cooperates with CNB.

The year 2009 was characteristic by the financial crisis, and the Committees reacted to this through the selection of discussed topics. Their activities comprised assessment of the market situation and measures adopted by individual member states in connection with the financial crisis, including any implementation already completed. They addressed recommendations included in the report prepared by the group led by J. de Larosière, which related to the European supervision framework reform, problems relating to impaired assets in the banks' balance sheets, cross-border financial stability, crisis management, restriction of pro-cyclical effects of the financial system, derivatives markets, completed load tests of banks, exit strategies in respect of supporting measures, SEPA project, proposal for a new accounting standard for financial instrument, uncooperative jurisdictions, preparation for the meetings of ministers and governors of G20 countries.

In 2010, one of the key discussed topics has been the cross-border management of financial sector crises, namely in connection with an establishment of a European framework for managing crises in transnational banking groups. Existing developments have shown that the EU lacks effective and uniform critical management for financial situation, which operate/are part of groups operating in several member states.

ECOFIN Council

The priorities of the ECOFIN Council for the year 2009 mainly were the financial crisis and the supervisory framework reform in the EU.

[48] For more information on Level 3 Lamfalussy Committees – see section 8.1.2. European and other international institutions.

In 2009, the ECOFIN Council:

- In the area of banks' capital supported requests to modify international regulations of capital and accounting rule with the aim of limiting excessive pro-cyclical consequences, and requested progress be made towards reaching this goal (20 January 2009);
- Supported initiative relating to the Single Euro Payments Area (SEPA) and urged the payment sector to accelerate necessary preparations for successful initiation of this regime (10 February 2009);
- Confirmed political agreement between the Council and the EP within the first reading of the codetermination process in respect of the following legislative acts: Solvency II Directive, Regulation of Credit Rating Agencies, EMD Directive, and Regulation of cross-border payments in the EU (5 May 2009);
- Confirmed political agreement between the Council and the EP concerning the revision of Capital Requirements Directives and the Community program for the support of specific activities in the area of financial services, accounting reporting and audits;
- Approved conclusions on the European supervision framework reform over financial services, in which it agreed with an establishment of an independent authority for prudential oversight on the macro-level (ESRB), comprising all financial sectors, with the fact that recommendations of the Larosière group be executed and completed immediately in respect of the establishment of a European System of Financial Supervisors (ESFS) (9 June 2009);
- Supported introduction of a prospective depreciations, which would contribute to the limitation of pro-cyclical developments, including models for dynamic depreciations, and agreed on the fact it is still necessary to strive attempt the mitigation of pro-cyclical developments by creating pro-cyclical capital cushions (6 July 2009);
- Urged IASB to amend the international accounting standard IAS 39, quickly and in time to allow preparation of financial statements for the year 2009 (6 July 2009);
- Agreed that it is necessary to prepare a coordinated exit strategy from extensive stimulation policies and that considerable fiscal consolidation is necessary, which would suspend and potentially reverse growing indebtedness and recover health fiscal positions. The Council agreed on principles, on which such exit strategies are to be based (20 October 2009);
- Reached agreement on the general approach concerning proposals for an establishment of ESRB, which would ensure supervision over the financial system as part of the EU supervision framework reform for banking markets, insurance markets, and securities markets (20 October 2009);
- Agreed that it is necessary to reinforce the regulatory framework for crises prevention, management and resolution, and develop a comprehensive Community framework for closer coordination of policies in the area of financial stability (20 October 2009);
- Adopted the Solvency II Directive, which sets down new rules for solvency of insurance undertakings with the aim of increasing the integration, competitivenes of EU insurance industry and improve protection of policy holders and beneficiaries (10 November 2009);
- Agreed on general approach of tightening up capital requirements and remuneration policies in the banking sector (CRD III) (10 November 2009);
- Agreed on general approach in respect of proposals for regulations which are to establish three new European Supervisory Authorities (ESAs);
- Welcomed the communication of the EC on the EU framework for the management of cross-border banking sector crises, which relates to 3 main areas: timely intervention, measures for resolving banks' problems, and insolvency proceedings, and urged the EC to present a report with specific political proposals concerning further progress in this area by spring of 2010. At the same time, it entrusted EFC to continue in the work on the EU framework for the coordination of policies on crises management, including the issue of shared costs, and to present the Council with specific proposals by spring of 2010 (2 December 2009);
- Supported the execution of the SEPA project and urged the EC to perform assessment of the potential need for legal regulations specifying deadlines for an establishment of SEPA and, if needed, to prepare appropriate legislative proposal (2 December 2009);
- In the area of derivatives markets agreed with the need to significantly mitigate counterpart credit risk and with improving transparency, effectiveness, and integrity of derivative transactions (2 December 2009).

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

In 2009, two informal meetings of ministers of finances and governors of central banks took place. The first meeting took place in Prague during the Czech Presidency (April 2009). The ministers and governors agreed on the main principles of the EU financial market supervision reform, namely on the need to reinforce oversight of macroeconomic stability and harmonize the European supervision framework. The second meeting took place in Gothenburg during the Swedish Presidency (October 2009), and it also addressed the issues concerning the financial market supervision and measures aimed at reinforcing financial stability (crisis management).

At the beginning of 2010, the ECOFIN Council mainly concentrated on the situation relating to the public finance deficit and public debt in Greece. During its March meetings, it dealt with the exit strategies from government involvement, welcomed the EFC report on the given problem area, and acknowledged specific improvements, which were registered in respect of the financial markets functioning. The Council also urged EFC to support coordinated termination of supporting measures of member states and to examine how it would be possible to prevent adverse impacts in consideration of specific conditions of member states.

During its meeting in May of 2010, the ECOFIN Council approved general approach to the proposal for an Alternative Investment Fund Managers Directive (AIFMD) and accepted conclusions to the crisis management and exit strategy within the financial sector.

ECOFIN Council's Working Party on Financial Services (WP D3)

One of the priority agendas, the discussion of which started in the Working Party D3 in the fall of 2009, is the **reform of the supervision organization over the EU financial market**. The reform reacts to the recent crisis in the financial markets as well as the deficiencies it uncovered. It concerns a package of 5 legislative proposals, which should lead to an establishment of a two-pillar structure. The first pillar is the European Systemic Risks Board (ESRB), which will monitor and assess risks endangering financial stability in the EU and, if if needed, issue warnings and recommendations. The second pillar will be formed by the European System of Financial Supervisors (ESFS), which would include national supervision authorities and 3 new authorities established by the transformation of existing supervision committees (the so-called Level 3 Lamfalussy Committees)[49] in the sector of banking, insurance, and capital market. These authorities will perform existing tasks of their predecessors, but they will also gain new powers (e.g. preparation of binding technical standards, binding resolution of disputes between national supervision authorities, reinforced role for resolving critical situation).

The supervision reform also includes a proposal for the so-called Omnibus I Directive. It relates to certain changes, which would have to be made within the sector legislation in order to consider an establishment of new authorities and their powers. Negotiations on these proposals commenced in WP D3 in the fall of 2009; general approach was approved during the COREPER II meeting dated 15 April 2010.

The European Parliament plans to vote on the above mentioned six proposals during its June plenary session. The new supervision framework should be operational at the beginning of 2011.

Banking

Several important changes took place in the area of banking in 2009. Under the revision of the CRD Directives[50], a legislative text was successfully negotiated during the Czech Presidency of the Council of the European Union under the command of MoF representatives; this legislative text was subsequently approved by the European Parliament and published in the Official Journal of the EU in November 2009 under the number 2009/111/EC. This revision, which has been denoted as CRD II, significantly reacts to the financial crisis – introduces stricture rules for large exposures (limits for receivables from one client), higher harmonization of hybrid capital instruments, and fundamentally revises the regulatory framework in the area of securitization. Significant changes also take place in the area of supervision, where the so-called councils of supervision authorities are established to ensure more effective cooperation (e.g. information sharing) among supervision authorities over consolidation units and among supervision authorities over members of such units. The amendment also embeds rules for coordinated procedure of supervision authorities, central banks, and ministries of finance for both standard and extraordinary situations.

