Ministerstvo financí
ČESKÉ REPUBLIKY

REPORT ON FINANCIAL MARKET DEVELOPMENTS IN 2013

June 2014

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The data presented in this report were obtained from the specified sources between March and April 2014.

SUMMARY OF DEVELOPMENTS IN 2013

Macroeconomic situation and external development

Year-on-year, the Czech Republic's real GDP decreased by 0.9%. The positive trend in the development of the trade balance continued in 2013 and the trade balance surplus reached a record level (CZK 188 billion). The inflation rate fluctuated below the goal over the course of the entire year and an increase of 1.4% was reported for year overall. In October, the inflation rate was even below 1%. The CNB could no longer respond to the situation by decreasing interest rates and thus tried to influence inflation through the exchange rate. Specifically, in November, the CNB implemented foreign exchange interventions, with the intent of using them to prevent the strengthening of the Czech crown to a level where it would be less than 27 CZK/EUR until at least the start of 2015. By the end of 2013, the Czech crown had weakened by 9.1% in relation to the euro to a rate of 27.4 CZK/EU and by 4.4% in relation to the dollar to a rate of 19.9CZK/USD.

Funds available in the financial market

After another period of year-on-year growth (5.3%) the volume of funds available in the financial market attained a level of approximately CZK 4.4 trillion. In absolute terms, the greatest growth was recorded for the segment that holds the largest share in the financial market – deposits with credit institutions. The greatest relative growth was recorded by collective investment funds (14.7%) and in Pillar 3 of the pension system (14.4%).

The structure of household savings

As far as the structure of savings is concerned, 2013 didn´t see a number of important changes. The greatest outflow of resources can be seen in the case of term deposits (their share of total decreased by 1.7 pp), with the funds moving to non-term types of accounts. In addition, there was a decrease in the share of savings held in building savings schemes (1 pp) and in life insurance (0.2 pp). Conversely, there was an increase in the share of household savings held in supplementary pension insurance and supplementary pension savings (0.9 pp) and in mutual funds (by 0.8 pp).

Financial market entities

The institutional structure of the financial market has remained stable and there have been only slight changes in the individual sectors. In the credit union sector, the largest entity – Metropolitní spořitelní družstvo – lost its licence to operate as a credit union. The original pension funds were transformed into pension companies as one of the first steps of the pension reform. There was an increase in the number of financial product intermediaries and entities in the capital market, which provides evidence of the fact that it is recovering and becoming more attractive for investors.

Banking sector

The total volume of banking sector assets increased by 8.8% to CZK 5.2 trillion. The pre-tax profit reported by banks totalled CZK 73.6 billion, which reflects a year-on-year decrease of 4%. Historically, however, this is the second best result that has ever been achieved. The main reason for the year-on-year decrease was the lower level of interest income. The capital adequacy of the banking sector increased to a level of 17.2%.

Interest rates

The CNB kept its base rate (the two-week repo rate) at a level of 0.05% for all of 2013, which was reflected in the continuing decrease in the average interest rate for new loans and in the slightly lower interest paid on deposits. The APR for new consumer loans decreased by 0.9 pp to 15%, and, in the case of residential real estate, the APR went down by 0.2 pp to 3.5%.

Deposits and loans

The volume of bank deposits grew by 6.7% and attained a level of CZK 3.3 trillion at the end of the year. In comparison to 2012, the volume of bank loans grew at a more dynamic rate (6.5% as compared to 2.4%) and reached CZK 2.5 trillion by the end of 2013. The indicator reflecting the share of non-performing loans to total client loans decreased slightly from 6% to 5.9% over the course of the year. The ratio of client deposits to client loans has been stable over the long-term in the Czech Republic and was at a level of 146.4% at the end of 2013.

Mortgage market

The unpaid principal from mortgage loans provided to households increased by CZK 46.1 billion in 2013 to reach a level of CZK 746.6 billion. The tempo of the change did not significantly change and, as compared to 2012, increased by only 0.3 pp to 6.6%. Mortgage rates as reported by Hypoindex declined moderately by 0.11 pp to 3.06% at the end of the year.

Building savings banks

Approximately 450,000 new building savings contracts were signed in 2013. This type of product is used for savings purposes by 4.1 million individuals. However, in spite of the year-on-year increase in the number of new contracts (3.8%), for the first time ever there was a decrease in the overall saved amount, specifically by 1.4% to CZK 429.1 billion. The volume of new loans that were provided totalled CZK 41.3 billion, bringing the total volume of loans reported by building savings banks to CZK 261.4 billion (a decrease of 7.4%).

Credit unions

In 2013, the CNB revoked the operating licence of the largest credit union on the market – Metropolitní spořitelní družstvo. This action significantly affected the development of the individual indicators as reported at the end of the year. As a result, in 2013 the balance sheet total for this sector decreased by 19.4% to CZK 31 billion at the end of the year. The number of credit union members decreased by 1.5% to 53,595. The volume of unpaid loans reflected a year-on-year decrease of 24.9% to almost CZK 27 billion. There was however a significant increase in the share of non-performing loans – from 9.9% in 2012 to 21.9% in 2013.

Regulated markets

The main PX index recorded a decrease of 4.8% and ranged between 853 to 1,066 points. The declining trend in share trading activities continued in 2013, reflecting a year-on-year decrease of 30.3%.

Securities dealers and asset management

The trading volume in the securities dealer sector increased by 30% year-on-year to CZK 65.4 trillion. This significant increase in trading volume is due to the activities of non-bank securities dealers, which closed trading deals involving the assets they manage for clients at a level that was CZK 17.4 trillion higher than in 2012. As a result, the dominant position of bank securities dealers weakened and their share of trading deals within the entire sector was only 70.7% (a decrease of approximately by 25 pp). The volume of managed assets increased by 10.1% in 2013 to CZK 975.1 billion at the end of the year.

Investment funds

The volume of assets placed in collective investment funds increased by 14.7% year-on-year to CZK 269.8 billion. As compared to 2012, there was a greater growth in the value of the assets held in foreign funds (an increase of CZK 20.5 billion) than in domestic funds (an increase of CZK 14 billion). Mixed funds saw the greatest influx of new resources, followed by equity funds. The number of qualified investment funds continued to grow in 2013 and the volume of managed assets increased to CZK 68.8 billion.

Insurance companies

In spite of slight growth (1.9%), the insurance market may still be described as stagnating over the medium-term time frame. Total gross premiums written reached CZK 156.5 billion, which corresponds to the volume in 2010. In the non-life insurance segment gross premiums written increased by 4.2% to CZK 85 billion. Conversely, as far as non-life insurance is concerned, the value of premiums written decreased by 0.7% to CZK 71.6 billion.

Retirement savings

At the end of the first year of the new retirement savings system, the resources in retirement funds totalled CZK 346 million. Over the course of 2013, almost 82,000 individuals started to participate in the retirement savings scheme.

Supplementary pension insurance and supplementary pension savings

Starting in 2013, Pillar 3 of the pension system was expanded to include supplementary pension savings plans offered through participating funds. Supplementary pension insurance continues to be provided through the transformed funds, but no new participants are allowed to join. At the end of 2013, the resources in both types of funds totalled CZK 282 billion, reflecting an increase of 14.3%. The number of participants in Pillar 3 decreased by 172,000 to 4.96 million individuals. The new conditions for receiving the state contribution resulted in a significant increase in the average monthly contribution made by participants in the transformed fund, specifically by 22.2% to CZK 568. The share of contracts that include an employer contribution, which had been decreasing in the previous years, increased slightly in 2013 to 18.9%

The government sector

In the government sector, the financial results for 2013 report a deficit equal to 1.5% of GDP. This is a significant improvement (by 2.7 pp) in comparison to the previous year. Total government debt at the end of 2013 was equal to 46% of GDP.

Financial market legislation

As far as Czech legislation is concerned, the new regulations governing Pillars 2 and 3 of the pension system entered into force as well as new provisions for the activities of investment companies and investment funds. In addition, amendments were implemented to the various regulations governing the CNB, consumer loans, foreign exchange activities, and motor vehicle third-party liability. On the European level, the priority topics included legislative proposals associated with the establishment of the EU Banking Union; a framework for the recovery and resolution of credit institutions and investment firms; the new regulatory framework for the financial instrument market and central depositories; payment services; reducing the excessive reliance financial institutions have on external ratings systems; and contracts for housing loans.

1. MACROECONOMIC SITUATION AND EXTERNAL DEVELOPMENTS

1.1. Macroeconomic Situation

The GDP continued in its downward trend in 2013 and the performance of the Czech economy decreased year-on-year by 0.9%. Taking a closer look at the individual quarters, it however becomes apparent that the Czech Republic exited the recession during the second quarter of 2013, even though the year-on-year GDP growth was not recorded until the last quarter. The forecasts for GDP development indicate that the gradual recovery of the economy should continue in 2014.[1] As was the case in the previous year, in 2013 the growth performance of the Czech economy continued to be below that of its neighbours. However, taking into account the strong existing foundations (e.g. the problem-free status of the banking sector), it is obvious that this development was more related to the continuing lack of confidence in future development on the part of businesses and consumers.

Table 1.1: GDP growth rates[2]

Annual (in %)	2008	2009	2010	2011	2012	2013
Czech Republic	3.1	-4.5	2.5	1.8	-1.0	-0.9
EU-27	0.4	-4.5	2.0	1.6	-0.4	0.1
Eurozone	0.4	-4.5	1.9	1.6	-0.7	-0.4
USA	-0.3	-2.8	2.5	1.8	2.8	1.9

Source: Eurostat

The decrease in GDP that occurred in 2013 resulted primarily from the negative development of gross fixed capital formation, which decreased by 3.5%. However, the other GDP indicators recorded growth, as can be seen in Table 1.2[3] After a quite significant decrease in 2012 household consumption grew slightly by 0.1%. This was closely associated with the continuing weak level of consumer confidence, which did, however, slowly start to increase towards the end of the year. Government final consumption expenditure increased by 1.6%. In spite of the improving situation in the main partners' countries, the export of goods and services recorded only a slight growth of 0.2%. As a result of low domestic demand, imports increased by only 0.6% over the course of the year.

Based on a random labour force survey, i.e. according to the indicator used for international comparisons, unemployment remained stagnant at a level of 7.0% in 2013.[4] Viewed from this perspective, the development in the unemployment rate is significantly better than could be expected based on the other macroeconomic indicators. The development in the employment rate continued in 2013, primarily as a result of an increased number of part-time employment relationships. The level of economic activity with the 15 to 64 age group increased year-on-year by 1.3 pp and reached 72.9%.

Table 1.2: Macroeconomic indicators of the Czech economy

(in %)	2010	2011	2012	2013
GDP growth (in constant prices)	2.5	1.8	-1.0	-0.9
Final consumption expenditure:				
Household consumption (change, in constant prices)	0.9	0.5	-2.1	0.1
Government consumption (change, in constant prices)	0.2	-2.7	-1.9	1.6
Gross fixed capital formation (change, in constant prices)	1.0	0.4	-4.5	-3.5
Unemployment rate (MLSA, average for period)	7.3	6.7	7.0	7.0
Inflation (CPI, average for period)	1.5	1.9	3.3	1.4

Source: CSO, CNB, MLSA

[1] Based on the macroeconomic forecast published by the MoF in April 2014, it is predicted that the GDP will grow by 1.7%.
[2] Information published as of 1 April 2014.
[3] As of the date this report was prepared, the data for net exports had not yet been published.
[4] However, according to the methodology used by the Ministry of Labour and Social Affairs since 2012 (the share of unemployed individuals within the population aged 15 to 64) the unemployment rate increased by a significant 0.9 pp to 7.7%.

The average inflation rate as measured by the consumer price index (CPI) decreased in 2013 by 1.9 pp to 1.4%. The increase in consumer prices was driven primarily by administrative factors, particularly the increase in indirect taxes. Taking into account the fact that the Czech economy was still in a negative output gap within the economic cycle, market influences played a weak role. From the perspective of the individual items contained in the consumer basket, the greatest increases were recorded for the prices of food and non-alcoholic beverages (4.8%).

As far as the development in prices is concerned, there was a decrease in the inflation rate in the Czech Republic, in the eurozone, and in the USA. Both in the Czech Republic as well as abroad, it fluctuated primarily below the inflation goals of the individual central banks. The ECB reacted to this development in prices in May by decreasing the key interest rate by 25 basis points to 0.5%. In October, however, the year-on-year inflation in the Czech Republic and in the eurozone decreased below 1% (this occurred in September in the USA). For this reason, in November the ECB decreased the key interest rate again, this time by 25 basis points, to 0.25%. In contrast, because the CNB had already exhausted the options for using the main monetary policy instrument, it could no longer respond to the situation by easing monetary conditions through the interest rate channel and thus the CNB chose to implement a stimulus in the form of easing monetary conditions through the foreign exchange channel. More information on the foreign exchange interventions and their impact on the Czech crown is provided in Chapter 1.2. As compared to the previous year, neither the American Fed nor the ECB implemented any other non-standard monetary policies.[5] The Fed affected even the global financial markets when it began contemplating the possibility of partially restricting some of its existing non-standard measures. This led to a decrease in the prices of some assets, particularly on emerging markets. At the end of the year, the Fed did actually announce a gradual decrease in the volume of purchased bonds, stating that it does not intend to raise interest rates in the foreseeable future. In contrast, at the start of 2013 the Bank of Japan approved a new 2% goal for price stability and, at the same time, announced that it intends to meet this goal by the end of 2014 with the help of a joint programme of this national bank and the Japanese government that is called "Quantitative and Qualitative Monetary Easing". During this period of time, the Bank of Japan intends to double its monetary base, primarily through increasing the volume of Japanese government bonds that are held.

Table 1.3: Comparison of the development of inflation and the key interest rate of central banks

2013	Inflation[6] (year-on-year in %)			Key interest rate of central bank (in %)		
	Czech Republic	Eurozone	USA	Czech Republic	Eurozone	USA
January	1.9	2.0	1.6	0.05	0.75	0.00 - 0.25
February	1.7	1.8	2.0	0.05	0.75	0.00 - 0.25
March	1.7	1.7	1.5	0.05	0.75	0.00 - 0.25
April	1.7	1.2	1.1	0.05	0.75	0.00 - 0.25
May	1.3	1.4	1.4	0.05	0.50	0.00 - 0.25
June	1.6	1.6	1.8	0.05	0.50	0.00 - 0.25
July	1.4	1.6	2.0	0.05	0.50	0.00 - 0.25
August	1.3	1.3	1.5	0.05	0.50	0.00 - 0.25
September	1.0	1.1	1.1	0.05	0.50	0.00 - 0.25
October	0.9	0.7	0.9	0.05	0.50	0.00 - 0.25
November	1.1	0.9	1.2	0.05	0.25	0.00 - 0.25
December	1.4	0.8	1.5	0.05	0.25	0.00 - 0.25

Source: CSO, CNB, Eurostat, ECB, Fed

As far as foreign trade is concerned, the ratio of the balance of payments current account deficit to GDP reached a level of 1.4% (a 0.1 pp increase as compared to the previous year). The development in the balance of payments current account has traditionally been affected by a growing income deficit resulting primarily from the disbursement of dividends to foreign investors (the amount of which increased as compared to the

[5] The non-standard monetary policy instruments used by the individual central banks of developed economies include, amongst other things, the quantitative easing of monetary conditions through buying government securities or other assets; a reduction in collateral requirements in order to add liquidity and improve the structure of bank assets; the provision of central bank loans with longer maturities; and the implementation of foreign exchange interventions, which is the option that was chosen by the CNB.