[49] Committee of European Banking Supervisors (CEBS); Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS); Committee of European Securities Regulators (CESR).
[50] It is a collective denomination of Directives 2006/48/EC and 2006/49/EC.

The objective of another revision of the Capital Requirements Directive (the so-called CRD III), which was published by the EC in July of 2009, is the area of credit institutions' commercial portfolios, remuneration policy, and resecuritization. A working group with an active participation of MoF and CNB representatives discussed this proposal very quickly and the ECOFIN Council already approved general approach for the proposal in November of 2009. These changes are also justified by the need to react to financial crises. The proposal for a Directive amendment reflects principals relating to remuneration, which are included in the EC recommendations dated 30 April 2009 and on the remuneration in the area of financial services (2009/384/EC). Introduction of requirements for a remuneration policy in credit institutions – i.e. banks, credit unions, as well as IF – should create prerequisites for limiting the progressing of excessive risk through these institutions.

European Council

The European Council is the most important political body of the EU, comprising supreme 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 general political direction of the EU.

In the area of financial services, the European Council mainly addressed the reinforcement of financial regulation, including the financial market supervision, CRD Directives, issues concerning remuneration, and exit strategies from government involvement during its meetings in 2009.

Level 2 Committees of the Lamfalussy process

European Banking Committee (EBC)

EBC is the advisory committee to the EC, comprising high officials of member states and EC representatives. It closely cooperates with CEBS and performs two basic functions:

- Advisory function in the course of creation of proposals for EU legislative acts in the area of banking, and ensures proper implementation of European legislation in the national law of member states in the course of fulfilling tasks of the EC; and
- Regulatory (Comitology) function – i.e. it has the right to approve EC Directives in areas the relevant authority is entrusted to the EC.

The Committee met four times in 2009. Under its regulatory function, it discussed the proposal of the so-called Comitology Directive, which amends Directives 2006/48/EC, in respect of including the Slovenian SID bank among institutions, to which Article 2 of Directive 2006/48/EC applies (Article 2 includes a list of institutions, which are not subject to the requirements specified in the Directive). The Directive is expected to be published in the Official Journal of the EU at the beginning of 2010.

The main topics of the year 2009 discussed during the EBC meetings with active involvement of MoF representatives included the situation in the financial market in general. The Committee also addressed proposals of the EC for a revision of the Credit Requirements Directives (CRD II, III, and IV), i.e. mainly in respect of remuneration policies in credit institutions, regulation of capital and liquidity, etc. Other discussed topics included, for example, crisis management in the banking sector and deposit guarantee schemes. The discussion of these topics also continues in 2010.

European Insurance and Occupational Pensions Committee (EIOPC)

The advisory committee of the EC - EIOPC – deals with not only professional but also political issues associated with the insurance sector, including pension funds. It comprises government representatives of member states on the level of ministries as well as EC representatives. Representatives of CEIOPS and EEA countries take part in the Committee activities as observers. The mission of the Committee is to assess any issues relating to an application of EU regulations in the area of insurance and occupational pension insurance.

The Committee mainly focused on the Solvency II Directive. It was also active in the preparation of the implementing measures for the Solvency II Directive, with a special working group being established for their elaboration. Furthermore, the Committee deals with the revision of the Insurance Mediation Directive (IMD). Simultaneously, it monitors an initiative in the area of retail investment products. Last but not least, the

Committee discusses issues of the ongoing reform of the supervision framework and its impact on the insurance sector.

In the long-term, activities of EIOPC should touch upon the harmonization of implementation and regulation of guarantee schemes within the insurance sector and new approach to risk management and capital requirements in connection with the Directive on the activities and supervision of Institutions for Occupational Retirement Provision (IORP), this time within a wider area of topics introduced by the EC in respect of pensions.

European Securities Committee (ESC)

ESC is also an advisory and regulatory body of the EC. It discusses and votes on proposals of the EC in respect of regulation of the European investment instruments market. It provides consultations for political issues relating to the capital market and issues implementing regulations to framework legal regulation of this area. It comprises high officials of member states and representatives of the EC.

MoF attended all meetings of the Committee in 2009. ESC supported the EC proposal – amendment to the Prospectus Directive. In connection with the public consultation of the EC on potential modifications and supplementations of the Investor Compensation Schemes Directive (ICSD), the Market Abuse Directive (MAD), and the Transparency Directive, it also discussed issues associated with these areas. In 2009, ESC presented proposals to the EC for implementation measures to Directive 2009/65/EC (the so-called UCITS IV). During its meetings, ESC also touched upon the issues concerning regulation of retail investment products, status of a central counterpart and clearing institutions, register of regulated markets transactions, UNIDROIT Treaty on mediated possession of securities or the Securities Rights Directive. Joint meetings of ESC members and members of the Working Group IV for direct taxation took place as well.

OECD

Committee on Financial Markets under OECD (CMF under OECD)

CMF is the main body of OECD involved in the area of financial markets, which monitors and studies measures aimed at improving the functioning of national financial markets and international financial and foreign exchange market, and discusses conceptual and strategic issues. The Committee belongs to the international network of authorities, which perform supervision over the financial system development, attend to international cooperation and coordination and higher compatibility of the financial markets regulation. The Committee comprises representatives of ministries of finance and central banks of OECD member states. The specificity and exceptionality of CMF meetings is a meeting with representatives of international private financial sphere, during which important issues in the joint interest of the public and private sector are addressed.

MoF representatives attended all meetings of the Committee in 2009, which addressed general issues concerning the financial markets' situation and future direction. Specifically, the Committee mainly addressed measures adopted in connection with the ongoing financial and economic crisis as well as the possibility of their cancellation, namely in respect of excessive increases in deposit insurance. The private sector mainly called for the public sector support in the coordination of activities, higher transparency of the financial market, and better standards. The proper supervision over the financial market and balanced regulation were identified as the most important exit measures on the long-term basis. For a long time now, the Committee has been discussing effectiveness of the financial markets regulation, financial education and protection of consumers in the financial market.

Insurance and Private Pensions Committee (IPPC under OECD)

IPPC is the main OECD body dealing with the area of insurance market, supervision in the area of insurance, and issues concerning private pensions – i.e. private sector of pension insurance (the issues concerning private pensions within IPPC are addressed by the Working Party on Private Pensions, WPPP). IPPC seeks international cooperation, coordination, and higher compatibility of regulation of the aforementioned financial market sectors. The Committee comprises representatives of the ministries of finance and central banks of OECD member states.

Key agenda of the Committee includes discussing and adopting the report on impacts of the financial crisis on the insurance sector. Furthermore, the Committee discusses the so-called Guidelines on Insurance Governance, financial education, private health insurance, catastrophic risks or effectiveness and efficiency of regulation. A joint seminar took place on the WPPP level with IOPS (The International Organization of Pension Supervisors) and ICPM (International Centre for Pension Management) on the risk management of pension funds. Other tasks of this Working Party included DC schemes,[51] the investment strategies for such schemes, and pensions. Last but not least, negotiations continued on the accession of Russia, Slovenia, Israel, Chile, and Estonia.

G20

The G20 Group, which comprises ministers of finance and central bank governors of 19 countries[52] and the EU (currently represented by the presiding country and ECB), was established in 1999, to act as a forum for exchanging opinions and positions of the major global economies in respect of key issues of the global economy.

In 2009, Great Britain presided over the Group and leaders met twice during the year – in the spring (London) and in the fall (Pittsburgh).

During the April meeting, G20 leaders issued a Declaration on enforcement of financial system. In the Declaration, G20 leaders agreed on the following items:

- Establishment of the Financial Stability Board (FSB) as the successor to the Financial Stability Forum (FSF), which would; however, have larger powers. Members of FSB will be G20 countries, FSF members, Spain and the EC;
- Cooperation of FSB with the International Monetary Fund (IMF) which would allow early warnings in respect of macroeconomic and financial risks, and the preparation of procedures reacting to such risks;
- Preparation of a regulatory system, which would allow relevant authorities to identify and consider macro prudential risks;
- Expand supervision to all Systemically Important Financial Institutions (SIFIs), instruments, and markets;
- Approval and implementation of new FSF principles relating to remuneration schemes;
- Adoption of measures aimed at improving quality, quantity, and international consistency of capital in the banking system;
- Adoption of measures in connection with uncooperative jurisdictions, including the so-called tax haves;
- Urge accounting standards creator to quickly work with supervisory and regulatory authorities on improving such standards in order to achieve uniform set of high-quality accounting standards;
- Expand regulatory supervision and registration of rating agencies.