[6] In the case of the Czech Republic and the US expressed as the year-on-year increase in the CPI, in the case of the Eurozone expressed as the year-on-year increase in HICP.

previous year). The significant year-on-year increase in the balance of the financial account was primarily caused by the growing volume of short-term deposits made by foreign banks and the increased interest of foreign investors in Czech government bonds and bank bonds. The income deficit specifically associated with direct investments was offset by a growing balance of payments surplus, which, as in the past, was positively affected by the export of machinery and means of transport. The positive trend in the development of the trade balance continued in 2013 and the trade balance surplus reached a historical high of CZK 188 billion, reflecting an improvement of almost CZK 40 billion as compared to the previous year. The ratio of the trade balance to nominal GDP reached 4.8% (which is 0.9 pp higher than in 2012). The main reason behind the positive development in the trade balance was the recovery of the global economy, primarily in Germany. In addition, the competitiveness of domestic exporters was supported by the weakening Czech crown. This effect should continue throughout all of 2014. The trade balance may thus achieve yet another historically high surplus in 2014; this however will also depend on the development in domestic consumption and the associated increase in imports. The currently ongoing development in foreign trade is significantly related to the weakening domestic currency – both the weakening that occurred during the recent financial crisis as well as the weakening resulting from the foreign exchange intervention.

Table 1.4: External financial relations

Annual (CZK bn)	2009	2010	2011	2012	2013
Payment balance - current account	-89.3	-146.6	-104.0	-51.3	-56.0
Current account balance to GDP (%, current prices)	-2.4	-3.9	-2.7	-1.3	-1.4
Trade balance	87.3	53.8	90.3	148.6	188.0
Trade balance to GDP (%, current prices)	2.3	1.4	2.4	3.9	4.8
Payment balance - capital account	51.2	32.5	14.7	51.9	74.8
Payment balance - financial account	143.2	174.3	59.4	74.3	187.9

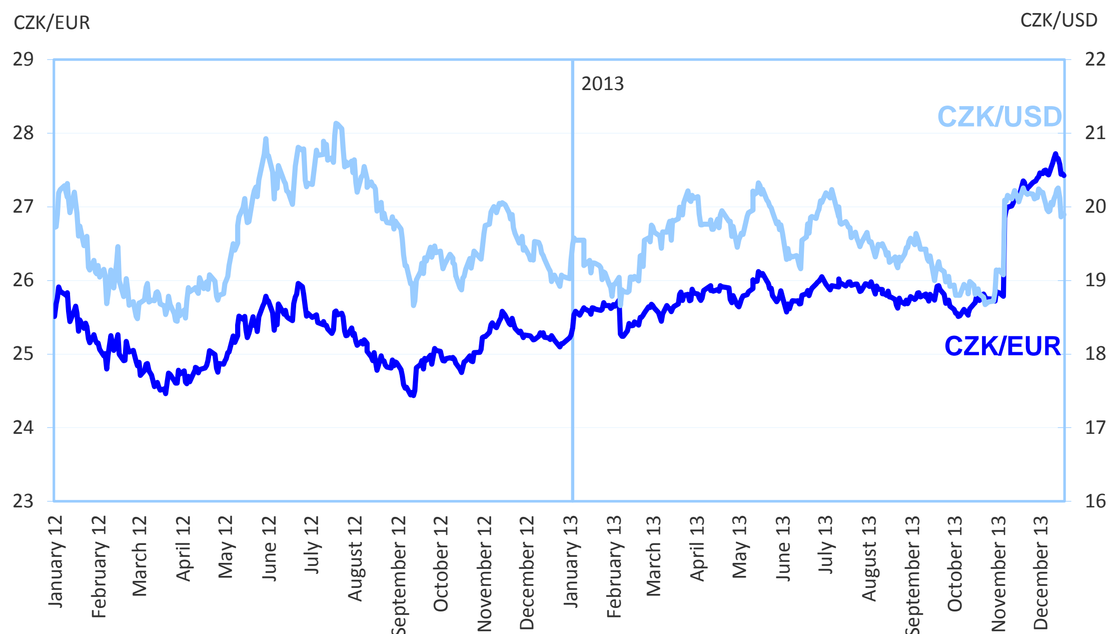
Source: CNB – ARAD

1.2. Foreign Exchange Market

The most important occurrence on the Czech foreign exchange market in 2013 was the foreign exchange intervention implemented by the CNB. The decision to weaken the Czech crown to a rate of 27 CZK/EUR was approved by the CNB Bank Board at its November meeting with the aim of influencing the inflation rate, which, according to the inflation forecasts, was significantly below the targets defined by the central bank. This is the first time that the CNB has approved a foreign exchange intervention since 2002. As a result of this measure, at the end of the year the Czech crown had weakened relative to the euro by 5% and the situation relative to the USD was similar. According to the individual representatives of the CNB, the national bank will try to prevent any significant strengthening of the exchange rate to a level below 27 CZK/EUR until at least the start of 2015.

Until the time the exchange rate intervention was implemented, the Czech crown did not significantly fluctuate in relation to the world’s two major currencies. During the first two quarters of the year, the Czech crown remained at a level between 19 and 20 CZK/USD. The Czech crown was at its strongest in relation to the dollar in February, when it attained a level of 18.7CZK/USD; it was at its weakest in May, when it fluctuated at a level of approximately 20.3 CZK/USD. The dollar did not pass this boundary even at the end of the year, when the Czech crown was intentionally weakened by the CNB's exchange rate intervention. The reason for this was the relatively significant strengthening of the Czech crown in relation to the dollar in the third quarter, i.e. in the period preceding the exchange rate intervention. The development in the CZK/EUR currency pair was unusually stable during the first three quarters of the year. The Czech crown was at its strongest in relation to the euro at the start of the year, when the exchange rate was 25.2 CZK/EUR; it was the weakest at the end of the year, when, due to the CNB’s exchange rate interventions it attained a level of 27.7 CZK/EUR. The sizeable impact of the CNB’s exchange rate interventions can also be seen in the year-on-year changes in exchange rates. Whilst at the end of 2013 the Czech crown reflected a year-on-year weakening of 9.1% in relation to the euro to a level of 27.4 CZK/EUR, the recorded weakening at the end of October was only 2.6%. The situation was comparable in relation to the dollar, when, by the end of the year, the crown had weakened by 4.4% to 19.9 CZK/USD but, at the end of October, the crown had in fact strengthened in relation to the dollar by 2.3%.

Graph 1.1: CZK exchange rates relative to major currencies



Source: CNB

The CNB measure as described above was also reflected in the development of the exchange rate of the Czech crown in relation to other currencies in the Central European Region (HUF and PLN). Table 1.5 illustrates the year-on-year changes in the exchange rates for the Czech crown in relation to the world's major currencies and the regional currencies as of the end of the year. Year-on-year the Czech crown weakened in relation to the Hungarian forint by 7.4% to 9.2 CZK/100 HUF; in relation to the Polish zloty, the weakening was 7.0% to a rate of 6.6 CZK/PLN. At the end of October, i.e. prior to the implementation of the exchange rate interventions, the Czech crown had weakened in relation to the zloty by only 1.6% and had actually strengthened by 1.1% in relation to the forint.

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

Exchange rate as at the end of	2009	2010	2011	2012	2013	Year-on-year change (%)
CZK/EUR	26.5	25.1	25.8	25.1	27.4	9.1
CZK/USD	18.4	18.8	19.9	19.1	19.9	4.4
CZK/100 HUF	9.8	9.0	8.2	8.6	9.2	7.4
CZK/PLN	6.5	6.3	5.8	6.2	6.6	7.0

Source: CNB, CSO

As a result of the fact that the central bank started to implement exchange rate interventions in November, there is a significant difference in the year-on-year change in the average CZK exchange rates in relation to the other currencies and the currency pair exchange rates at the end of the year. The development in the average CZK exchange rate relative to the USD is interesting, as it illustrates the general tendency of the crown to strengthen in relation to the dollar during 2013 in spite of the exchange rate interventions.

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

Average exchange rate	2009	2010	2011	2012	2013	Year-on-year change (%)
CZK/EUR	26.4	25.3	24.6	25.1	26.0	3.3
CZK/USD	19.1	19.1	17.7	19.6	19.6	-0.1
CZK/100HUF	9.4	9.2	8.8	8.7	8.7	0.6
CZK/PLN	6.1	6.3	6.0	6.0	6.2	3.0

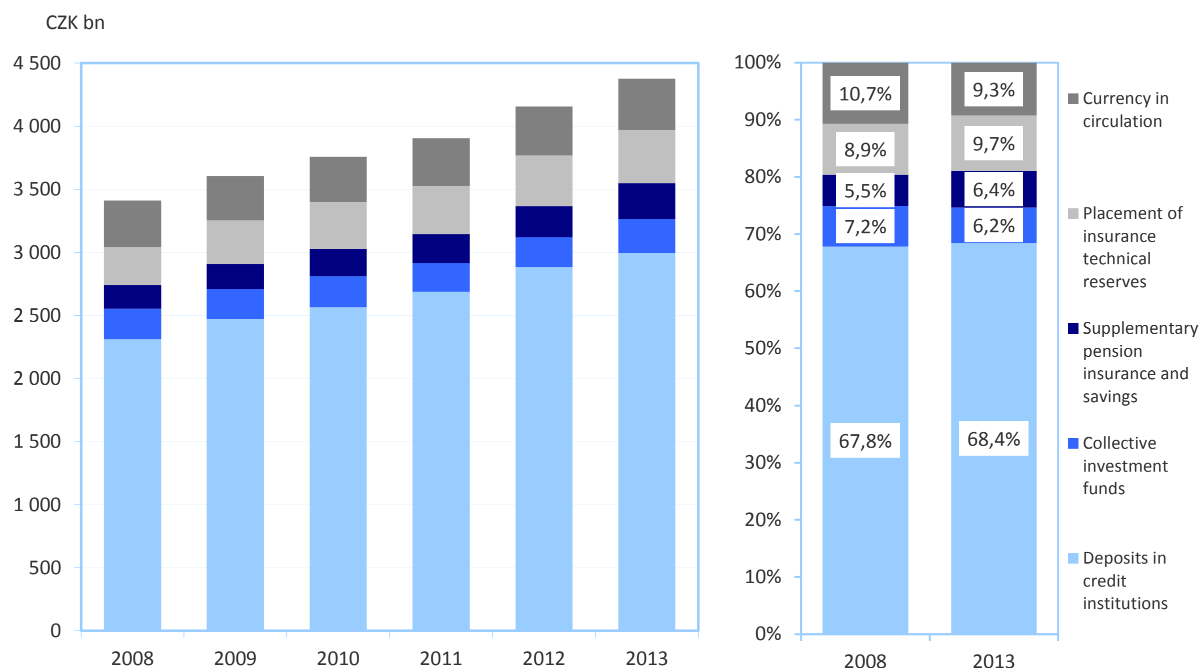
Source: CNB, CSO

Generally speaking, it is possible to say that specifically the activities of the central banks had the greatest impact on the movements in the foreign exchange market. This is also one of the reasons why it is very difficult to predict how exchange rates will develop in 2014. At the same time, the developments in the foreign exchange market were not influenced only by the easing of monetary policy on the part of the central banks, but also by indications that this policy will be tightened. Mere speculations that the USA might limit its quantitative easing of monetary policy led to the sharp weakening of the currencies in emerging markets, such as the Brazilian real, the Indonesian rupiah, and the Turkish lira. At the same time, there was an outflow of investments from these developing markets. Limiting the extent of non-standard measures may thus have some impact on the future development in the exchange rate of the crown in relation to the world's major currencies even after the exchange rate interventions are no longer in effect.

2. FUNDS AVAILABLE IN THE FINANCIAL MARKET

The volume of usable funds in the financial market[7] has been increasing over the long-term, however not as dynamically as in the past. Since 2008, the annual increases of over 10% that occurred between 2004 and 2007 have been replaced by growth at approximately one-half of that rate (4-6%). In absolute terms, in 2013 the total volume of funds in the financial market totalled approximately CZK 4.4 trillion.

Graph 2.1: Funds available in the financial market



Source: AKAT, CNB – ARAD, MoF
Note: The right side of the graph shows the differences in structure between 2008 and 2013

The highest absolute growth in 2013 was once again recorded in the most significant category – deposits in credit institutions. All of the other categories (with the exception of the building savings sub-category) also experienced growth, however only at about one-quarter of the volume. As opposed to the development in the previous year, there was a significant percentage change for two entries, specifically supplementary pension insurance and savings, and collective investment funds.

[7] This aggregate figure is one of the ways used to express the size of the financial market by focusing on the intermediary financial market. It includes the monetary resources of individuals and legal entities that are placed in the financial market through the financial products offered by credit institutions, insurance companies, pension companies (previously the pension funds), and collective investment instruments as well as cash. It does not include direct investments in securities.

Table 2.1: Funds available in the financial market

As at 31 Dec (in billions of CZK)	2008	2009	2010	2011	2012	2013	Year-on-year change	
							Abs.	(%)
Deposits in credit institutions[8]	2 311.3	2 473.2	2 563.3	2 689.6	2 882.9	2 995.3	112.4	3.9
of which: building savings schemes	401.3	415.2	430.1	433.4	435.0	429.1	-5.9	-1.4
Collective investments funds	243.9	234.5	247.5	224.1	235.3	269.8	34.6	14.7
Supplementary pension insurance and savings	186.7	200.6	216.1	232.1	246.6	282.0	35.4	14.4
Placement of insurance technical reserves	302.4	345.2	373.7	381.2	403.1	424.0	20.9	5.2
Currency in circulation	365.5	353.6	357.5	377.9	388.9	405.4	16.6	4.3
Total	3 409.8	3 607.0	3 758.1	3 904.9	4 156.8	4 376.6	219.8	5.3

Source: AKAT, CNB – ARAD, MoF

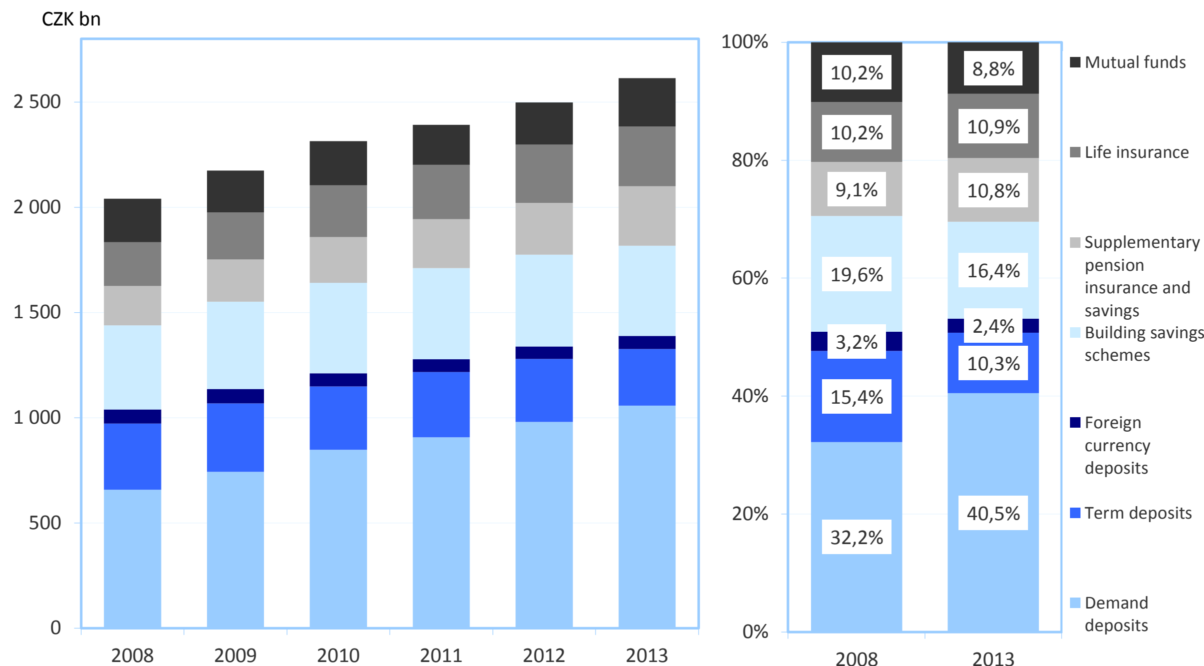
The tendencies identified for the 2008-2013 period are described below. As can be seen in the right-hand section of Graph 2.1, there was in an increase in the share held in supplementary pension savings and supplementary pension insurance schemes (from 5.5% to 6.4%). Conversely, there was a decrease in the amount of cash in circulation (from 10.7% to 9.3%). The share of funds available in the financial market in the categories of insurance technical reserves and deposits in credit institutions has been stable, ranging from 9-10% for the former and 68-69% in the case of the latter. A more significant change occurred only in the category of collective investment funds when, after four years of decline (from 7.2% to 5.7%), the trend reversed and the share of this category increased to 6.2% by the end of 2013.

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

3. STRUCTURE OF HOUSEHOLDS SAVINGS

The amount of household savings has continued to gradually increase over the past few years. The year 2013 was not an exception and the total volume increased to CZK 2.6 trillion, reflecting a year-on-year change of 4.6%.

Graph 3.1: Structure of household savings



Source: AKAT, CNB - ARAD, MoF
Note: The right side of the graph shows the differences in structure between 2008 and 2013

There were only a few insignificant changes in the structure of household savings over the course of the year (less than approximately 2 pp). The most significant change can be seen in the term deposits segment (-1.7 pp), as funds are being moved to non-term deposit products. As can be seen in Graph 3.1, this shift has been happening over the long-term, primarily due to the fact that interest rates are at a historical low and households now prefer savings accounts (included within the non-term deposit category) as opposed to the term deposit accounts that enjoyed popularity in the past. The second category that is losing in importance consists of the savings kept in building savings accounts. There was a year-on-year decrease of 1 pp in this segment and, looking at the 2008-2013 period, the total decline is equal to 3.2 pp, thus making it the largest relative long-term change in the structure of savings. The reason for this is the decreased attractiveness of build savings schemes, from the perspective of their use as savings product as well as with regard to their use as a loan product. (More detailed information is provided in Chapter 5.8). The share of foreign currency accounts is also decreasing. Nevertheless, in spite of these changes in the individual segments, households continue to keep most of their savings (70%) in credit institutions.

Outside of the banking sector, over the course of 2013 households increased the volume of savings in Pillar 3 of the pension system (supplementary pension insurance and supplementary pension savings) by almost 1 pp. Looking at the six-year time frame, it is possible to see a noticeable growth trend within this particular segment and its share has increased from 9.1% to 10.8%. This is due to the increase in the number of participants at the end of 2012 and the higher contributions they made in 2013 as a result of the changes in the conditions for Pillar 3 of the pension system. (More detailed information is provided in Chapter 8.)

The savings kept in mutual funds also increased year-on-year (by 0.8 pp). This represents a reversal in the downward trend, when interest decreased from 10.2% in 2008 to 8% in 2011 and 2012. This is most probably the result of the renewed confidence that small capital market investors have in relation to the valuation of assets.

The last segment, specifically life insurance, decreased only insignificantly by 0.2 pp, although the absolute volume of savings increased. However, this growth was smaller than in the case of other products. If we compare the years 2008 and 2013, then the share of household savings managed by insurance companies has increased by 0.7 pp.

A more detailed analysis of the individual sectors is provided in Chapters 5 to 8.

4. INSTITUTIONAL ASPECTS OF THE FINANCIAL MARKET

4.1. Financial Market Entities

During the monitored period, there were no significant institutional changes within the Czech financial market. One of the reasons is that the market structure is stabilised and there is fairly limited space for the entry of new entities, particularly in the main sectors. The changes that do occur usually take place in the form of mergers and acquisitions within the existing structures, as entering the market and building a credible position for a new institution in the financial market is a long-term process that is very costly and quite often the results are uncertain. A number of examples from the past show that the actual results of a new entity in practice do not always meet the original expectations and, after a period of time, the financial institution's owner decides to leave the Czech financial market.

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

As at 31 Dec	2010	2011	2012	2013
Credit institutions				
Banks	41	44	43	44
of which: foreign banks branches	19	21	20	21
of which: building savings banks	5	5	5	5
Credit unions	14	14	13	12
Capital market				
Securities dealers	37	35	35	36
Investment funds having legal personality	47	58	77	87
Investment companies	23	21	21	24
Mutual funds	145	152	155	182
Qualified investment funds	75	94	119	143
Collective investment funds	117	116	113	126
of which: standard	37	37	39	48
of which: special	80	79	74	78
Investment intermediaries	9 064	10 072	8 457	7 671
Tied agents	11 250	14 729	20 045	25 821
Pension funds / companies	10	9	9	10
Insurance				
Insurance companies	52	53	52	51
of which: branches of foreign insurance companies	17	18	18	18
Reinsurance companies	1	1	1	1
Insurance intermediaries	115 713	137 486	147 971	156 217

Source: CNB

There were only slight changes within the two key sectors of the financial market – banks and insurance companies – and the natural, sufficiently competitive nature of these sectors was not affected in significant way. Four of the largest financial groups, operating through three banks (ČSOB, ČS, and KB) and Česká pojišťovna (Generali PPF Holding) in the insurance sector, play a key role within the financial market structure. Their comprehensive activities, performed through numerous subsidiaries with extensive branch networks, provide even regional coverage for most of the areas of the financial market, thus strengthening the synergy within the portfolio of products they offer.

As far as the banking sector is concerned, the domestic market has been enhanced by the new Prague branch of the foreign MEINL BANK Aktiengesellschaft. In addition, the Western Union International Bank GmbH established a new branch through the conversion of an existing payment institution. On the other hand, the AXA Bank Europe, organisational unit, terminated its activities. Within the insurance sector, a merger was completed between Metlife and Amcico.

There was, however, one much more critical event in the credit union sector, when the CNB adopted a decision to revoke the licence that allowed the Metropolitní spořitelní družstvo (MSD) to operate as a credit union. This decision became legally enforceable on 18 December 2013. This decision was adopted due to the serious inadequacies in the credit union's business activities, which damaged the interests of the

institution's depositors and posed a significant risk to its security and stability. Specifically, the credit union seriously neglected its obligation to maintain a functioning management and control system. Credit risk was not effectively managed, or, more precisely, it was managed only at a formal level and the credit union was thus exposed to a high level of risk that a large volume of loans would remain unpaid. MSD was notified of these inadequacies earlier and the actual revocation of the permit was preceded by preliminary measures implemented by the CNB in May 2013, which prohibited the credit union from accepting deposits and providing loans. Although MSD was the largest credit union in the market, the revocation of its permit did not have any significant impact on the stability of the financial sector. In spite of the fact that the overall balance sheet total for credit unions has increased a multitude of times during recent years, these institutions comprise only a very small segment of the financial market. More information about the credit union sector is provided in the separate chapter 5.9.[9]

The most important structural changes took place in the supplementary pension insurance and savings sector. The original pension funds were transformed into pension companies, which manage the funds from Pillars 2 and 3 of the pensions system as well as the transformed funds in the case of those participants who decided to retain the conditions from the original contracts for supplementary pension insurance. There was also a change in the number of entities active in this particular market sector – the smallest pension fund, Generali, was taken over by the Česká pojišťovna Pension Company within the framework of the PPF Group[10]. As a result of these mergers, the largest pension company in the market strengthened its leading position even more. The Conseq Pension Company is a new entity operating in the market within the framework of Pillar 3 of the pension system. The consequences of the above-described changes in this particular sector are described in more detail in Chapter 8.

The number of entities active in the majority of the capital market sectors continues to increase, which provides evidence that the market is recovering and investor confidence is on the rise. The increase in the demand for capital market products, together with the more relaxed legislation for establishing new types of funds is also reflected in the number of entities who offer and act as intermediaries for these particular products and services.

The number of entities active in the field of financial intermediation continued to increase in the case of investment intermediation carried out by tied agents (the number of whom increased by 28.8% in 2013). There was, however, a decrease (9.3%) in the number of investment intermediaries. This opposite direction in the growth of the number of entities providing investment intermediation services is the result of legislative changes. According to the amended Act on Capital Market Undertakings, level 2 investment intermediaries have become tied agents for whom a separate register is maintained. Since the aforementioned amendment took effect, the number of tied agents has been continuously increasing at the expense of the number of investment intermediaries. There continue to be general issues in the field of financial intermediation between the individuals who actively perform their profession and those who either perform it on a random part-time basis or have already informally terminated their activities. This is most obvious in the insurance intermediary sector. At the end of 2013, the CNB had a record of 156,000 issued permits; however, estimates indicate that there are less than a 100,000 individuals who actively provide insurance intermediation services.

Within the context of the principle of free movement, the entities active in the Czech Republic's financial market supplement and expand the financial products offered by internally licensed entities on the basis of a "Single European Passport". As they do not have reporting obligations and are not even supervised by the CNB, it is only possible to guess at the exact scope of their activities. Their activities are not aimed at standard retail clients but rather they narrowly focus on the personal requirements of individual clients. Although the services they offer are limited, they contribute towards increasing competitiveness and, for this reason, they are considered to be an integral part of the financial market in the Czech Republic. The number of these entities who are authorised to operate in the Czech financial market is not negligible. During the past few years, the rate at which their number is increasing has started to slow down, and, in the case of funds, there is a definite downward trend.

[9] In April 2014, the WPB Capital Credit Union received the decision of the CNB to revoke its licence to operate as a credit union; however, this decision is not yet legally enforceable.

[10] An announcement was made at the start of 2014 that the customer base of the newly established Raiffeisen Pension Company was also being taken over by the Česká pojišťovna Pension Company.

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

As at 31 Dec	2009	2010	2011	2012	2013
Credit institutions	275	284	302	329	340
Insurance companies	621	658	696	730	743
Funds	1 449	1 347	1 239	1 173	1 165
Investment companies	47	48	46	45	47

Source: CNB

4.2. Guarantee Schemes

There are two guarantee schemes that are an integral part of the financial market in the Czech Republic. They serve to protect both savers/investors as well as financial institutions and subsequently also provide protection for the entire market against the negative consequences that are associated with the insolvency of any of the involved entities. Both guarantee systems are harmonised at the EU-wide level. Nevertheless, recently there have been signs of a discussion at the national level in the Czech Republic regarding the optimal settings for the system conditions, particularly concerning the prevention of moral hazard, as the current system conditions for the disbursement of compensation is not sufficiently effective.

The Deposit Insurance Fund (DIF) plays a preventive role with regard to credit institutions (it decreases the risk of panic withdrawals by the public should any problems arise) and provides a recovery function for depositors. If the CNB announces that a credit institution participating in the DIF is unable to meet its obligations, the DIF will pay out to all individuals and legal entities 100% of their deposit balance, including interest, up to a maximum of EUR 100,000. The disbursement of funds must start within twenty working days of the date the announcement is published. The annual contribution of banks and credit unions to the DIF is equal to 0.04% of the average volume of their insured deposits (including interest) for the relevant quarter. In the case of building savings banks, their contribution is one half of that specified above as the probability of their insolvency is lower.

In 2013 the DIF collected more than CZK 3.8 billion from a thirty-six financial institutions. As far as disbursements from the DIF are concerned, these were once again made to compensate the members of credit unions. Whilst in 2012 this involved an amount of CZK 1.8 billion (the compensation disbursed to the clients of the failed UNIBON), only CZK 32 million was paid out in 2013 (the last of the disbursements from the previous years and compensation associated with the failed PDW Credit Union). A critical moment in this sector arose during the second half of 2013, when the licence of the Metropolitní spořitelní družstvo was revoked. This led to the requirement to disburse compensation totalling CZK 12.4 billion to the credit union’s 13,000 members. The disbursements started being made in January 2014 through the branches of Česká spořitelna. The DIF’s available resources at the start of 2014 (CZK 28.6 billion) are sufficient to cover these disbursements, however, 43% will be used.

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

As with the DIF, the main source of STGF assets consists of the contributions made by the involved players, i.e. securities dealers and investment companies that manage client assets. As, unlike in the situation of the DIF, the covered client assets remain in the hands of the securities dealer only for a relatively short period of time but repeatedly (as compared to the bank deposits covered by the DIF), the amount of the annual contribution is calculated as 2% of the amount of fees and commissions for the investment services provided during the past year. In 2013 the STGF collected contributions of CZK 109 million from forty-two entities. The STGF disbursed CZK 1.5 million as compensation for client assets in 2013. At the end of 2013, although the Guarantee Fund’s available resources total CZK 590 million, its net financial position is negative, as it has an obligation to repay CZK 1.13 billion in financial assistance that it previously received from the state budget.

4.3. Financial Arbitrator

The Office of the Financial Arbitrator (FA) is a non-judicial authority established by the state (as of 1 January 2003 as a part of the harmonisation of the legal code of the Czech Republic with EU law). It has the competence to decide certain civil disputes regarding financial market issues. According to the Act on the Financial Arbitrator (Act No 229/2002 Coll.), if certain additional conditions are met and if a dispute falls within the jurisdiction of a Czech court (the existence of an Arbitration Agreement does not preclude the FA's authority), the Financial Arbitrator has the competence to decide in the following types of disputes:

- a dispute between a payment service provider and a payment service user regarding the provision of payment services (e.g. cases involving unauthorized payment transactions, incorrectly executed payment transactions, incorrectly settled fees, etc);
- a dispute between an electronic money issuer and an electronic money holder regarding the issuance and redemption of electronic money;
- as of 1 July 2011, a dispute between a creditor or intermediary and a consumer with regard to offering, providing, or brokering a consumer loan (e.g. cases involving fees for entering into a loan agreement, fees for the early repayment of a loan, the incorrect calculation of the APR, the validity of a loan agreement, etc);
- as of 1 July 2011, a dispute between an investment fund, domestic or foreign investment company, securities broker, or insurance intermediary and a consumer with regard to investments made in a standard fund or a special fund that accepts monetary resources from the public (e.g. a dispute between a client and an investment company regarding the accuracy of the billed fees);
- as of 1 November 2013, a dispute between an insurance company or insurance intermediary and a potential insurance client, insurance policyholder, insured individual, authorised individual, or beneficiary with regard to offering, providing, or intermediating life insurance; and
- as of 1 November 2013 a dispute between a foreign exchange operator and a potential client or actual foreign exchange client for whom a foreign exchange transaction has been performed.