During the fall meeting, G20 leaders asked ministers of finance and central bank governors to agree on an international framework, which would relate to the financial system reform and include the following key points:

- Creation of high-quality capital and mitigation of pro-cyclical developments;
- Reform of practices in the area of remuneration in order to promote financial stability;
- Improvement in the situation on OTC derivative markets;
- Cross-border management of crises and SIFIs.

Other selected platforms of the European Commission

European Financial Conglomerates Committee (EFCC)

EFCC is a Level 2 committee mainly dealing with expert issues directly associated with conglomerates. It comprises representatives of member states' governments on the level of ministries as well as EC representatives. Representatives of Level 3 committees – most frequently CEIOPS or CEBS - take part in the Committee activities as observers.

[51] Defined contribution plan – pension plan, which defines the participant's contribution. The pension amount depends on the contribution amount and period, for which a participant makes such payments.

[52] Member states are: Argentina, 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.

The Committee deals with the possible revision of the Financial Conglomerates Directive (FICOD) so that it would at least cover the same instruments which are available within the banking or insurance sector. This promotes convergence of national supervision authorities and financial sectors. It simultaneously verifies the justification of certain requirements included in FICOD. A specialized working group has been established for this purpose – FICOWG.

As a result, EFCC should propose changes to the provisions concerning supervision in the CRD Directive relative to a financial holding group, and in the IGD Directive (Insurance Group Directive) relative to an insurance holding group, to also include cases when a hybrid financial holding company acts as a parent company. Furthermore, it concerns other changes in FICOD, such as quantitative determinants. Last but not least, it concerns a definition of “participation” or the definition of management companies or, as the case might be, their integration within the definition of financial conglomerates..

FICOWG meetings and changes in above mentioned directives were postponed for the time when the legal environment will be settled, i.e. when the the Solvency II project will be completed.

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 issued in May of 2007. Both specific legislative/non-legislative proposals of the EC and topics in the professional debate stage are presented during the Group meetings. MoF representatives attend all meetings of this Group.

The main topics discussed by GEGRFS in 2009 were issues relating to informing consumers, bank fees and the so-called switching (i.e. terms and conditions applicable in case of a change of bank, which administers client’s current account). These issues are monitored by the EC on long-term basis, in order to formulate a policy in the future, which should adequately address these problems associated with consumer protection and retail financial market development.

A discussion took place within the Expert Group on the current status of transposition of Directives concerning unfair business-to-consumer commercial practices in the internal market, difficulties relating to an implementation of this Directive in the EU member states, and on the need for its potential revision. During the GEGRFS meetings, EC presented its intents in the area of the so-called responsible borrowing in the financial market and associated operation of interconnected credit registers under the single market, and informed members of the Group about an upcoming revision of the IMD Directive. The revision of this Directive should take place on coordinated basis with the EC initiative in the area of the so-called packaged retail investment products (the so-called PRIPs) and the revision of the Markets in Financial Instruments Directive (MiFID). Proposed changes should mainly reflect the need for a complex reinforcement and integration of consumer protection within the financial market sectors, ensure higher volume of cross-border provision of financial services, and facilitate better enforcement of supervision. We can expect the initiative in the PRIPS area and the revision of the aforementioned sector Directives to be among the key prospective topics to be discussed by GEGRFS in 2010.

Government Expert Group on Mortgage Credit (GEGMC)

GEGMC is another expert group of the EC. Unlike the cross-sector oriented GEGRFS, GEGMC is highly specialized. The Group was established in 2005 as an advisory body assisting the EC in defining and developing policies in the area of mortgage credit. In addition to presentational meetings, this Group also acts as a network for acquiring information on the situation on national markets in surveys on specific topics.

In 2009, the subject matter of discussions related to expanding application of the consumer credit regulation on the level of individual member states (member states’ discretion) to mortgage loans as well.

Early Intervention Working Group (EIWG)

EC EIWG has mainly been analyzing experience with the past financial crisis in an attempt to define gaps and barriers of national systems preventing quick and effective intervention in case of a crisis within a cross-border financial institution. The main topics discussed during the Working Group meetings included problem areas associated with crisis management.

On 20 October 2009, the EC presented for public discussion the EC Communication – EU framework for managing cross-border crisis within the banking sector. The EC plans to issue a communication in respect to Bank Resolution Funds in June 2010, a communication on the European framework for crisis management in October 2010, and to present legislative proposals on crisis management in the spring of 2011.

The crisis management area was addressed during a substantial part of the ECOFIN Council meeting in April 2010; conclusions of the Council on this topic were adopted in May of 2010.

Deposit Guarantee Schemes Working Group (DGSWG)

The preparatory works of the EC aimed at the revision of guarantee scheme in the banking, insurance, and capital market sectors continued in 2009. At the beginning of the year, the EC organized public consultation to the revision of the Investor Compensation Schemes Directive (ICSD) and public consultation in the area of Deposit Guarantee Schemes (DGS), during which MoF commented individual alternative proposals of potential changes of the DGS and ICS organization. During the DGS Working Group meetings, which were attended by MoF representatives, potential changes were discussed in respect of the DGS system (mainly in the area of insurance coverage amount, shorter periods for indemnification payments, financing, geographic aspects, mutual cooperation level, and overlap with the crisis management area), including modifications of the ICS system and potential introduction of guarantee schemes in the area of insurance. The EC considers the harmonization and simplification principle to be the key basis. In 2010, the EC legislative proposal is expected to be published, with a following legislative process on the EU level leading to an adoption of the discussed changes.

Capital Requirement Directive Working Group (CRDWG)

During the first half of the year, the Working Group meetings dealt with securitization, business portfolio, national discretion, and dynamic depreciations. On 24 July 2009, the European Commission issued a consultation material for further possible changes of the CRD Directive, which mainly addressed dynamic depreciations and revisions in the treatment of exposures secured by commercial and residential real-estate.

During its meetings in the second half of the year, CRDWG discussed proposal of other possible legislative changes of the CRD Directive, which were to take place throughout 2010. The working title of the proposal is CRD IV. The proposals mainly comprise dynamic depreciations, additional capital cushions, systematically important financial institutions, and liquidity standards. The changes should also be reflected in the capital regulation in order to increase its quality. Working subgroups were established for various specific proposed changes in the CRD Directive, with involvement on the part of selected representatives of member states.

Payments Committee (PC)

PC is a standing advisory Committee for legislative issues in the area of payment services. At present, it mainly deals with the transformation to SEPA.

Derivatives and Market Infrastructures Working Group

This Working Group, which was established at the end of 2009, deals with the proposal of a future Directive on derivatives and market infrastructures for the settlement of derivative transactions. Six working parties are expected for the first half of 2010, with a subsequent publication of a draft EC Directive.

The objective is the reduction of a systemic risk, risk of counterparty default, and higher transparency of the entire process of derivatives trading. Furthermore, the legal certainty of investors should increase, together with an introduction of more comprehensive regulation in this area.

Securities Law Directive Working Group (SLDWG)

SLDWG deals, which was established at the end of 2009, deals with the finalization of draft Directive harmonizing the law on indirectly held securities. The EC proposal is based on the project of the so-called Legal Certainty Group (advisory group to the EC). Six working parties are expected for the first half of 2010, with a subsequent publication of a draft EC Directive.

The objective is to reduce transaction costs and ensure cheaper cross-border securities transactions. Furthermore, the legal certainty of investors should increase, together with an introduction of more comprehensive regulation in this area.

8.1. Financial market legislation

8.1.1. Community law

Activities in the field of formation of Community legislation continued in 2009. The EC commenced the preparation of certain legal regulations, which it believed would react to the past financial sector crisis. Certain other proposals prepared for other reasons were discussed as well. MoF, which represents the Czech Republic in the bodies of the Council and the EC in the process of formation of Community regulations in the area of financial markets regulation, actively participated in the negotiation of regulations, succeeding in adopting some regulations during the Czech Presidency already.