The proceedings held before the FA are not subject to a fee. The proceedings are initiated on the basis of an application filed by the petitioner (i.e. the payment service user; the electronic money holder; the consumer from a consumer loan relationship; the client of a collective investment fund; the insurance policy holder, insured person, authorised person, or beneficiary of a life insurance policy; or the client of foreign exchange transaction). The legally binding ruling of the FA is enforceable through the courts in accordance with the Code of Civil Procedure. If the parties to the proceedings do not agree with the FA's ruling, it is possible to bring an action against the FA and obtain a court decision to replace the ruling.

Both the volume of disputes heard as well as the number of enquires received have increased. There were more than 700 proceedings initiated in 2013. This tripled the number of dispute proceedings in 2012. The number of processed enquiries doubled to almost 2,300. The vast majority of the enquiries and the dispute proceedings concerned consumer loans. Towards the end of the monitored period, on the basis of a civic initiative the FA accepted a collective batch consisting of 93,000 applications to initiate proceedings concerning loan management fees.[11]

4.4. Economic Results of Financial Institutions

The majority of the financial market sectors experienced a decline in profit generation in 2013 (refer to Table 4.3). In spite of a slight decrease in the profit within the dominant banking sector, the profit level may still be considered as fairly good, as it is historically the second best financial result following the extraordinary profit attained by banking institutions in 2012. The reasons for the decline include a lower interest rate margin and a reduction in net income from fees and commission. More detailed information is provided in Chapter 5.3. Financial leasing companies experienced the greatest drop in profits (46%). This may most likely be attributed to the reduced interest in the renewal of technical equipment and vehicle fleets in the corporate sector as a result of ongoing austerity measures.

[11] During the first half of 2014, the results of several key court disputes were made public, in which the courts sided with the bank and confirmed that the account management and loan management fees were justified.

Non-banking financial institutions are the only sector where there was an increase in profit generation. The primary reason is because of the savings attained for all of the main expense items.

Table 4.3: Profit/loss of financial institutions before tax

As at 31 Dec (CZK bn)	2009	2010	2011	2012	2013	Year-on-year change (%)
Banking financial institutions	71.3	65.9	63.4	76.7	73.6	-4.0
Non-banking financial institutions[12]	35.2	48.5	24.6	38.9	57.9	44.0
Financial leasing companies	3.4	4.9	8.6	7.4	4.2	-46.2
Pension funds/companies	2.8	4.6	4.6	4.9	4.4	-8.3
Insurance companies	23.1	28.4	12.0	15.9	13.9	-11.5

Source: CSO

The overall employment rate in the financial sector is stagnating. If we look at the development in the specific sectors (Table 4.4) it is possible to see some differences. In the key banking and insurance sectors, there was a slight decline in employment due to the ongoing austerity measures and also probably because of the as-of-yet unconfirmed economic recovery. The decreased interest of the commercial sector in obtaining leasing led to a decline in the number of employees in this particular sector.

Conversely, the increased demand for the services provided by non-banking financial institutions led to an increase in the employment rate within this sector. The situation is similar in the case of the pension funds and pension companies. This sector saw a relatively high increase in the number of employees (by almost 18%) as a result of the pension reform activities. It is, however, necessary to mention that this particular sector employs only a negligible number of people.

Taking into consideration the significant delay in the link between employment and economic growth, the fairly low flexibility of the labour market, and also the rapid development of substitute technologies that replace the human labour force, it is probably not realistic to expect any significant increase in the financial market employment rate in the Czech Republic.

Table 4.4: Average headcount of financial institutions[13]

As at 31 Dec	2009	2010	2011	2012	2013	Year-on-year change (%)
Banking financial institutions	38 263	38 189	39 124	39 804	39 396	-1.3
Non-banking financial institutions	14 174	14 311	13 855	14 119	14 863	4.3
Financial leasing companies	2 724	2 630	2 586	2 464	2 276	-7.4
Pension funds/companies	484	452	470	531	622	17.6
Insurance companies	14 498	14 359	14 260	14 459	14 213	-1.7
Total	70 143	69 941	70 295	71 377	71 370	-0.4

Source: CSO

[12] Includes primarily credit unions, money market funds, and collective investment funds.

[13] Average headcount (full-time equivalent), individuals.

5. CREDIT INSTITUTIONS AND OTHER PROVIDERS OF ASSET FINANCING

This chapter primarily focuses on credit institutions, specifically banks (the bulk of the chapter), including building savings banks (Chapter 5.8), and credit unions (Chapter 5.9). The issues associated with interest rates are also covered (Chapter 5.4) as well as the topic of deposits and loans (Chapter 5.5). The final chapter (Chapter 5.10) deals primarily with non-bank providers of financing. The sub-sector covered in the last section of this chapter offers products that are fairly close substitutes for bank loans and, if they are offered to retail clients, contribute towards the indicator of overall household indebtedness.

Given the importance of households as the key customer segment, a separate section (Chapter 5.6) addresses the development in household indebtedness and the relative level of this indebtedness in relation to both bank as well as non-bank credit providers.

5.1. Stability of the Banking Sector

The banking sector in the Czech Republic continued in its stable development in 2013. The long-term factors, which contributed to this sector's post-2008 stability following the global financial crisis and during a period when other countries were negatively affected by the problems in the eurozone, continued to have a positive impact. In particular, these include a high level of capital adequacy, a relatively low dependence on funds from the interbank market, a high share of retail loans secured by real estate lien rights, and only a small amount of foreign-currency denominated loans.

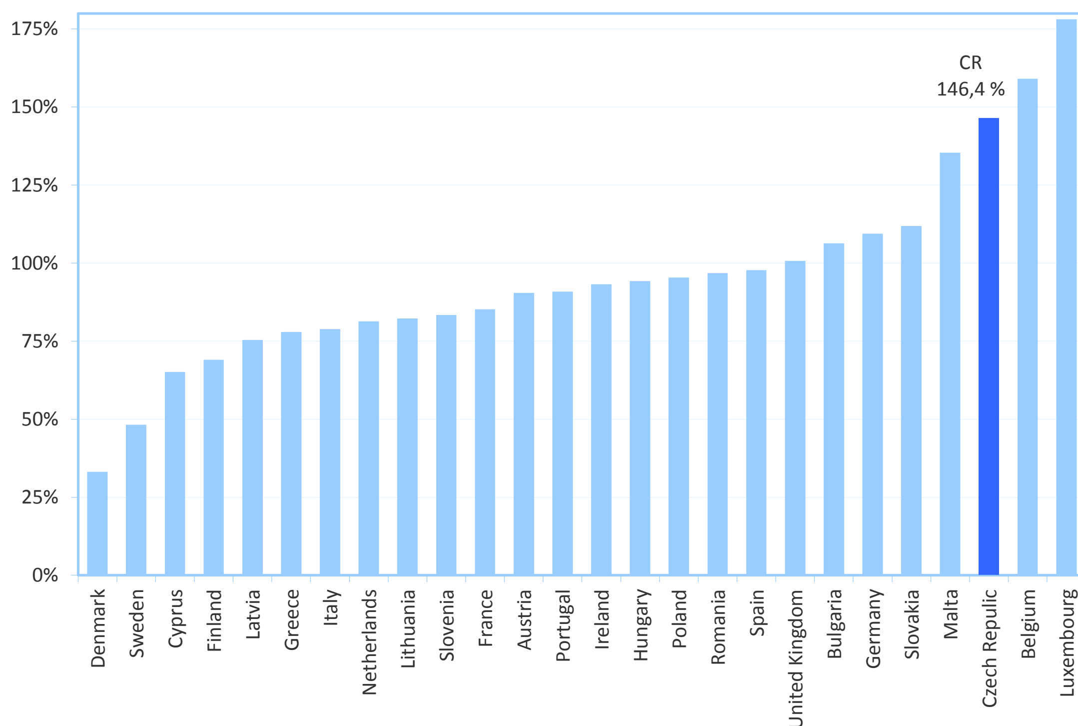
The capital adequacy of the banking sector in the Czech Republic as a whole continued to increase in 2013. It has long been significantly above the regulatory requirements and at the end of 2013 capital adequacy achieved a level of 17.2% (a year-on-year increase of 0.8 pp). The regulatory requirement is set at 8%. Although the banking sector reported a slight decline (0.3 pp) in capital adequacy in 2011, it is possible to notice quite rapid growth over the long-term. If we compare the value of this indicator in 2013 with the situation prior to the global financial crisis (at the end of 2007), we can see an increase of more than 5.5 pp, which reflects an almost 50% (relative) increase to the 11.6% capital adequacy reported at that time. As a result of this development, the banking sector in the Czech Republic has significantly increased the size of the capital cushion that can be used to cover any unexpected losses in the future.

The resilience of this sector to any possible negative shocks has also been repeatedly confirmed by the stress tests regularly performed by the CNB. According to the results published on 10 December 2013 (which used data from the end of the third quarter of 2013), even in the event of a situation that is more theoretical and less likely, specifically a high-stress scenario, the sector's capital adequacy would still remain above the regulatory minimum of 8%. This type of scenario expects a continuous decline in the economic activity in the Czech Republic and abroad during the three following years. According to the CNB, even if this negative development were to occur, the capital adequacy of the banking sector would remain at slightly below 14%. The total estimated recapitalisation requirements for all of the individual entities are CZK 10 billion (approximately 0.3% of GDP), which is an amount that the CNB believes will not pose a threat to the stability of the sector as a whole.

The sector's relatively lower dependence on funding from the interbank market also contributes towards the stability of its financing sources and overall liquidity. Banks in the Czech Republic have been obtaining the majority of their funding through client deposits for a long time. At the same time it generally applies that during periods of acute liquidity, disturbances have first appeared in the interbank market in which financial institutions lend to each other. In contrast, after the outbreak of a liquidity crisis and if the public continues to have confidence in the deposit guarantee system, client deposits are usually a more reliable and stable source of funding.

The monitored ratio of deposits to loans (refer to Chart 5.1) has remained fairly stable in the Czech Republic over the long term and, at the end of 2013, achieved a level of 146.4% (reflecting a year-on-year increase of 3.8 pp).[14] This ratio indicates that the loans provided to the clients of the banks in the Czech Republic are more than fully covered by the deposits received from clients. From this perspective, the Czech banking sector is one of the most resilient to risk in the entire European Union. Conversely, the least positive values for this indicator are reported by, for example, Denmark and Sweden, where, in the past, there was a rapid increase in the volume of loans without a corresponding increase in client deposits. Primarily the countries where the banking sector has either undergone some sort of crisis or shock in the recent past or is currently being restructured (e.g. Ireland, Spain, Slovenia, Latvia, and Romania) reported a year-on-year increase in the funding of loans through deposits.

Graph 5.1: Client bank deposits to loans ratio in 2013 in selected EU member states[15]



Source: ECB

In general, however, it is difficult to find a universal interpretation and explanation of the development in the deposits to loans indicator across countries. The value of this indicator is favourably affected by an increase in the volume of deposits as well as by a decrease in the volume of loans. However, the latter may be the result of uncertainty on the financial markets or within the real economy. In these cases, an increase in the value of the monitored indicator may in fact be an unfavourable sign. Another issue associated with the interpretation of this indicator is the need to set it within the context of the product structure of the relevant national financial market. If, for example, the majority of retirement savings in a country are managed within the non-bank sector, this could lead to a decrease in the volume of bank deposits. Although these funds could ultimately be included in the banks' balance sheets (and thus in the aforementioned indicator), they would only be partially reflected in, for example, the deposits made by retirement savings managers (e.g. pension funds and life insurance companies). In addition, from the perspective of the bank's stability, these sources cannot be equated with the more diversified retail deposits. This is because institutional deposits are associated with a lower number of subjects and may thus generally be more volatile.

[14] The international comparison uses the data published by the ECB specifying the volume of loans and deposits for monetary financial institutions (excluding the ESCB – European System of Central Banks) in relation to all clients, including central governments but excluding other monetary financial institutions. For this reason the figures for the Czech Republic differ from those published by the CNB in its Report on Supervision. One of the reasons for this difference is because the volume of deposits and loans used by the CNB for calculating the ratio indicator does not include the deposits and loans of the government sector. For this reason, the value is generally lower. In 2012 it exceeded 120%.

[15] Croatia became a member of the European Union during the monitored period, which it makes it difficult to perform an international comparison of the development in this country as a member of the EU.

However, the majority of the factors mentioned above, which may weaken the reporting strength of the indicator, do not apply in the case of the Czech Republic to any significant degree. The high value of this indicator in the Czech Republic did not result from bank deleveraging and from the forced limitation of bank-provided loans as a result of uncertainty in the financial markets or due to problems faced by banks. To the contrary, within the scope of financing activities the banking sector is able to use a significant portion of the deposits made by households who place the majority of their savings in banks (see Chapter 3 – Structure of Household Savings).

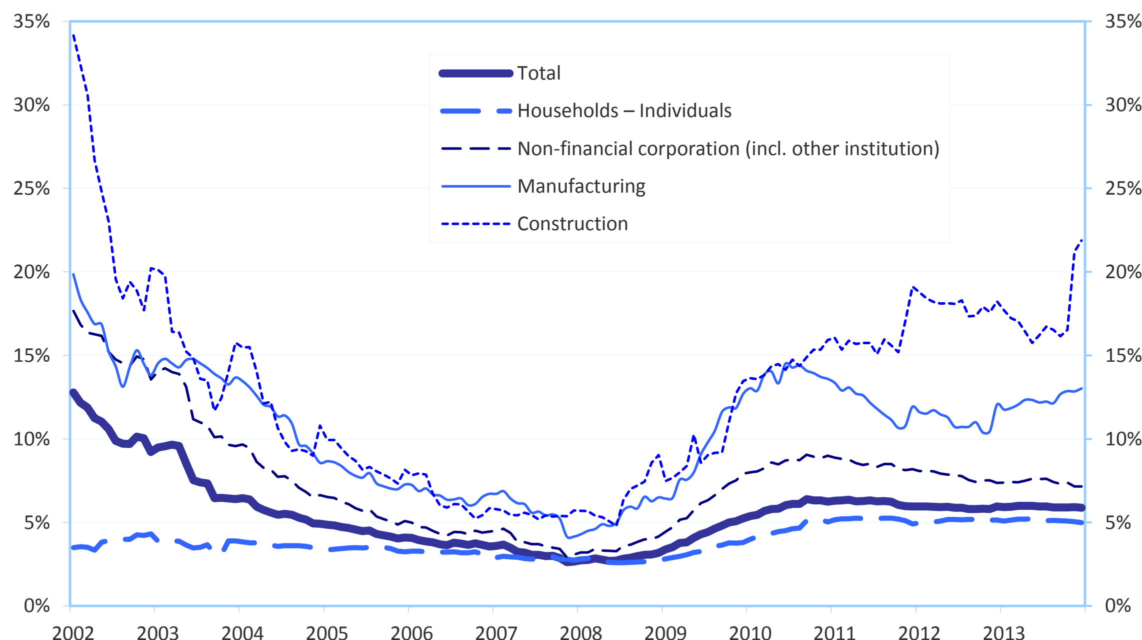
Finally, it should be noted that the deposits to loans ratio discussed above evaluates the banking sector as a whole, which does not exclude the fact that some banks have a significantly lower value for the coverage of loans by primary deposits and are more vulnerable from this particular perspective.