The Czech Republic significantly contributed to the finalization of works on the Solvency II Directive, which newly codifies insurance undertakings' activities in the EU. Several previous Presidencies had failed to negotiate this Directive. Elaboration process of very extensive proposals for implementing measures for this Directive started in the EC in 2009.

The following legal acts were adopted: Regulation on Credit Rating Agencies, amendment to Capital Requirements Directive (CRD II), new Electronic Money Directive (EMD), and new Regulation on cross-border payments within the Community. For detailed information on the aforementioned regulations, see chapter 8.1.1.

In 2009, the debate process started in connection with the Alternative Investment Fund Managers Directive (AIFMD). It later became apparent that the proposal brings about so much controversy that the originally planned quick adoption is unrealistic. However, it was becoming ever more apparent at the end of 2009 that with the exception of the Czech Republic and Great Britain, which raised important objections in respect of the proposal, the majority of member states actually support it.

On the EU level, negotiations started in 2009 in respect of an amendment to the Directive on securities prospectus, which is to contribute to an administrative simplification of the process. Furthermore, works commenced on the implementation measures (Level 2) for Solvency II Directive and UCITS IV Directive – they are expected to be approved in 2010.

In addition to that, other Capital Requirements Directives are being negotiated (CRD III, IV).

In April of 2009, the EC issued a Communication of other planned measures in the area of regulation of the so-called Packaged Retail Investments Products (PRIPs). In the Communication, which represents a summary of impact study conclusions, the EC leans towards the future regulation of selected investment products in the form of a Directive. This initiative reacts to the need for integration of the consumer protection levels in respect of products, which are currently subject to different degree of regulation, although they meet identical economic functions. According to the EC, the objective of the Directive is the formation of a uniform and adequate legal framework of rules for conduct with customers relating to the provision of information for retail financial services with an investment element. The EC should formulate first proposals for the new regulation by the end of 2010 (instead of the end of 2009, as originally planned). MoF has been supporting the entire EC initiative in the area of distribution of the so-called PRIPs for a long time, and lobbies for the idea of a maximum possible integration of regulation across individual financial market sectors. The EC initiative in the area of the so-called PRIPs was approved by the ECOFIN Council during the Czech Presidency, including supplementations on the basis of a presidency document prepared by the Czech side.

In connection with the recent crisis in the global financial markets, which also significantly affected real economy, stakeholders started to discuss how to prevent similar crisis in the future. This wide debate on the EU level even resulted in a conviction that the current supervisory arrangements for the financial markets in the EU are insufficient and must be regulated to reflect the reality of the single market more. First somewhat compact recommendations were prepared by the high-level working group led by J. de Larosièr (the so-called de Larosièr Group) in February of 2009. The EC then issued a Communication in May, in which it outlined possible future changes. The June meeting of the ECOFIN Council and the European Council set political boundaries of the reform. In another step, the EC presented a package of five legislative proposals for a reform of the financial market supervision in the EU. The objective of the proposals is to create two-pillar structure:

- European Systemic Risks Board (ESRB, the so-called macro-supervision), which will monitor and assess risks endangering the financial stability in the EU, issuing warnings and recommendations if needed.[53]
- European System of Financial Supervisors (ESFS, the so-called micro-supervision), which will consists of national supervision authorities and three new authorities formed via transformation of existing supervision committees (the so-called Level 3 Lamfalussy Committees)[54]. These authorities (Supervisory Authorities, ESAs)[55] will perform existing tasks of their predecessors, but they will also gain new powers (e.g. preparation of binding technical standards, binding resolution of disputes between national supervision authorities, reinforced role for resolving critical situation).[56]

In October of 2009, the EC published another legislative proposal (the so-called Omnibus I Directive) relating to the supervision reform. The proposal covers certain changes that must be made within the sector legislation to take into account the formation of new authorities and their powers (namely identification of areas for issuing technical standards and specification of areas for binding resolution of disputes).[57]

The Council agreed on the general approach to proposals on ESRB and formation of ESAs in October and December of 2009, respectively. The general approach to the Omnibus I Directive was agreed by member states during the COREPER II meeting on 15 April 2010. In 2010, a compromise will be negotiated by the EP, Council, and EC.

8.1.1. National legislation

MoF, which is the processing and submitting entity of legislative acts in the area of the financial markets regulation, continued to execute certain projects in the area of the national legislation and started to create new regulations.

In 2009, a new Act on Payments passed through the legislative process, taking effect on 1 November 2009. Adoption of the Act relates to the transposition of the Directive of the European Parliament and of the Council on the payment services on the internal market (PSD). The objective of this Directive is to harmonize the provision of payment services in the EU – both in the area of statutory regulation of these activities as well as in the area of civil relations, which arise in the course of the payment services provision. In addition to the transposition of the Payment Services Directive, the draft Act on Payments adopted the regulation on electronic money issuance and on payment systems with settlement finality from the existing Act on Payments.

In 2009, MoF (as the co-presenter) and MIT (as the principal presenter) commenced the preparation of new wording of the Act on Consumer Credit – as a transposition of the Directive of the European Parliament and of the Council on credit agreements for consumers. Inter-department reminder/comment proceeding took place during the summer of 2009, and the proposal was discussed by the Government Legislative Council at the end of the year. The approval process in the Parliament of the Czech Republic took place in the first half of 2010.

[53] Draft Regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board (COM(2009) 499; 13648/09); Draft Council Decision entrusting the European Central Bank with specific tasks concerning the functioning of the European Systemic Risk Board (COM(2009) 500; 13645/09).

[54] CEBS, CEIOPS, CESR.

[55] EBA, EIOPA, ESMA.

[56] Draft Regulation of the European Parliament and of the Council establishing a European Banking Authority (COM(2009) 501; 13652/09); Draft Regulation of the European Parliament and of the Council establishing a European Insurance and Occupational Pensions Authority (COM(2009) 502; 13653/09); Draft Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority (COM(2009) 503; 13654/09).

[57] Draft Directive of the European Parliament and of the Council amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Banking Authority, European Insurance and Occupational Pensions Authority, and European Securities and Markets Authority (COM(2009) 576; 15093/09).

The legislative process was also completed in the case of the new Act on Insurance (MoF already presented it to the Parliament of the Czech Republic in the summer 2008), which replaced the existing legal regulation and newly transposed the Reinsurance Directive. The Act takes effect on 1 January 2010.

Furthermore, the legislative process was also completed in case of the act transposing the Directive on reporting duties of issuers of listed securities as well as the act regulating certain aspects of the banking sector crisis (e.g. the so-called bridge bank concept).

In the spring of 2009, MoF presented an Act on pension savings. This extensive regulation, which is to govern the supplementary pension insurance sector to separate assets of companies and participants and which adopted modern regulatory elements from the financial market sector, was prepared at the turning of the years 2008 and 2009. However, the Parliament has not started discussing the act so far.

MoF also prepared an act transposing the Directive on Deposit Guarantee Schemes (DGS) and an act adapting the Regulation on Credit Rating Agencies. It is expected to be approved by the Parliament of the Czech Republic in the spring of 2010.

MoF started to prepare new act on financial security as well as an act transposing the Electronic Money Directive and Directive on settlement finality in payment and securities settlement systems. They should be presented to the government in mid-2010.

8.1. Consumer protection in the financial market

In 2009, MoF carried on with its activities in the field of the financial market development and especially the execution of a Framework policy in the area of consumer protection. The central topic became the harmonization of distribution and requirements for distributors' expertise. In connection with the public consultation process of 2008, MoF formed a Working Group on distribution in the financial market at the beginning of 2009. The objective of the Group is to assess potential and propose solutions for the future harmonization of the distribution regulation, namely in the following areas: (1) regulation concerning the formation of business licenses on the financial market and setting distributors' liability towards their clients; (2) registration of financial services distributors; (3) requirements for distributors' expertise; and (4) rules for conduct with customers. Following the first stage, debate of the Working Group members (representatives of MoF, CNB, professional associations, and consumer associations) was summarized in the form of specific recommendations that were submitted to MoF as the financial market regulator in September of 2009. The second stage was under way from October of 2009 to May 2010, and it was dedicated both to specification of primary recommendations, issues relating to rules of conduct, and the system for verifying expertise of persons dealing with clients. The efforts are expected to continue from the fall of 2010 as the third stage unveils.

The public consultation on the revision of the existing system of out-of-court resolution of consumer disputes on the financial market, which was under way in 2008, was followed by works on specific legislative solution. In addition to expanding powers of the Financial Arbitrator to the consumer credits sector, changes were proposed in respect of the financing of this office – directly from the state budget funds. The draft Act was presented to the government in the spring of 2010. Since 2008, MoF has been a member of the Platform for out-of-court resolution of consumer disputes. The Platform is an inter-department authority, which rules on basic issues of the out-of-court resolution of disputes project in the competence of MIT. MoF regularly attends meetings under this project.

Work of the Working Group for Financial Education continued in 2009. This Group comprises representatives of concerned ministries (MoF as well as MIT and MEYS), CNB, professional association active in the financial market, representatives of entities providing educational projects, consumer association, and educational experts. This Working Group meets approximately twice a year; members discuss their respective projects and experience and strive to find common procedure for increasing financial literacy in the Czech Republic. At the yearend, MoF commenced works on the update of the Financial Education Strategy, which was approved by the government in May of 2010 as a national strategy. Furthermore, MoF and CNB launched a joint project aimed at measuring financial literacy of adult population of the Czech Republic. The results of the project are expected back at the end of 2010.

MoF also actively presents its views on the issues of retail financial services and consumer protection on the international level, namely in exert working groups/parties of the EC and OECD. Under the Czech Presidency of the Council of the European Union, the Czech Republic accentuated the need for harmonization of distribution terms throughout the financial market, namely from the perspective of code of conduct with clients, provision of information, expertise of distributors, and commission schemes.

LIST OF ABBREVIATIONS

abs.	Absolutely
AIFMD	Alternative Investment Fund Managers Directive
ICMA	International Capital Market Association
APF CR	Association of Pension Funds of the Czech Republic
ARAD	Time series database - Czech National Bank
BPS	Basis Point
PSE	Prague Stock Exchange
CD	Central Securities Depository (Centrální depozitář cenných papírů, a.s.)
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of Securities Regulators
CMF	Committee on Financial Markets
COREPER	Committee of Permanent Representatives
CP	Securities
CPI	Consumer price index
CRA	Credit rating agencies
CRD	Capital Requirements Directive
CZK	International code for Czech crown
CNB	Czech National Bank
CR	Czech Republic
CZSO	Czech Statistical Office
VAT	Value added tax
DGS	Deposit Guarantee Schemes
EBA	European Banking Authority
EBC	European Banking Committee
PXE	Power Exchange Central Europe
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
EEA	European Economic Area
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EIOPC	European Insurance and Pensions Committee
EIWG	Early Intervention Working Group
EC	European Commission
EMD	Electronic Money Directive
EP	European Parliament
EC	European Community
ESAs	European Supervisory Authorities
ESC	European Securities Committee
ESFS	European System of Financial Supervisors
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
FICOWG	Financial Conglomerates Working Group
FSB	Financial Stability Board
FSC	Financial Services Committee
FSF	Financial Stability Forum
GEGMC	Government Expert Group on Mortgage Credit
GEGRFS	Government Expert Group on Retail Financial Services
GDP	Gross Domestic Product
ML	Mortgage loan

IASB	International Accounting Standards Board
IBRD	International Bank for Reconstruction and Development
ICPM	International Centre for Pension Management
ICSD	Investor Compensation Schemes Directive
IGD	Insurance Group Directive
IMD	Insurance Mediation Directive
IOPS	International Organization of Pension Supervisors
IORP	Directive on the activities and supervision of Institutions for Occupational Retirement Provisions
IPO	Initial public offering
IPPC	Insurance and Private Pensions Committee
MiFID	Markets in Financial Instruments Directive
MoF	Ministry of Finance of the Czech Republic
IMF	International Monetary Fund
MRD	Ministry for Regional Development of the Czech Republic
MIT	Ministry of Industry and Trade of the Czech Republic
MEYS	Ministry of Education, Youth and Sports
NPISH	Non-profit institutions serving households
DE	Deferred Expenses
IF	Investment Firm
OECD	Organization for Economic Co-operation and Development
OKEČ	Branch classification of economic activities
OPF	Open-ended pension fund
pp	Percentage point
PC	Payment Committee
PF	Pension funds
PL	Share
PRIPs	Packaged Retail Investment Products
IC	Insurance Contract
PSD	Payment Services Directive
RM-S	RM-Systém
APR	Annual percentage rate
SEPA	Single Euro Payments Area
SIFIs	Systemically Important Financial Institutions
SLDWG	Securities Law Directive Working Group
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 American dollar
VŠPS	Selective workforce inquiry (Výběrové šetření o pracovních silách)
WPPP	Working Party on Private Pensions
ACMU	Act on Capital market undertakings

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APPENDIX 1: FINANCIAL MARKET LEGISLATION

The following modifications were made in respect of the legislation of the Czech Republic/EU legislation in the financial market area in 2009:

1.1. Cross-sector regulations in the sphere of financial markets

1) ***European legislation and other initiatives published in 2009:***
   - **Draft Regulation on Community macro prudential oversight of the financial system** and establishing a European Systemic Risk Board (COM(2009) 499; 13648/09);
   - **Draft Council Decision entrusting the European Central Bank with specific tasks** concerning the functioning of the European Systemic Risk Board (COM(2009) 500; 13645/09);
   - **Draft Regulation establishing a European Banking Authority** (COM(2009) 501; 13652/09);
   - **Draft Regulation establishing a European Insurance and Occupational Pensions Authority** (COM(2009) 502; 13653/09);
   - **Draft Regulation establishing a European Securities and Markets Authority** (COM(2009) 503; 13654/09);
   - **Proposal for a Directive of the European Parliament and of the Council amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC** in respect of the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (COM(2009) 576; 15093/09)
2) ***Pending European legislation (including legislation published after 31 December 2009) and other initiatives of the European Commission:***
   - **Communication of the EC to the European Parliament and the Council – Structured retail investment products** COM(2009) 2004 dated 30 April 2009 (PRIPs). The objective of this initiative is to create a single and adequate legal framework of rules for dealings with customers and provision of information in respect of retail financial services with an investment element

3) ***Acts that took effect in 2009:***
   - **Act no. 295/2009 Coll.,** which amends Act no. 2/1969 Coll., on Establishment of ministries and other central administration authorities of the Czech Republic, as amended. The responsibility for primary legislation in the area of payments and electronic money shifted to MoF; introduction of shared responsibility of the Ministry of Finance and the Czech National Bank in the area of currency circulation. The Act came into effect on 19 September 2009.

4) ***Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2009):***
5) *Draft Act on consumer credit and on amendment to selected acts**; it is a transposition of the Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (foreseen effectiveness: January 2011)***

1.2. Legislation in the sphere of capital markets

1) ***European legislation and other initiatives published in 2009:***
   - Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 **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 (30.6.2009);
   - **Directive 2009/65/EC** of the European Parliament and of the Council of 13 July 2009 **on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (7.12.2009);**
   - **Regulation** of the European Parliament and of the Council (EC) **No 1060/2009** of 16 September 2009 **on credit rating agencies** (7.12.2009)
   - **Proposal for** a directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/65/EC (29.4.2009)

- **Proposal** for a directive of the European Parliament and of the Council amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (24.09.2009);
- **Proposal for a Commission Directive** implementing Directive 2009/65/EC of the European Parliament and of the Council on selected measures relating to fund mergers, master-feeder structures, and reporting procedures (foreseen effectiveness: no later than 30 June 2006);
- **Proposal for a Commission Directive** implementing Directive 2009/65/EC of the European Parliament and of the Council on organizational requirements, conflict of interest, conduct of commercial matters, risk management, and content of a contract between a custodian and an investment company (foreseen effectiveness: no later than 30 June 2006);
- **Proposal for a Commission Regulation** implementing Directive 2009/65/EC of the European Parliament and of the Council on the form and content of standard UCITS reports and certificates, utilization of electronic communication between relevant authorities for reporting purposes, and procedures for onsite inspections, investment and information sharing among relevant authorities (foreseen effectiveness: no later than 30 June 2006);
- **Proposal for a Commission Regulation** implementing Directive 2009/65/EC of the European Parliament and of the Council on key information to investors and on terms and conditions, which must be met for the provision of key information to investors or prospectus on other than permanent paper data carrier or via a website (foreseen effectiveness: no later than 30 June 2006);
- Call for evidence on review of **Directive 2003/6/EC of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)**
- **Guidelines of the Committee of European Securities Regulators** – Risk management principles for standard funds (27 February 2009);
- **Guidelines of the Committee of European Securities Regulators –** Third report on CESR guidelines and information about the uniform application of the Market Abuse Directive in relation to market participants (15 May 2009);
- **Joint recommendation of the European Central Bank and the Committee of European Securities Regulators** for securities transaction settlement systems and recommendations for central counterparts in the European Union (23 June 2009).