5.2. Banking Sector Assets

At the end of 2013 the total asset volume reported by the banking sector, including building savings banks, totalled CZK 5.2 trillion. [16] When compared with 2012, it is possible to see a renewed speeding up of growth dynamics, and the balance sheet total increased by 8.8% over the course of 2013. This is the highest relative increase of the past four years. The growth rate in 2012 was not even at one-half of the level (3.7%). This reaccelerated growth was also reflected in the faster increase in the number of receivables due from clients (an increase of 6.5% as compared to the increase of 2.4% in the previous year). This may be viewed as an indication of the recovery of credit activity.

As far as the quality of assets is concerned, the banks' balance sheets are in relatively good condition. The quality of the loan portfolios, which are the most important factor given the specific focus placed on the provision of loans by the domestic banking sector, is illustrated in Graph 5.2 (the share of non-performing loans, i.e. the NPL ratio, for each individual borrower category).

Graph 5.2: Share of non-performing loans



Source: CNB – ARAD

At the end of 2013 the ratio of non-performing customer loans to total customer loans (granted to residents and non-residents) reflected a slight year-on-year decrease (0.07 pp) and was at 5.88%. This fact confirms the hypothesis that the deterioration in the quality of loans, which started in 2008 mainly due to the macroeconomic consequences of the global financial crisis, apparently stopped in 2011.

[16] The values published in the CNB's ARAD time series system are different from the values published by the CNB in other information, such as its Report on Supervision, due to the different methodologies that are used. These differences may then be reflected elsewhere, such as in the case of the indicator showing the distribution of non-performing loans (Graph 5.2).

It is possible to see an improvement in the quality of loans in both of the most important segments. The NPL ratio for the loans provided to non-financial companies dropped to 7.15% (a year-on-year decrease of 0.21 pp). In the case of households (the general population), the NPL ratio dropped to a level below 5% (a year-on-year decrease of 0.16 pp to 4.98%).

However, the share of non-performing loans is still at twice the level it was in the relatively short period of 2007 and 2008, when it was below 3% in some months. Nevertheless, it is at a much lower level in comparison to the situation in the banking sector in 2002, when this indicator generally exceeded 10%.

The data for the individual segments often present a better representation of the different development tendencies. In order to illustrate these differences in development, information is provided regarding the individual sub-segments of the loans provided to non-financial companies. It is possible to see a deterioration in the quality of the loans provided to the manufacturing industry (by 0.97 pp to 13.0%) as well as to the construction industry (by 3.63 pp to 21.88%). However, given the total volume of these loans (CZK 24 billion and CZK 51 billion in the manufacturing and construction industries respectively), this development cannot be used to draw any clear-cut conclusions, particularly in a situation when the share of non-performing loans provided to non-financial companies reflects an overall downward trend for the past year. In addition, the development in the quality of the provided loans may not necessarily provide an accurate picture of the overall changes in a particular sector, as it is primarily a reflection of only a portion of the companies within the given economic sector, which accepted a larger volume of loans in the past, as opposed to a reflection of the overall situation in the given sector as a whole.

From the perspective of potential problems caused by external factors, specifically the developments in exchange rates, it is essential to monitor loans denominated in foreign currencies. As was the case in the preceding year, the ratio of these loans to the total number of loans did not significantly change in 2013 as compared to the previous period and remained relatively low. It is however important to keep in mind the positive implications of this long-term status with regard to the resilience of debtors against any shocks caused by exchange rate fluctuations and subsequently the positive effect it provides for the functioning of the real economy and the stability of the financial sector.

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

5.3. Economic Results of the Banking Sector

The banking sector's pre-tax profit for 2013 achieved a level of CZK 73.6 billion (refer to Table 5.1). Although this represents a slight year-on-year decrease of 4%, it is the second best result in historical terms. The lower interest rates in the economy are one of the contributing factors to this decrease, and they are reflected in the drop in the net interest margin and in the slight decrease in net profit from fees and commissions. However, the banks partially offset this decrease through reducing their administrative costs and other expenses. As compared to the overall pre-tax profit, the financial and operating profit before taxes increased by 0.6% to CZK 168.1 billion.

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

Item (in billion CZK or %)	2010	2011	2012	2013	Year-on-year change
Financial & operating income and expenses	157.4	162.1	167.2	168.1	0.6%
Net interest income	105.3	109.9	107.8	105.5	-2.1%
Interest income	167.0	172.3	170.4	154.9	-9.1%
Interest expenses	61.7	62.5	62.5	49.4	-20.9%
Net fee and commission income	38.5	39.1	37.3	37.0	-0.7%
Fee and commission income	48.4	50.0	49.2	49.8	1.4%
Fee and commission expenses	9.9	10.9	11.9	12.8	7.9%
Administration costs	62.4	66.1	66.6	65.7	-1.4%
Other costs [17]	29.2	33.0	32.2	31.4	-2.4%
Total profit or loss before tax	**65.6**	**63.5**	**76.7**	**73.6**	**-4.0%**
Ratio of net interest income to net fee and commission income	2.7	2.8	2.9	2.8	-1.8%
Ratio of net interest income to financial & operating income and expenses	66.9%	67.8%	64.7%	62.8%	-3.0%
Ratio of net fee and commission income to financial & operating income and expenses	24.5%	24.1%	22.4%	22.0%	-1.7%

Source: CNB

There was a slight decrease in the net interest margin (as was the case in the previous period). This figure (i.e. the difference between interest income and interest expense) decreased year-on-year by 2.1% to 105.5 billion. The reduction in the monetary policy rates and the gradual trickling down of this development to the interest rates associated with banking assets and liabilities is reflected in the tendency of both interest expense as well as interest income to decline. However, not even the fact that interest expense decreased by more than 20%, i.e. by more than twice the 9.1% decrease in interest income, was sufficient to maintain the same net interest margin that was reported a year ago. This was because, in absolute terms, the expenses were more than triple the income. The decrease in income, although at a much slower rate, amounted to CZK 15.5 billion. In comparison, the expenses went down by only CZK 13.1 billion, which resulted in a slight decrease of CZK 2.3 billion in the interest margin.

Net fee and commission income did not significantly change, and they decreased year-on-year by 0.7% to CZK 37.0 billion. Although (gross) fee and commission income grew slightly (by 1.4%), this increase was offset by the concurrent increase in the expenses incurred in order to achieve this level of income (by 7.9% to CZK 12.8 billion).

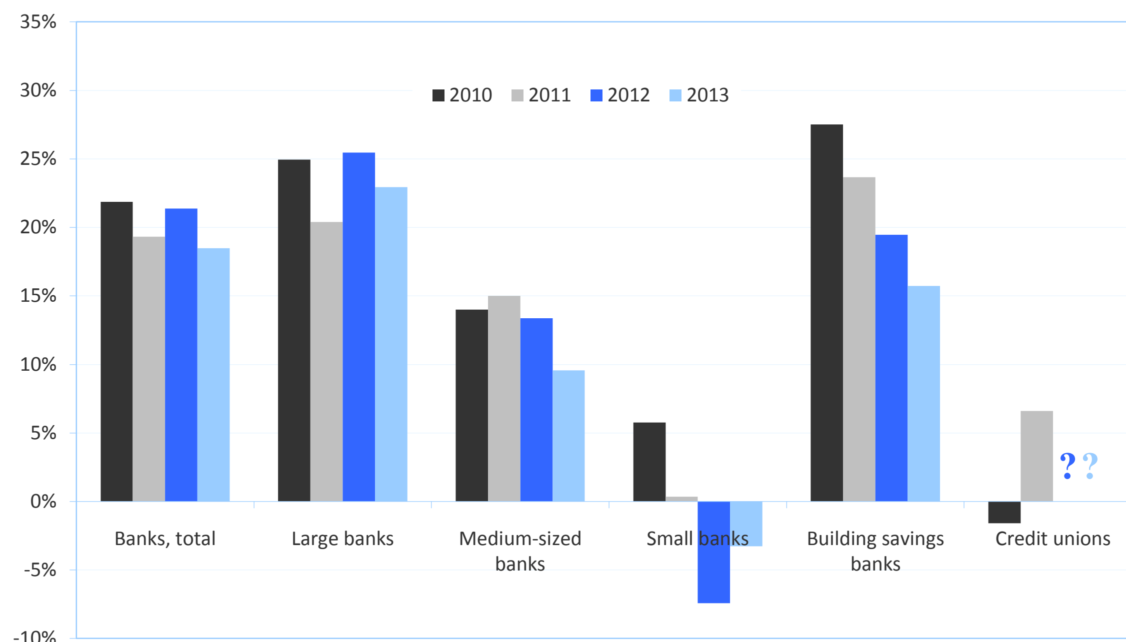
The ratio indicators provided at the bottom of Table 5.1 better illustrate the relative importance of the individual items. Comparable to previous years, net interest income in 2013 was almost three times the net income from fees and commissions. However, this particular indicator reflects a slight year-on-year decrease (1.8%) after two years of growth. The dominance of net interest income can also be illustrated with respect to profit from financial and operating activities, as it has a 62.8% share. On the other hand, the contribution of net fee and commission income amounted to only 22.0%.

As a whole, the banking sector is achieving the fairly high profitability with regard to Tier 1 capital. This decreased slightly over the course of the year by 2.9 pp and reached a level of 18.5%. The increase in Tier 1 capital and the concurrent decrease in the net interest margin may be one of the explanations for this. However, the causes may vary amongst the individual segments and entities. However, as in previous years, significant differences can be observed in the profitability (and its development) within the individual categories of credit institutions (refer to Graph 5.3, which, for the sake of comparison, also provides information on the profitability of the credit union sector). Despite the individual year-on-year changes, it is not possible to detect any significant tendency of these values to come closer together. As can be seen in Graph 5.3, there was only a slight deterioration in all of the segments with the exception of small banks. The profitability of this particular sector was much lower in comparison the other categories and even dropped

[17] Other costs include depreciation, provisions and impairment. Together with the items Financial & operating income and expenses and Administration costs, they are included in the profit before tax.

into the negative numbers. This may be related to the recent entry of new banks into this segment, which, taking into account the life cycle of their activities, have a tendency to suffer losses during the first few years that they are in operation. A continuing decline in profitability can be seen over the past four years for the category of building savings banks (more detailed information is provided in Chapter 5.8).

Graph 5.3: Profit (loss) after taxation/Tier 1 capital (%)[18]



Source: CNB

5.4. Interest Rate Development

The development in market interest rates is affected by many factors, but primarily by the CNB's setting of interest rates and its other monetary policy instruments. In 2012 the central bank decided to cut its key 2W repo rate at three occasions (it gradually went from 0.75% down to 0.05%). In 2013, the CNB could no longer perform a similar reduction in its currency policy interest rates as they were already almost at the zero bound.

However, in autumn 2013 the CNB decided to implement exchange rate interventions with the aim of weakening the domestic currency. The declared effort to maintain the exchange rate of the Czech crown relative to the euro close to the level published by the central bank may have an indirect effect on the financial markets, including with regard to the anticipated development of interest rates. There exists the belief that during the declared period of time when the Czech crown is intentionally weakened the central bank will not hike its monetary policy rates. As a result, these rates may possibly remain at their historically lowest level for a longer period of time. A basic overview of the rates at the end of each half of individual years is provided in Table 5.2.

Table 5.2: CNB interest rates

(%)	30/6/2011	31/12/2011	30/6/2012	31/12/2012	30/6/2013	31/12/2013
2W repo	0.75	0.75	0.50	0.05	0.05	0.05
Discount	0.25	0.25	0.25	0.05	0.05	0.05
Lombard	1.75	1.75	1.50	0.25	0.25	0.25

Source: CNB

[18] The graph does not include data for the credit unions sector in 2012 and 2013, because the data were not published by CNB.

As is illustrated in Table 5.2, together with this reduction of the key monetary policy rate to its record low level, a further adjustment was made to the spread between the base rate and the other CNB rates. The discount rate, which up to this point was 0.25 pp less than the 2W repo rate (and before that even a full percentage point lower), was left at the same level as the repo rate. The Lombard rate underwent similar changes. In the past it was 1.0 pp higher than the 2W repo rate. After the repo rate was reduced down to 0.25%, this margin also decreased to 0.2%.

A number of other key central banks from around the world are implementing an easy monetary policy stance. However, it needs to be emphasised that the other central banks are also using additional instruments to a higher degree, such as asset purchases. As was specified in more detail in Chapter 1.1, none of the world's most important central banks acceded to changing their interest rates. The Bank of England left its base interest rate at 0.5% and the American Fed at a range of 0.0 to 0.25%. The ECB did implement two cuts to bring its rate down to 0.25%. There are, however, some new concerns arising in connection with the signs that the American economy is recovering, particularly with regard to the effects of limiting the current expansive monetary policy in the USA. According to these pessimistic views, from the perspective of worldwide development this could lead to a decrease in the volume of funds investors place elsewhere in the world, which would have negative consequences not only for emerging economies but also for other more high-risk assets.

The overview of average client interest rates in the Czech Republic in individual years (refer to Table 5.3) shows a gradual decrease in the interest rates. As far as deposits are concerned, the interest rate paid in the case of non-financial companies is clearly lower than the rate paid on the deposits of households (it has been approximately 50% lower for the past three years). Conversely, even as recently as 2008, the deposits of households and small business owners earned interest at lower rates. At this time there is also an apparent difference in the sensitivity of the interest paid on the deposits in these two client segments. Whilst in the case of households there has been a gradual decline of one third during the entire monitored six-year period, if we look at the non-financial business there was a drop of two thirds in the first three years, which continued to deepen even further.

The average interest charged on new loans provided to households also continued to decrease. In 2013 there was a more significant decrease (0.5 pp) in the interest charged for housing loans and it went down to 4.3%. The average interest for new loans provided to non-financial business also dropped, specifically by 0.5 pp to 3.2%. However, in general, the lowest interest is charged on loans provided to larger enterprises. As is the case with deposits, it is possible to see a higher relative change in the interest rates in the non-financial business segment as compared to households.

Table 5.3: Average interest rate

	As at 31 Dec (%)	2008	2009	2010	2011	2012	2013
Deposits	households	1.5	1.4	1.3	1.2	1.2	1.0
	non-financial businesses	1.8	0.9	0.6	0.5	0.6	0.4
Loans	to households	6.8	7.0	7.0	6.8	6.5	6.0
	for consumption and others	13.4	11.3	11.3	11.2	10.9	10.7
	for residential real estate	5.1	5.2	5.3	5.1	4.8	4.3
	to non-financial businesses	5.6	4.6	4.1	3.9	3.7	3.2

Source: CNB – ARAD
Note: Data refers to bank interest rates on CZK-denominated loans and deposits – new business.