2) ***Pending European legislation (including legislation published after 31 December 2009) and other initiatives of the European Commission:***

Proposal of the Commission Decision exempting the Banque de France from the application of Regulation n° 1060/2009 of the European Parliament and of the Council on Credit Rating Agencies

3) ***Acts that took effect in 2009:***

- **Decree no. 234/2009 Coll., of** 21 July 2009 **on the Protection against Market Abuse and on Transparency**
- **Act no. 230/2009 Coll.,** of 17 June 2009 **amending Act no. 256/2004 Coll., on professional business on Capital Market,** as amended, and other associated acts (effective from 1 August 2009). Act implements the following ESC directives (or a part thereof): Directive **2004/109/EC** of the European Parliament and of the Council of 15 December 2004 (the so-called "Transparency Directive"), Directive **2006/46/EC** of the European Parliament and of the Council of 14 June 2006, which amends Council Directive 78/660/EEC on annual financial statements of certain companies (selected provisions), Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, Commission Directive **2007/16/EC** of 19 March 2007, amending Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), in respect of clarification of certain definitions (selected provisions), Directive **2007/44/EC** of the European Parliament and of the Council of 5 September 2007, which amends Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC, in respect of procedural rules and assessment criteria for prudential assessment of acquisitions and participations increases within the financial sector (effective since 1 August 2009);
- **Act no. 420/2009 Coll.**, of 5 November 2009 amending Act no. 513/1991 Coll., Commercial Code, and other associated acts (effective from 1.12.2009). This Act implementea Directive **2007/36/EC** of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies in the Czech legislation (proposal was legislated by the Ministry of Justice).

4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2009):

- Act amending the acts relating to adoption of the Regulation of the European Parliament and of the Council (EC) No 1060/2009 on credit rating agencies (effective since 7 June 2010);
- **Draft Act on financial collateral arrangements**, transposition of the Directive of the European Parliament and of the Council 2009/44/EC as concerns part amending Directive 2002/47/EC on financial collateral arrangements, regarding interoperable systems and credit claims, and re-transposition of the Directive 2002/47/EC on financial collateral arrangements, regarding interoperable systems and credit claims (effective to be as from 30 December 2010);
- **Draft Act, the acts in relating to adoption of the Act on financial collateral arrangements**; amendments reflect adoption of the Act of financial security (effective to be as from 30 December 2010).

5) Secondary legislation:

- **Decree no. 143/2009 Coll.**, on the expertise of natural persons whose services are placed at the disposal or under the control of the investment firm in order to perform its activities (effective since1 June 2009);
- **Decree no. 231/2009 Coll.**, on the details and means of keeping of client orders and decisions to deal book of investment firm and investment agent (effective since 1 April 2010);
- **Decree no. 232/2009 Coll.,** of 21 July 2009, amending Decree no. 605/2006 Coll., on the reporting obligations of investment firm (effective since 1 January 2010);
- **Decree no. 233/2009 Coll.,** on applications, approval of persons and the means of proving professional qualifications, good repute and experience of persons, and on the minimal amount of funds to be provided by a foreign bank to its branch (in respect of the registration in the list of sequestration administrators and liquidators) (effective from 1 August 2009);
- **Decree no. 234/2009 Coll.,** on the protection against market abuse and on transparency (effective since 1 August 2009);
- **Decree no. 235/2009 Coll.,** on eligible financial instruments for UCITS investments (effective since 1 August 2009).

1.3. Legislation in the sphere of banking, building savings schemes and credit unions

1) European legislation and other initiatives published in 2009:

- **Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009** amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management; the Directive was adopted in reaction to the financial markets crisis. The objective of the Directive is to reinforce financial stability, improve cooperation of supervision authorities, and promote integration of the internal banking services market. According to the Directive, transposition regulations of member countries should come into force and effect on 31 October 2010 and 31 December 2010, respectively;
- **Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector,** which sets down basic remuneration principles, which were further reflected in the proposal for a Directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC, in respect of capital requirements for commercial portfolio and securitization and in respect of remuneration policies supervision;
- **Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC** on deposit-guarantee schemes as regards the coverage level and the payout delay; the reason for adopting the Directive was an effort to restore and maintain the confidence of depositors in the banking system and to achieve higher stability in the financial markets. Among others, the Directive shortens deadlines for indemnification payments and sets down higher deposit insurance amount. The latest transposition deadline will expire on 31 December 2010.

2) Pending European legislation (including legislation published after 31 December 2009) and other initiatives of the European Commission:

- **Proposal of Directive 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** (COM(2009) 362 final). The EC published this proposal, which was also issued in reaction to the financial markets crisis, 13 July 2009. It mainly reinforces capital requirements for credit institutions' credit portfolio, regulates securitization and requirements for an introduction of remuneration policies in credit institutions;
- **Commission Directive 2010/16/EU of 9 March 2010 amending Directive 2006/48/EC of the European Parliament and of the Council as regards the exclusion of a certain institution from the scope of application.** The Directive includes the Slovenian bank SID among entities listed in Article 2 of Directive 2006/48/EC, which are not subject to the requirements of the aforementioned Directive.

3) ***Acts that took effect in 2009:***

- **Act no. 215/2009 Coll., amending** Act no. 513/1991 Coll., the Commercial Code, as amended, amending **Act no. 21/1992 Coll., on Banks, as amended by Act no. 126/2002 Coll.,** amending Act no. 357/1992 Coll., on Inheritance Tax, Gift Tax and Real Estate Transfer Tax, as amended, amending Act no. 125/2008 Coll., on Transformation of Companies and Co-operatives, and amending Act no. 40/1964 Coll., the Civil Code, as amended (effective from 20 July 2009)
- **Act no. 227/2009 Coll., amending selected acts in relation to the adoption of the Act on Central Registers** (amendment to the Act on Banks, Act on Building savings schemes and state contribution to building savings; effective from 24 July 2009);
- **Act no. 230/2009 Coll., amending the Act No 256/2004 Coll., on Business Activities on Capital Market, as amended, and other associated acts** (amendment to the Act on Banks and Act on Credit unions; effective from: 1 August 2009);
- **Act no. 281/2009 Coll., amending selected acts in relation to the adoption of the Rules of the Tax Procedure** (amendment to the Act on Banks, Act on Building savings schemes and state contribution to building savings, and Act on Savings and credit union; effective from 1 January 2011);
- **Act no. 285/2009 Coll., amending selected acts in relation to the adoption of the Act on Payment Transactions** (amendment to the Act on Banks, Act on Savings and credit union, and Act on CNB; effective from 1 November 2009);
- **Act no. 289/2009 Coll., amending Act on Banks** (the Act introduces new instruments in case of threats to stability of either individual banks or the banking/financial system as a whole; effective from 4 September 2009).

4) ***Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2009):***

- **Draft Act, which amends certain acts in connection with the specification of capital requirements and supervision of procedures in respect of bank, credit unions, and securities traders** (it is a transposition of Directive 2009/111/EC and proposal for a Directive of the European Parliament and of the Council, which amends Directives 2006/48/EC and 2006/49/EC, in respect of capital requirements for commercial portfolio and resecuritization and in respect of remuneration policies supervision. The transposition deadline will expire on 31 December 2010 or 1 January 2011, and the Act should come into effect on the day it is promulgated with the exception of several provisions, the effectiveness of which has been proposed for 31 December 2011);
- **Draft Act, which amends Act no. 87/1995 Coll., on Credit unions and certain related measures and on the amendment of Czech National Council Act no. 586/1992 Coll., on Income taxes, as amended, and other related acts** (regulation of a possible transformation of credit unions to banks)**;**
- **Draft Act, which amends Act no. 21/1992 Coll., on Banks**, as amended, and other related acts (Act no. 156/2010 Coll. – it is a **transposition of Directive 2009/14/EC** and adaptation of Regulation no. 924/2009).

5) ***Secondary legislation:***

- **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 (effective from 1 august 2009);
- **Provision of the Czech National Bank no. 2 of 30 November 2009 on reporting by banks and foreign bank branches to the Czech National Bank** (effective from 1 January 2010).

1.4. Legislation in the sphere of payments

6) European legislation and other initiatives published in 2009:

- **Directive 2009/44/EC** of the European Parliament and of the Council of 6 May 2009 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. The deadline for the transposition in the Czech law will expire on 30 December 2010; implementation regulations are to come into effect by 30 June 2011.
- **Directive 2009/110/EC** of the European Parliament 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. The new legal regulation of the terms and conditions relating to the electronic money institutions undertaking. The transposition deadline will expire on 30 April 2011.
- **Regulation (EC) No. 924/2009** of the European Parliament and of the Council on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001. Expansion of the principle of equal fees for domestic and cross-border payment transactions to direct debit forms of payments, introduction of an obligatory reachability of accounts for direct debit transactions.

3) Acts that took effect in 2009:

- **Act no. 284/2009 Coll., on Payments.** The Act was adopted in connection with the transposition of Directive 2007/64/ES of the European Parliament and of the Council on payment services in the internal market. The objective of the Directive is to harmonize the provision of payment services within the European Union, both in the area of statutory regulation of this activity as well as in the area of civil relations, which arise in the course of the payment services provision. In addition to the transposition of the Payment services Directive, the draft Act on Payments adopted the regulation on electric money issuance and on payment system with settlement finality from the existing Act on Payments. The Act annulled the existing Act no. 124/2002 Coll., on Payments, as amended, and its implementing legal regulations. The Act came into effect on 1 November 2009;
- **Act no. 285/2009 Coll., amending selected acts in relation to the adoption of the Act on Payments.** The Act amends more than 20 Acts, reflecting in them necessary changes in connection with an adoption of the Act on Payments (e.g. Act on Credit unions, Act on Financial Arbitrator, Foreign exchange Act, and the Commercial Code).

4) Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2009):

- **Draft Act on the circulation of notes and coins.** In 2009, the government received a draft Act on the circulation of notes and coins, which is to regulate the circulation and protection of legal tenders – both the common European currency and Czech crowns. The Act adopts certain provisions of Decree no. 37/1994 Coll., thereby annulling the Decree. These provisions are being slightly liberalized, in order to provide more space for an agreement of concerned parties. The draft Act newly introduces mandatory registration of legal entities that carry out cash processing for other entities. The foreseen effectiveness date of the Act is 1 January 2011.
- **Draft Act, which amends Act no. 21/1992 Coll., on Banks**, as amended, and other related acts (Act no. 156/2010 Coll. – transposition of Directive 2009/14/EC **and adaptation of Regulation no. 924/2009)** Among others, the Act adapts important regulation, which governs cross-border euro payments. The Act has been submitted to the government and it is expected to be adopted in the spring of 2010.
- **Draft Act, which amends Act no. 284/2009 Coll., on the Payments, and certain other acts.** Preparatory works started at the end of 2009 with regard to an amendment to the Act on Payments and certain other acts, the objective of which was to transpose the Electronic Money Directive as well as the Directive on settlement finality in payment and securities settlement systems. The foreseen date the draft Act would be submitted to the government is 30 June 2010.

5) Secondary legislation:

- **Decree no. 374/2009 Coll.**, on the Pursuit of business of payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers. The Decree was issued in connection to the new Act on Payments. It took effect on 4 November 2009;
- **Decree no. 375/2009 Coll.**, on reporting by payment institutions, small-scale payment service providers and electronic money institutions to the Czech National Bank. The Decree was issued in connection to the new Act on Payments. It took effect on 4 November 2009;

- **Decree no. 32/2010 Coll.**, on payment systems with settlement finality. The Decree was issued in connection to the new Act on Payments. It took effect on 3 February 2010.

1.5. Legislation in the sphere of insurance and supplementary pension insurance

6) ***European legislation and other initiatives published in 2009:***
   - Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

7) ***Pending European legislation (including legislation published after 31 December 2009) and other initiatives of the European Commission:***
   - Preparation of implementing measures for Directive 2009/138/ES (Solvency II);
   - Revision of Directive 2002/92/ES of the European Parliament and of the Council on insurance mediation.

4) ***Pending Acts (including acts already adopted that have taken effect or will take effect after 31 December 2009):***
   - **Act on Pension savings**; it has been prepared and presented to the Parliament. The Act transforms the existing supplementary pension insurance system – it namely separates assets of administrators from assets of participants;
   - **Act no. 277/2009 Coll., on Insurance** (effective from 1 January 2010) It is a new act which, among others, transposes the Reinsurance Directive;
   - **Act no. 278/2009 Coll., on changes to Acts in connection with approval of the Act on Insurance** (effective from 1 January 2010)

5) ***Secondary legislation:***
   - **Decree no. 433/2009 Coll.**, on the presentation, form and required content of financial statements of insurance and reinsurance undertakings (effective from 1 January 2010)

Decree no. 434/2009 Coll., implementing Certain Provisions of the Act on Insurance (effective from 1 January 2010).

APPENDIX 2: SUPPLEMENTARY TABLES

Table 8.1: Average interest rate

As at 31 Dec (%)		2005	2006	2007	2008	2009
Deposits	households and small entrepreneurs	1.24	1.23	1.34	1.55	1.38
	non-financial businesses	0.99	0.97	1.17	1.80	0.87
Loans	to households and small entrepreneurs	7.53	7.46	8.06	6.81	7.00
	for consumption	14.36	14.26	14.99	13.40	13.91
	for real estate	5.57	5.51	6.11	5.05	5.22
	to non-financial enterprises	4.27	4.22	4.57	5.59	4.58

Source: CNB - ARAD

Table 8.2: Loans by type

As at 31 Dec (CZK bn)	2007	2008	2009	Year-on-year change	
				Abs.	(%)
Overdrafts and debit balances of current accounts	155.2	161.1	148.3	-12.8	-7.94
Consumer loans (excl. overdrafts and debit balances of current accounts)	129.0	161.8	177.8	16.0	9.86
Housing loans excl. mortgages	192.1	236.1	161.0	-75.1	-31.80
Mortgage loans for residential properties	420.4	479.0	634.7	155.7	32.50
Mortgage loans for non-residential properties	21.7	50.0	79.0	29.0	58.00
Other loans	365.7	414.8	369.0	-45.8	-11.04
Investment loans	448.4	522.3	492.0	-30.3	-5.80
Bridge loans	2.9	5.2	4.3	-0.9	-18.05
Trade receivables	48.7	45.4	36.1	-9.4	-20.60
Total	1,784.0 *€ 67.0*	2,075.7 *€ 77.1*	2,102.1 *€ 79.4*	26.4	1.27

Source: CNB - ARAD

Table 8.3: Basic indicators of building savings development in the Czech Republic