In the case of loans provided to households, it is advisable to monitor the more comprehensive indicator that includes the other costs associated with the loan (i.e. the effective annual percentage rate, or EAPR[19]) in addition to the interest rate. Looking at the data for the individual months, it is possible to a certain seasonality, specifically the interest rate has tendency to decrease in the December of each individual year and then to once again increase to a certain level in the January of the following year. This can be partially explained by the fact that there is an increased effort to obtain to new clients specifically during the period when there is an increase in the volume of seasonal credit purchases.

[19] The EAPR represents the percentage of the amount due that the client must pay over the period of one year in addition to the amortisation of the loan amount, specifically in relation to fees, loan administration, and other costs associated with using the loan. The EAPR referred to is the EAPR on loans provided by Czech banks in Czech crowns (new transactions).

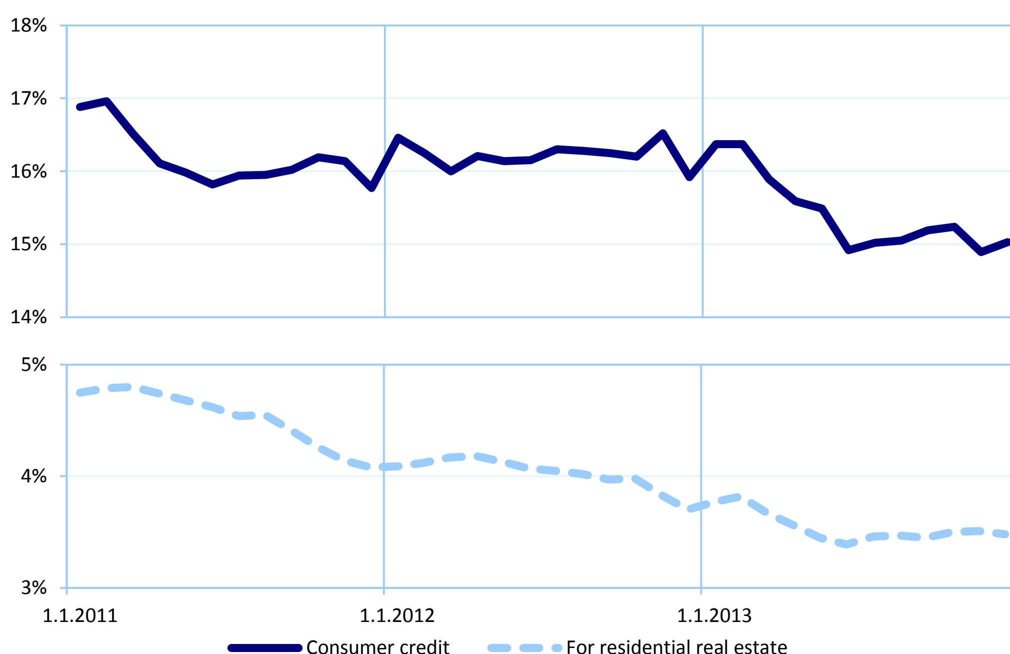
The EAPR for new consumer loans provided in 2013 decreased slightly (refer to Table 5.4 and Graph 5.4). In December 2012 it was at 15.9%. After an initial increase in January 2013 (up to 16.4%), the EAPR gradually decreased and was 15.0% at the end of the year. The EAPR for the purchase of residential real estate also recorded a decrease (by 0.22 pp) and was 3.48% at the end of the year. The cost of housing loans is thus approaching the lowest levels in history [20] as a result of how banks are reacting to the way in which the central bank is setting rates. An important role is also played by competition amongst the individual banks.

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

New loans in 2013 (%)	January	February	March	April	May	June	July	August	September	October	November	December
Consumer credit	16.4	16.4	15.9	15.6	15.5	14.9	15.0	15.1	15.2	15.2	14.9	15.0
For residential real estate	3.8	3.8	3.7	3.6	3.5	3.4	3.5	3.5	3.5	3.5	3.5	3.5

Source: CNB

Graph 5.4: APR (Annual Percentage Rate) of CZK loans provided by banks



Source: CNB

5.5. Deposits and Loans

The volume of bank deposits and loans (see Table 5.5) increased during 2013 at a comparable rate (by 6.7% and 6.5% respectively). In comparison to the development in 2012, when the volume of loans grew at a rate of only 2.4%, there was a recovery of lending. Conversely, the growth rate for deposits decreased to 6.5% (as compared to 7.3% in 2012). There were a number of factors that contributed to the recovery of the lending market. The year-on-year increase in the growth rate for loans provided to both households as well as non-financial companies may, however, indicate the gradual improvement of the economic situation, or, more specifically, the growing confidence of the individual economic subjects in future economic prospects.

As was the case in 2012, the deposits made by households grew at a slower rate (2.4%) than the deposits made by non-financial companies (8.5%). Taken together, this could mean that companies are increasing the volume of their monetary resources that they will have available to invest in the real economy if the economic recovery is confirmed. The volume of deposits made by the government sector grew year-on-year by 14.6%. In the case of financial institutions, the increase was 17.4%. Looking at the absolute change in the volume of

[20] The decline in client interest rates for residential housing (as measured by Hypoindex) continued at the start of the year 2014 and attained a level even lower than the previous historical minimum.

deposits, the most significant growth was recorded in the non-financial companies segment, followed by government institutions and households. However, it continues to be the case that households make up more than one half of total deposits (CZK 1.8 trillion out of a total of CZK 3.3 trillion). Non-financial companies, with a deposit volume of CZK 777 billion (23% of all deposits), are the second largest depositor.

From the perspective of the development in the structure of deposits according to withdrawal period, the volume of deposits in non-term types of accounts continued to grow faster than the volume in term accounts (an increase of 9.8% as compared to 1.9%). At the end of 2013, 63.1% of the total deposits across all of the client segments were kept in non-term types of accounts (in the case of households, this figure was 80% – refer to Graph 3.1). Just one year ago, it was only 61.4%. This is a continuation of the long-term trend in the decrease in the share of term-accounts. The main reason for this development is the growing popularity of savings accounts, which fall under the category of non-term deposits.

Over the past few years, given the volume of loans for housing, households top the list not only as depositors, but also as borrowers. The volume of bank loans provided to households grew at a slightly faster rate than the volume of their deposits (4.3% as compared to 2.4%) to reach CZK 1.1 trillion, which represents 47% of the total volume of bank loans. The volume of loans received by non-financial companies grew at a tempo comparable to that of households (by 3.8% to CZK 867.1 billion). In all cases, in comparison with the situation in 2012, there is an increase in growth dynamics. In the previous year, the volume of loans provided to non-financial companies grew by only 0.9%. If the new loans are used to make investments to spur entrepreneurial development, this may be considered as yet another indication of the increased confidence of the corporate and financial sectors regarding the forthcoming recovery. The situation may also be influenced by the continuing restructuring and the tendency to reduce indebtedness in those sectors that expanded in particular prior to 2008. As has been the case in the recent years, the greatest growth dynamics may be seen in the volume of loans provided to non-residents (an increase of 35.2%). Conversely, there was a significant reduction in the volume of loans received by government sector (a decrease of CZK 4 billion, which corresponds to 6.4%).

Table 5.5: Distribution of deposits and loans with banks by sectors

As at 31 Dec	Bank deposits (CZK bn)				Bank loans (CZK bn)			
	2012	2013	Change	Change (%)	2012	2013	Change	Change (%)
Households	1 770.3	1 812.2	41.9	2.4	1 132.2	1 180.7	48.5	4.3
Non-financial companies (including other institutions)	716.0	776.7	60.7	8.5	835.4	867.1	31.7	3.8
Government institutions	373.5	428.1	54.6	14.6	61.5	57.5	-4.0	-6.4
Financial institutions	138.2	162.3	24.1	17.4	116.4	119.7	3.4	2.9
Non-residents	106.1	132.1	26.1	24.6	212.3	287.1	74.8	35.2
Non-profit institutions	23.4	26.2	2.8	12.0	2.3	2.1	-0.2	-9.6
Total	3 127.6	3 337.8	210.2	6.7	2 360.1	2 514.3	154.2	6.5

Source: CNB – ARAD

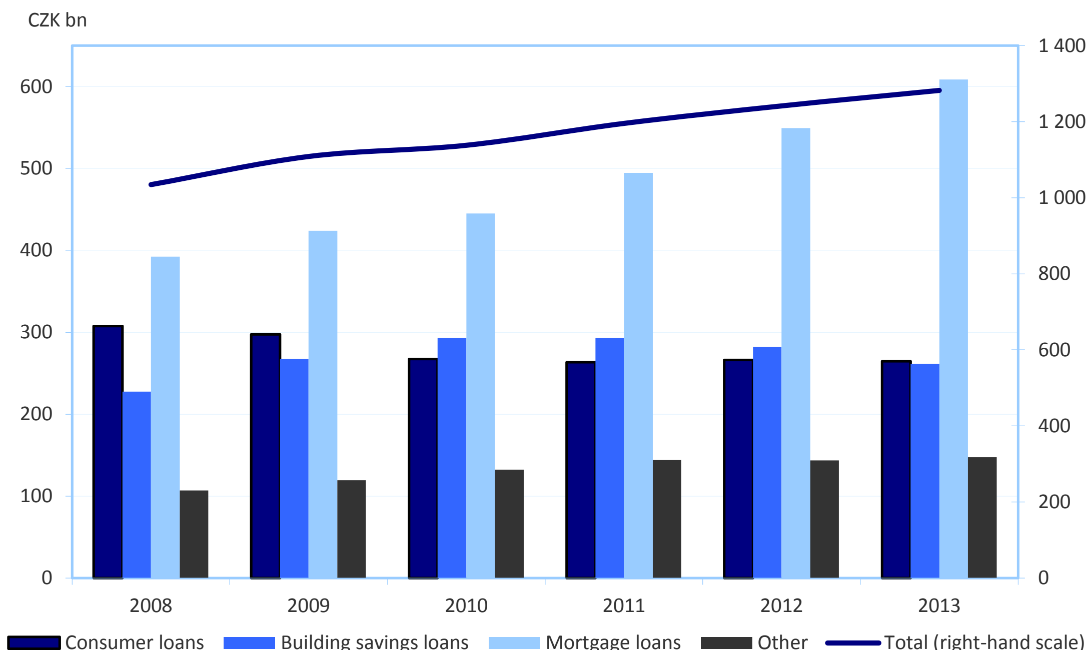
Note: The table shows deposits with banks in Czech crowns and in foreign currencies, which are subsequently converted to billions of CZK. The values are therefore different from table 2.1, which lists only bank deposits in Czech crowns.

5.6. Household Indebtedness

As the dominant client segment, the household sector deserves a more detailed analysis that exceeds the scope of the banking sector. The overall indebtedness of households with regard to both bank as well as non-bank financial institutions was CZK 1.3 trillion at the end of 2013 (refer to Graph 5.5). This represents a year-on-year increase of 3.3%, although the growth dynamics once again slowed down (by 0.1 pp). The development in the indebtedness within the individual lending segments continued to differ in 2013. Over the past three years the growth in the volume of mortgage loans has essentially not changed and remains at a level of approximately 11%.[21] Conversely, the volume of loans provided by building savings banks continues to decline at an increasing rate (by 7.4% in 2013 as compared to 3.7% in 2012). The volume of consumer loans has decreased, albeit slightly (by 0.5%).

[21] This figure reflects a different rate of growth than the indicator used in Chapter 5.7. This is the result of the fact that the indicator used for mortgage loans in Chapter 5.7 includes a portion of the loans provided by building savings banks.

Graph 5.5: Total household indebtedness[22]



Source: CNB – ARAD

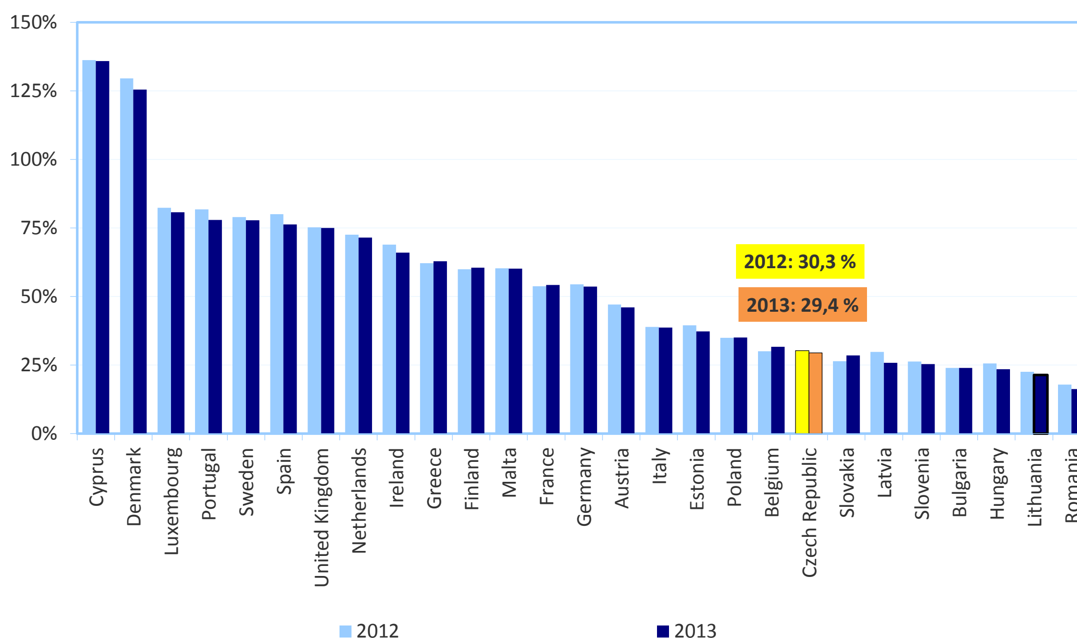
The absolute growth in housing loans totalled CZK 38.5 billion. However, whilst the volume of loans provided under building savings schemes decreased by more than CZK 20 billion, the volume of mortgage loans increased by more than CZK 59 billion. Although the volume of consumer loans dropped by CZK 1.4 billion, their status at the end of the year does not reflect any significant change over the past three years. The share that housing loans contribute to total indebtedness once again slightly increased this year (by 0.9 pp) to a level of 68% at the end of 2013 (CZK 0.87 trillion of a total of CZK 1.3 trillion).

As can be seen in Graph 5.6, the level of household indebtedness (monitored according to the ECB data on the volume of loans provided to households as reported in the balance sheets of monetary financial institutions, not including the ESCB) in relation to the size of the national economy, which indirectly reflects the amount of household income and thus the ability of households to meet their financial obligations, remains relatively low in the Czech Republic in comparison with the rest of the European Union. Using this method of measurement, there was even a year-on-year decrease of 0.8 pp to 29.4% of GDP.[23] As has been the case in previous years, it therefore applies that the costs associated with the servicing of household liabilities are generally not a factor that might limit private consumption to the same extent as in countries with higher relative levels of indebtedness. As is also apparent from Graph 5.6, the other new member states from Central Europe also report low levels of indebtedness. The reason may be the relatively recent transition of these countries to a market economy, as a result of which they have not yet had sufficient time to accumulate the relative volume of loans as is common in Western Europe. A marked decrease in the relative level of household indebtedness was reported primarily by those economies where there was an increase in indebtedness during the previous stage of the economic and financial cycle and now this level is gradually being reduced (e.g. Portugal, Spain, and Hungary), and by economies that have managed to reduce the value of their relative debt ratio by increasing the value of the denominator for this indicator, i.e. thanks to the renewed growth of the economy. The latter is typically the situation in the Baltic states, where, just in the past year, the economy grew by more than 5%.

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

[23] The development of this indicator viewed at the international level has a limited interpretative value in the case of economies that use a currency other than the euro. In those cases the values may reflect a volatility resulting from the fluctuation of the exchange rate of the national currency in relation to the euro, which is subsequently used for expressing household indebtedness reported in the national currency converted to the euro as the common European currency. Croatia became a member of the European Union during the monitored period, which makes it difficult to perform an international comparison of the development in this country as a member of the EU.

Graph 5.6: Volume of household indebtedness in the EU relative to GDP



Source: ECB, Eurostat

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

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

5.7. Mortgage Market

Within this chapter we will first take a look at the mortgage market from the perspective of the loans provided to households (individuals), which represents the dominant segment with regard to both the number of loan agreements as well as the volume of unpaid principal. However, further below Table 5.7 provides a comparison of the loans provided to households with the other client segments, namely business entities and municipalities.

The volume of mortgage loans provided to households[24] increased by CZK 46.1 billion in 2013 to reach a level of CZK 746.6 billion as is shown in Table 5.6. The tempo of the change did not significantly change and, as compared to 2012, increased by only 0.3 pp to 6.6%.

[24] This figure is based on the volume of unpaid principal. As far as the methodological approach is concerned, the growth in this indicator cannot be, for example, interpreted only as the increase in the loans provided on the part of banks or their willingness to provide loans.

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

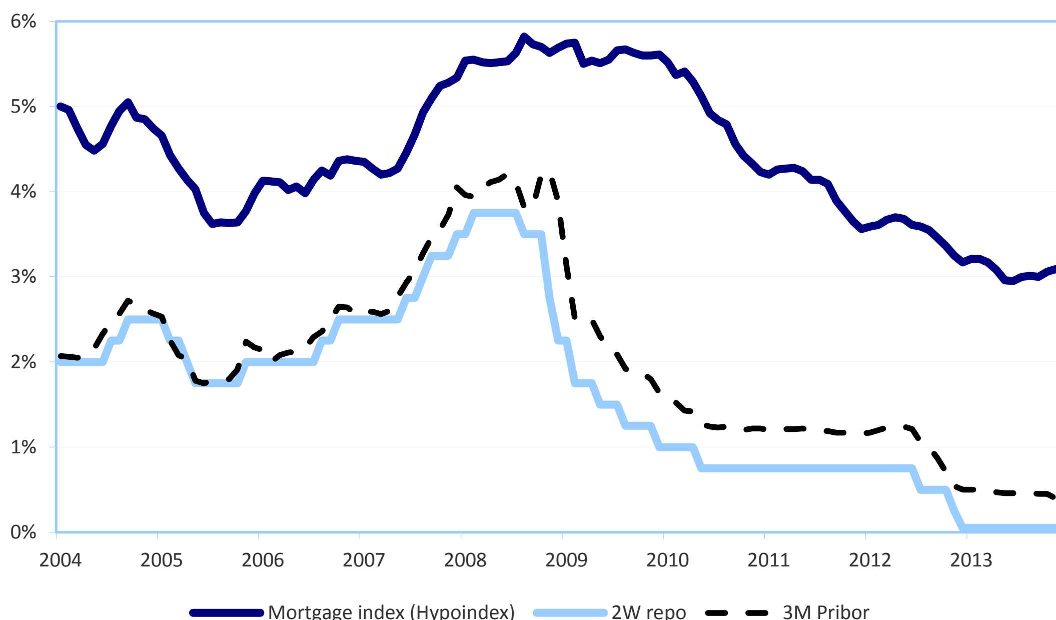
As at 31 Dec	2010	2011	2012	2013	Year-on-year change	
					Abs.	(%)
Number of mortgage loans (000s)	501.5	572.6	646.2	738.8	92.6	14.3
Contractual principal (CZK bn)	748.3	867.4	989.0	1 138.3	149.3	15.1
Volume of mortgages (CZK bn)	604.7	659.0	700.5	746.6	46.1	6.6

Source: MRD, CNB – ARAD

The growth in the Czech mortgage market has benefited from the continuing declining trend in client interest rates as reported by the Hypoindex[25], which, over the past two years, has been achieving historically low values (from the perspective of the period in question). The Hypoindex rate decreased year-on-year by 0.11 pp to 3.06% at the end of the period (refer to Graph 5.7). However, the tempo at which this indicator has been declining has slowed down over the past three years. In 2012, the decline was 0.39 pp, in 2011, 0.7 pp, and the year before that it was as low as 1.4 pp. However, this slowdown may be partially explained by the fact the rates have continually been coming close to their minimum values. The Hypoindex values fluctuated over the course of the year, and thus comparing the values at the end of the period may not provide a completely accurate picture. If we compare the arithmetic average of the rate for the twelve months in question, the decrease between the value in 2012 (3.55%) and its value in 2013 (3.07%) is more apparent. In March 2014, i.e. after the end of the period covered by the report, the Hypoindex rate dropped to a new record minimum of 2.93%.

Some of the long-term causes of the decline in the Hypoindex rate include the increasing competition amongst lenders, to a certain degree the popularity[26] of variable rate contracts (which are currently priced lower than fixed rate loans), and of course the cheaper financing of banks resulting from the effects of the eased monetary policy. The relationship between the development of the client, interbank, and monetary policy rates is worth further analysis and is depicted in Graph 5.7.

Graph 5.7: Development of selected interest rates



Source: Fincentrum, CNB

This is because the growth may not only be the result of provision of new loans, but may theoretically also reflect the consequences of the deterioration of borrowers' ability to repay their obligations (resulting in the amount due not being amortised).

[25] The FINCENTRUM HYPOINDEX indicator is the weighted average interest rate which is applied to new mortgage loans provided to individuals during the given calendar month. The development of this interest rate over time is presented in Graph 5.7.

[26] According to the data published by the CNB, variable rate mortgage loans and fixed rate loans with a maturity of less than one year make up approximately 34% of the volume of new mortgage loans provided in 2013. However, this indicator is somewhat distorted as the statistical methodology used by the CNB reports a portion of the loans provided by building savings banks together with standard mortgage loans.

Just like last year, the spread between the Hypoindex rate and the 2W repo rate during 2013 hovered at a level of approximately 3 pp. From the perspective of medium-term development, this spread has shown a downward tendency. It reached its maximum value (4.6 pp) at the end of 2009. The central bank was already lowering its interest rates at that time, but lenders reacted to this development only gradually as the situation in the real economy and in the financial markets started to improve during the next periods. With a certain period of delay, Hypoindex is thus reacting to the lowering of CNB's base interest rate, which began in 2008 in response to the global financial crisis At the end of 2013 (as was the case in the previous year) the value of this interest spread reached its lowest level since October 2008. However, at that time the monetary policy rate was substantially higher (above 3%) and the Hypoindex rate was almost 6%.

Table 5.7 provides an overview of mortgage loans according to the client segments. The total number of mortgage loan contracts increased by almost 94,000, which is a greater growth than was reported for the previous period (by 19,700 contracts). Due to the highest number of contracts and the highest rate of annual change in the individual clients segment[27], the highest absolute year-on-year increase in the number of contracts was achieved precisely by this segment. In terms of relative change, the growth in the number of contracts in the individual clients segment was the greatest (an increase of 14.3%), followed by the business entities segment (an increase of 10.2%). The slowest growth in the number of contracts was recorded by municipalities (7.4%)

Table 5.7: Mortgage loan (ML) balances by client segments[28]

As at 31 Dec		2011	2012	2013	Year-on-year change	
					Abs.	(%)
Individuals	total (000s)	572.6	646.2	738.8	92.6	14.3
	total contractual principal (CZK bn)	867.4	989.0	1 138.3	149.3	15.1
Business entities	total (000s)	15.7	16.8	18.6	1.7	10.2
	total contractual principal (CZK bn)	287.4	311.1	337.7	26.6	8.5
Municipalities	total (000s)	0.9	0.9	1.0	0.1	7.4
	total contractual principal (CZK bn)	9.3	9.5	10.2	0.7	6.9
Total	total (000s)	589.3	664.0	758.4	94.4	14.2
	total contractual principal (CZK bn)	1164.1	1309.6	1486.1	176.6	13.5
	Loans volume (CZK bn)	824.9	864.3	909.7	45.4	5.3

Source: MRD, CNB – ARAD

During the monitored period there was an absolute increase of CZK 176.6 billion in contractual principal, of which CZK 149.3 billion (approximately 84.5% of the total increase) is in the household segment and CZK 26.6 billion is in the business entities segment. The rather marginal municipalities segment recorded an increase of CZK 0.7 billion As far as dynamics are concerned, the total volume of unpaid principal increased by 13.5%, which is more than the increase reported in 2012 (12.5%). The principal segment, the loans provided to the household (individuals) segment, which holds a dominant share, grew even faster (by 15.1%). A slower growth rate was obvious in the other two segments – business entities (8.5%), and municipalities (6.9%).

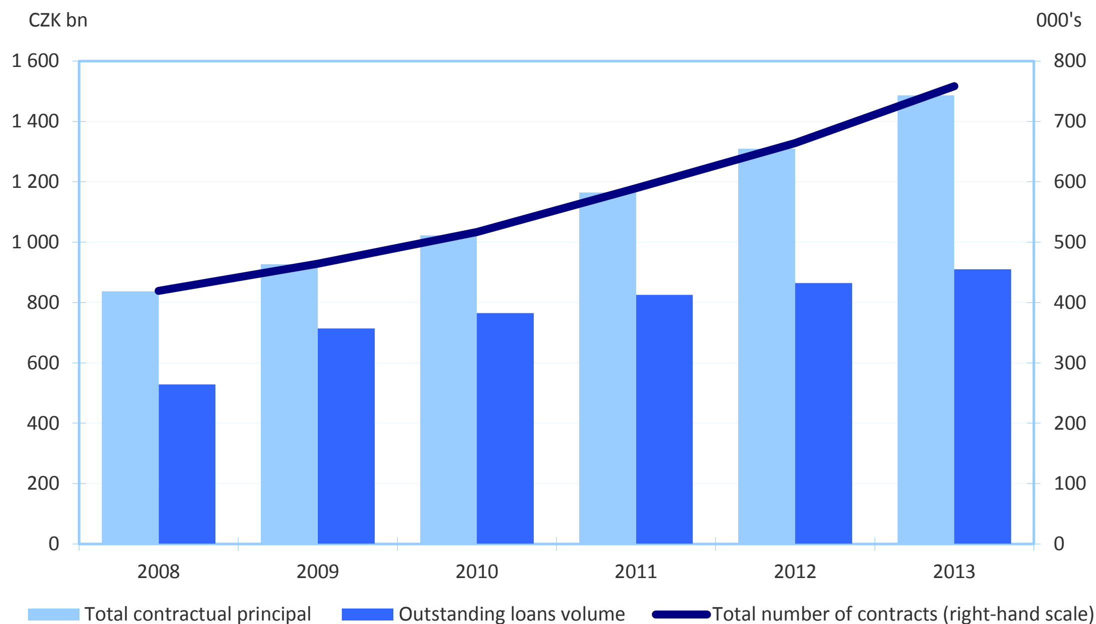
The last row of Table 5.7 specifies the total reported amount of unpaid principal for mortgage loans, which grew by CZK 45.4 billion (5.3%), which indicates the continuation of the faster growth that started in 2012. In 2012 the growth rate was 4.8% as compared to only 4.0% in 2011.

The development of the overall mortgage market indicators is depicted in Graph 5.8. The data on the total number of contracts and total contractual principal amounts in this graph includes not only households, but also business entities, and municipalities. The volume of loans includes mortgage loans for residential and commercial real estate.

[27] The Ministry of Regional Development uses this designation in lieu of the "household segment", which is the closest in nature based on the definition.

[28] The definition of the individual groups of beneficiaries is based on the statistics published by the Ministry of Regional Development.

Graph 5.8: Aggregate mortgage market indicators



Source: MRD, CNB – ARAD

It is not easy to predict the future development in the volume of mortgage loans provided to the individuals. Of course, the composition of the long-term factors (and the direction of their effects) that may influence this development does not tend to substantially change in the medium term time frame. The development may however be effected if the influence of any single factor continues or if its effect intensifies. In general, it is therefore possible to expect that the continuing relatively low debt ratio of Czech households may, in the long-term, be one of the factors that will allow for a further growth of the mortgage market. The factors that affect the short-term certainly include the rate of economic growth, which is itself influenced by the demand for loans and the developments in the financial markets. Change in the expectations of property prices developments and the effect of deferred demand resulting from earlier economic and financial uncertainty due to the recent global financial crisis and eurozone debt crisis may also play a temporary role. The falling mortgage interest rates, which can be monitored for example by the Hypoindex rate, has had a positive effect during the past two years. As in previous years, it of course applies that any rise in mortgage interest rates would play a significant role in future development. The refinancing of mortgages, which generates a significant proportion of new loans for housing (but not, however, a change in the total amount due), combined with the migration of clients from mortgage loans to loans provided by building societies, also continues to introduce a certain level of uncertainty with regard to future development.

From the perspective of the (annual) development in mortgage loans, it is necessary to monitor the volume of mortgage loans provided during the period in addition to the year-on-year change in the outstanding principal amount of mortgage loans granted to that point. This volume is higher because it also includes refinanced loans and is not adjusted by the amortised portions of principal paid during the period in question (unlike the calculation using the change in status at the end of the period). Particularly the share of refinanced loans within the total number of mortgage loans is continuing to grow. Not all the data required to calculate the exact amount of refinancing is available, however, based on other information, it is possible to estimate that this share is several tens of percentage points. Taking into account the above-specified distortion of the indicator of mortgage loans provided for the given year, the main reporting value of this indicator is primarily the fact that it illustrates the ability of the individual mortgage loan providers to maintain their respective market shares.