As at 31 Dec		2004	2005	2006	2007	2008	2009
New building savings contracts	**number**	314,650	430,233	516,385	579,730	705,463	575,292
	change (%)	-85.00	36.73	20.02	12.30	21.70	-18.45
Average target value for new building s. contracts with private individuals	**value (CZK th.)**	222.8	227.9	235.8	284.9	302.8	308.7
	change (%)	11.12	2.29	3.47	20.82	6.28	1.95
Building savings contracts in savings phase[58]	**number**	5,899,300	5,573,874	5,297,522	5,132,595	5,070,510	4,926,183
	change (%)	-6.37	-5.52	-4.96	-3.10	-1.21	-2.85
Awarded state contribution	**value (CZK bn)**	15.3 *€ 0.48*	16.1 *€ 0.54*	15.8 *€ 0.56*	15.0 *€ 0.54*	14.2 *€ 0.57*	13.3 *€ 0.50*
	change (%)	15.65	4.88	-1.95	-5.00	-5.05	-6.74
Average state contribution awarded per building savings contract for the relevant year	**value (CZK)**	3,256	3,242	3,173	3,090	2,927	n/a
	change (%)	3.07	-0.43	-2.10	-2.62	-5.28	n/a
Saved amount[57]	**value (CZK bn)**	287 *€ 9.4*	329 *€ 11.3*	360 *€ 13.1*	385 *€ 14.5*	401 *14.9*	415 *€ 15.7*
	change (%)	21.22	14.60	9.38	6.90	4.23	3.51
Loans total[57]	**number**	786,483	857,875	900,653	942,944	971,176	988,353
of which: building saving schemes	**number**	549,698	582,867	587,501	580,352	569,870	565,485
bridging[[59]	**number**	236,785	275,008	313,152	362,592	401,306	422,868
	change (%)	14.69	9.08	4.99	4.70	2.99	1.77
Loans total[57]	**value (CZK bn)**	84.2 *€ 2.8*	108.1 *€ 3.7*	135.5 *€ 4.9*	179.3 *€ 6.7*	227.4 *€ 8.4*	267.5 *€ 10.1*
of which: building saving schemes	**value (CZK bn)**	28.7	31.8	35.1	38.9	42.9	48.9
bridging[58]	**value (CZK bn)**	55.4	76.3	100.4	140.4	184.5	218.6
	change (%)	32.37	28.37	25.34	32.37	26.84	17.63
Loans total/saved amount	**ratio (%)**	29.32	32.85	37.64	46.60	56.70	64.44

Source: MoF

[58] Closing balance of the period.
[59] Loans under Section 5 (5) of Act no. 96/1993 Coll., on building savings schemes and state support for building savings schemes, as subsequently amended.

Table 8.4: Net assets in trusts domiciled abroad, by distributors

As at 31 Dec 2009	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
ČSOB investiční společnost	72.8	62.00	-3.98
Česká spořitelna	17.1	14.53	1.19
Conseq Investment Management	6.0	5.10	35.77
ING Investment Management (C.R.)	5.9	5.06	-53.89
Komerční banka	5.5	4.68	40.43
Raiffeisenbank	2.9	2.44	21.75
HSBC Bank	2.4	2.05	19.91
Pioneer Asset Management	1.6	1.32	-11.75
Citibank Europe	1.3	1.15	14.97
UniCredit Bank Czech Republic	1.1	0.94	82.36
Other	0.9	0.73	-33.65
Total	117.4 *€ 4.4*	100.00	-4.59

Source: AKAT

Table 8.5: Net assets of domestic trusts, by management companies

As at 31 Dec 2009	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
Investiční společnost České spořitelny	49.7	42.45	-0.19
Investiční kapitálová společnost KB	33.4	28.53	-7.39
ČP INVEST investiční společnost	8.8	7.49	55.48
Pioneer česká investiční společnost	8.6	7.32	-1.64
ČSOB investiční společnost	7.4	6.30	7.14
AXA investiční společnost	3.5	2.98	56.18
J&T ASSET MANAGEMENT, IS	1.5	1.28	10.91
REICO investiční společnost ČS	1.2	1.05	-26.11
PROSPERITA investiční společnost	1.1	0.97	14.86
AKRO investiční společnost	0.7	0.56	49.20
Other	1.9	1.64	-75.16
Total	117.2 *€ 4.4*	100.00	-3.28

Source: AKAT

Table 8.6: Allocation of assets of pension funds

As at 31 Dec (market prices, CZK bn)	2006	2007	2008	2009	Share in 2009 (%)
Bonds	110.2	119.4	144.8	171.6	79.55
Treasury bills	5.5	7.4	6.4	2.2	1.00
Shares	9.6	9.8	5.7	3.5	1.62
Unit certificates	4.8	7.6	6.2	6.9	3.21
Money and other assets	15.2	22.8	28.4	31.5	14.62
Total	145.4 *€ 5.0*	167.0 *€ 6.3*	191.5 *€ 7.1*	215.7 *€ 8.2*	100.00

Source: CNB

Table 8.7: Placement of technical reserves

As at 31 Dec (CZK bn)	2008			2009			Abs. Change			Year-on-year change (%)		
	LI	NLI	total	LI	NLI	total	LI	NLI	total	LI	NLI	total
Debt securities	162.1	55.0	217.1	171.7	64.3	236.0	9.6	9.2	18.9	5.93	16.79	8.69
Of which: bonds issued by the Czech state or its national bank	93.0	30.8	123.9	114.5	44.4	158.9	21.5	13.5	35.0	23.08	43.88	28.26
Listed bonds issued by the banks of member states	15.1	3.6	18.7	16.2	3.4	19.7	1.1	-0.1	0.9	7.26	-4.17	5.08
Listed shares issued by corporations	16.2	5.2	21.4	11.4	3.3	14.7	-4.8	-1.9	-6.7	-29.56	-36.58	-31.28
Treasury notes	0.2	3.2	3.4	2.1	3.2	5.3	1.9	0.0	1.8	856.08	-1.19	53.21
Listed municipal bonds	2.1	0.8	2.9	2.8	0.9	3.7	0.7	0.0	0.8	35.58	4.28	26.55
Mortgage bonds	13.0	7.8	20.7	11.6	7.0	18.5	-1.4	-0.8	-2.2	-10.94	-9.94	-10.57
Bonds issued by EIB, ECB, EBRD or IBRD	12.7	1.5	14.1	8.6	1.1	9.8	-4.0	-0.3	-4.4	-31.88	-22.74	-30.94
Foreign securities traded on any regulated market of OECD member states (debt)	9.9	2.1	12.0	4.5	1.0	5.5	-5.3	-1.1	-6.4	-54.03	-53.55	-53.94
Equities	32.3	6.1	38.4	31.3	5.2	36.6	-1.0	-0.9	-1.9	-2.97	-14.57	-4.82
Of which: listed shares	8.8	4.2	13.0	4.5	0.2	4.6	-4.3	-4.0	-8.4	-49.11	-96.34	-64.29
Securities by unit trusts complying with EC regulations	23.5	1.9	25.4	20.6	2.1	22.7	-2.9	0.2	-2.7	-12.46	9.66	-10.78
Loans, credits, and other receivables	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	99.17	-98.80	-84.83
Other receivables	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	-34.82	-	394.50
Bills	0.0	0.1	0.1	0.0	0.2	0.2	0.0	0.0	0.1	51.65	33.39	35.55
Real-estate	0.7	2.4	3.1	0.4	2.3	2.7	-0.3	-0.2	-0.4	-39.83	-6.18	-13.55
Deposits and certificates of deposits, depository bonds	11.2	8.6	19.7	9.4	6.8	16.2	-1.7	-1.8	-3.5	-15.63	-20.99	-17.95
Items and works of artistic/cultural value	0.0	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	-	0.10	0.10
Receivables from reinsurance companies	0.8	17.0	17.8	0.7	13.9	14.6	-0.1	-3.2	-3.3	-13.43	-18.60	-18.36
Derivatives	0.2	0.0	0.2	0.0	0.0	0.0	-0.3	0.0	-0.3	-108.77	-	-108.77
Other financial placements	0.0	x	0.0	9.9	x	9.9	9.8	-	9.8	-	-	-
Financial placements total	207.4 *€ 7.7*	89.4 *€ 3.3*	296.8 *€ 11.0*	223.5 *€ 8.4*	92.7 *€ 3.5*	316.2 *€ 11.9*	16.1	3.3	19.4	7.77	3.68	6.54

Source: CNB