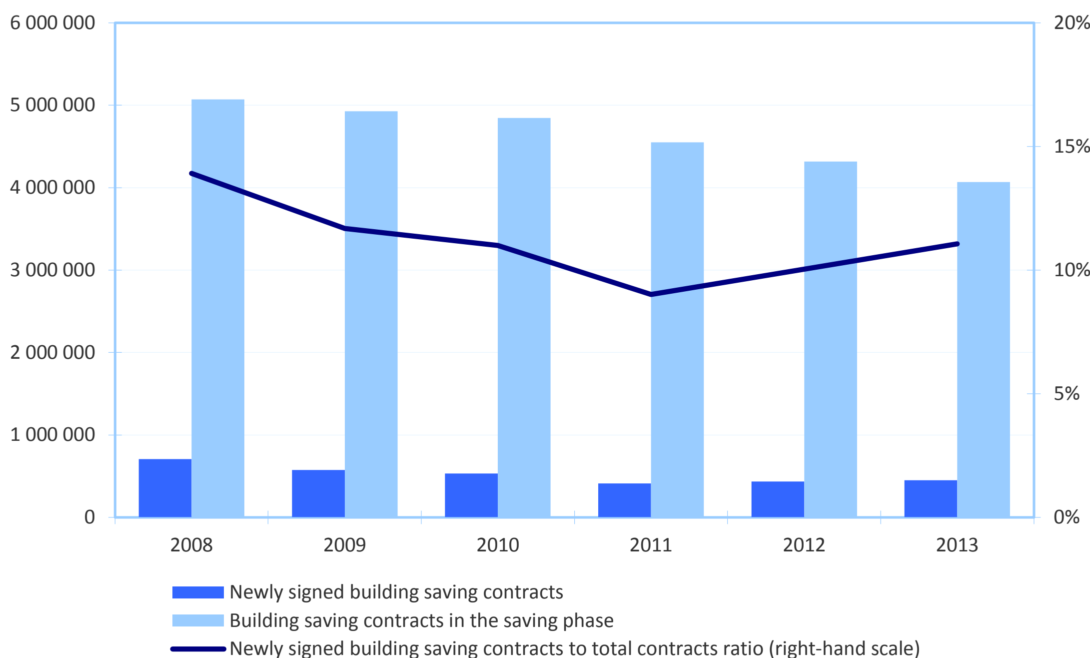
The CBV is also starting to publish this indicator. However, the CNB's quarterly time series starts in 2013 and thus it is not possible to perform a corresponding annual analysis.[29]

5.8. Building Savings Banks

Within the building savings bank sector there was another decrease in the number of contracts in the savings phase in 2013, thus continuing the trend that started in 2004. The total number of contracts, the number of which significantly increased during 2003, is thus gradually being reduced. 2003 was the last year in which it was possible to participate in a building savings scheme with a state contribution of up to CZK 4,500. As a result, a very high number of new participants were attracted as compared to the previous years. This led to the necessity to clear the market of contracts that were entered into by individual influenced by the last chance to receive up to CZK 1,500 more from the state each year. At the end of 2013, there were approximately 4.1 million contracts in the savings phase, which reflects a year-on-year decrease of approximately 250,000 contracts (i.e. a drop of 5.8%). The annual decreases in the number of contracts have always been in a range of between 1 and 6%. It is expected that during the next period the number of contracts will stabilise at about 4 million.

Almost 450,000 new contracts were signed for building savings schemes, which is 16,000 more than in the previous year. The annual number of new contracts added to the base of contracts in the savings phase has ranged from 9-14% over the course of the monitored period (refer to Graph 5.9).

Graph 5.9: Number of building savings contracts



Source: MoF calculation from building savings banks data

As far as the volume of funds is concerned, for the first time in history there was a year-on-year drop in the total saved amount, specifically a decrease of 1.4% to CZK 429.1 billion.

[29] Even in the future, performing an analysis will be slightly complicated, as the CNB's statistical methodology reports a portion of the loans provided by building savings banks in the mortgage loan category (specifically those that have a loan-to-value ration of more than 50%). According to the CNB's definition, a new mortgage loan is understood to include any new agreement between a bank and a client where the client must be actively involved in order for the new transaction to be generated. This includes all financial contracts that define an initial interest rate as well as all new negotiations associated with these existing contracts (e.g. the refinancing of a mortgage loan). Revolving loans are not included in the category of new transactions.

Table 5.8: Main indicators for the building savings bank sector

	2008	2009	2010	2011	2012	2013
Loans in total (CZK bn)	227.4	267.5	293.4	293.1	282.2	261.4
Saved amount (CZK bn)	401.1	415.2	430.1	433.4	435.0	429.1
Loans in total to saved amount ratio (in %)	56.7	64.4	68.2	67.6	64.9	60.9

Source: MoF calculation from building savings banks data

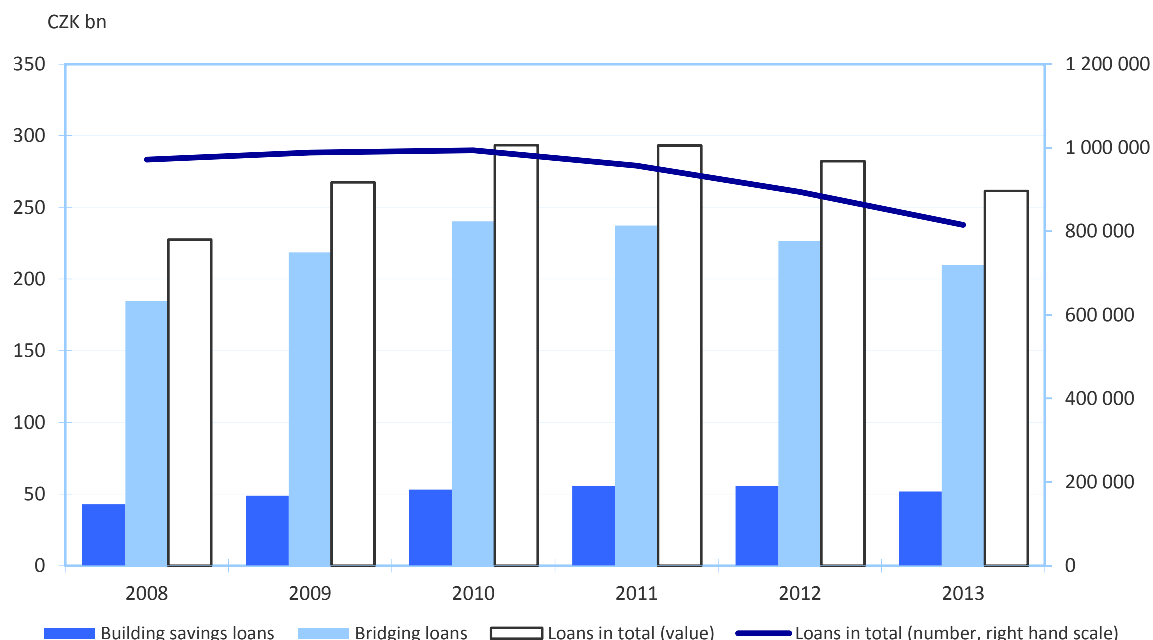
Primarily the following factors influenced the decrease in the volume of the saved amount: the unilateral withdrawal from contracts (by the building savings banks) after the minimum savings period because of the relatively high deposit interest rates (3 to 4.5%), the high interest rates on alternative products on the market, and low mortgage loan interest rates (which indirectly affect the behaviour of participants during the savings phase). Nevertheless, in spite of these circumstances households continue to maintain a significant part of their savings in building savings accounts (16.4%) as can be seen in Graph 3.1 in Chapter 3.

There was also a decrease in the main indicators for the provision of loans. The total number of loans[30] decreased by 79,000 to 815,000 (refer to Table P2.4 in Appendix 2), which confirms the reversal of the trend from 2011, when mortgage interest rates became more attractive (a trend that has continued through 2013).

The total volume of loans provided by building savings banks also dropped by approximately CZK 21 billion to CZK 261.4 billion, with both types of products (building savings loans and bridging loans) decreasing at almost the same rate (7.1% and 7.4% respectively). Their share of total loans has remained at the same level of 20:80 during the entire monitored period (2008-2013).

The high share of bridging loans indicates that the majority of those who borrow from building savings banks are resolving their ad hoc financing needs through a loan with a higher interest rate than they would receive in the case of a building savings loan, i.e. after meeting the condition of accumulating a specific saved amount (generally 40% of the target amount, after which they could apply for a standard building savings loan and take advantage of the lower interest rates for these types of loans). This implies that the building savings schemes in the Czech Republic are not functioning in the same way as in other countries and as was originally intended, i.e. in the form of the regular savings of funds and the subsequent use of a loan under more advantageous conditions known in advance.

Graph 5.10: Volume of loans granted by building savings banks

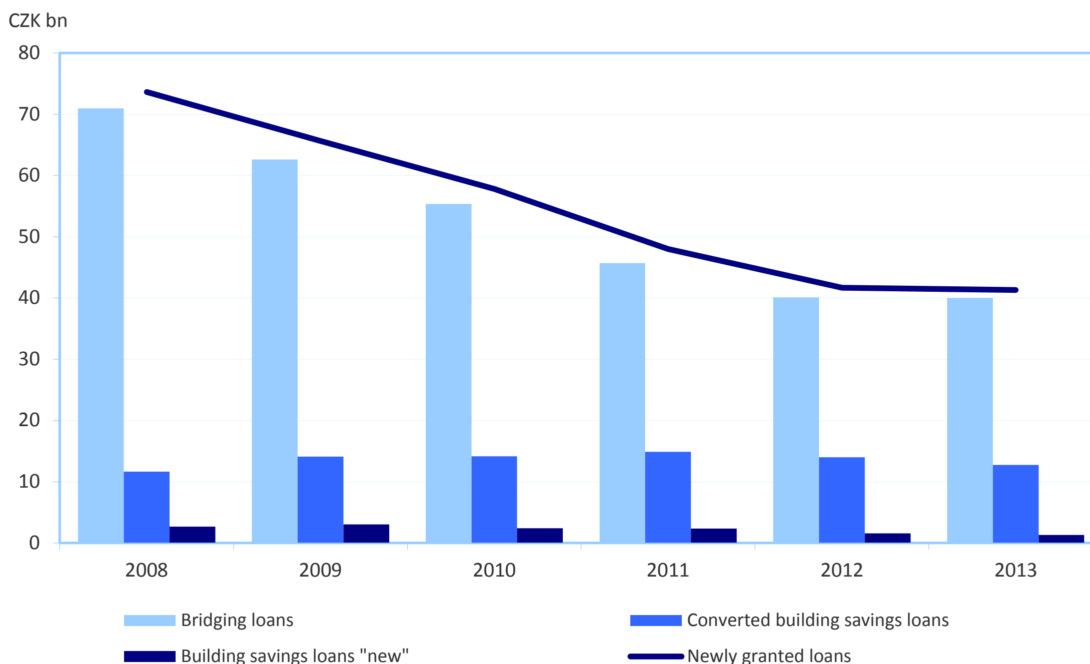


Source: MoF calculation from building savings banks data

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

The situation is different for the new loans provided. As far as this area is concerned, in 2013 the annual generation of newly provided loans[31] stabilised at a level of CZK 41.3 billion.

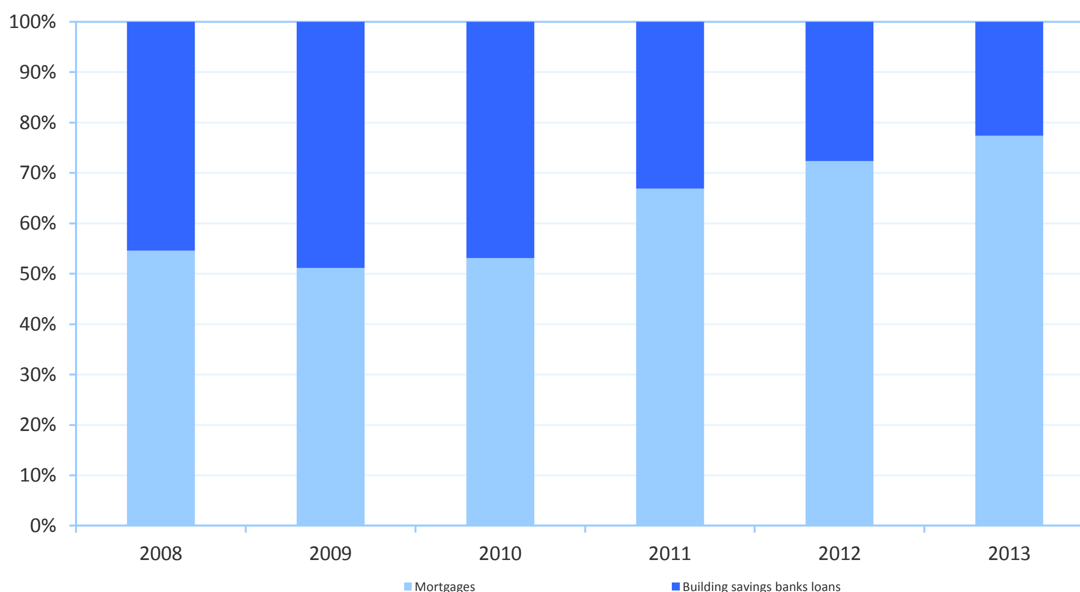
Graph 5.11: New loans in the building savings bank sector



Source: MoF calculation from building savings banks data

However, given that 2013 was the most successful year in the history of mortgage banks, it is possible to say that there is an even further decrease in the share that building savings banks contribute towards the financing of housing needs. The development in the share of new loans granted over the past six years is depicted in Graph 5.12 below.

Graph 5.12: Shares of new loans granted by commercial and building savings banks

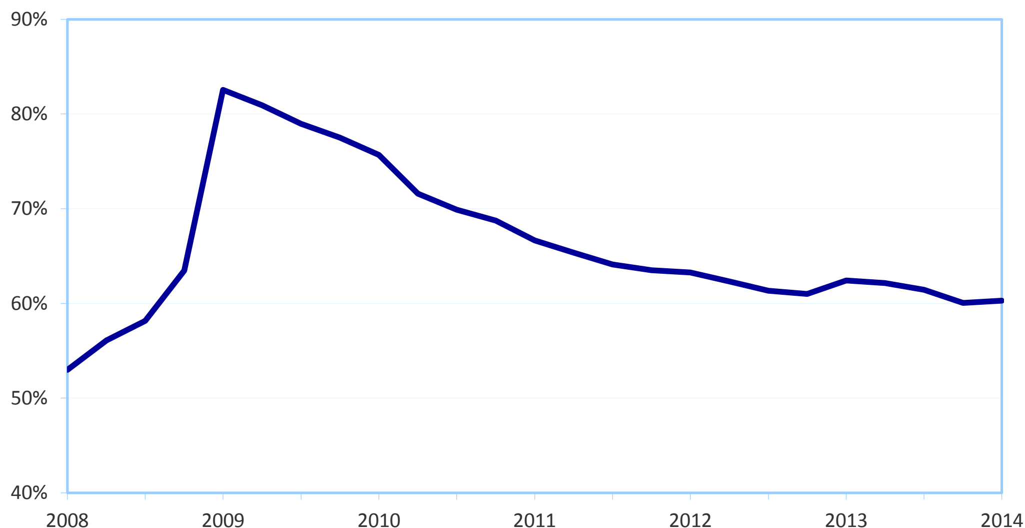


Source: CNB - ARAD + MoF calculation

[31] Newly granted loans are calculated as the sum of newly granted bridging loans (the light blue bar in Graph 5.11) and newly granted building savings loans (the dark blue bar in Graph 5.11). A special category consists of “converted building savings loans” (these are not newly granted loans), which were used by the borrowers as a bridging loan that, after the contractual conditions are met, are converted into standard building savings loans with a new repayment schedule and generally with better interest conditions.

In addition to the business indicators, the status of deposits after the minimum saving period provides further information regarding the situation in the building savings bank sector. This is the share of total deposits consisting of the deposits of those participants who have met the condition of the minimum saving period (currently six years) and who may theoretically terminate their building savings contract at any time and subsequently withdraw the saved amount (in accordance with the business terms and conditions) within a time frame of no more than three months. Looking at Graph 5.13 it is apparent that these deposits after the minimum saving period made up 60.3% of all deposits kept in building savings banks accounts. This particular indicator achieved its highest historical value at the end of 2008, which corresponds to the end of the minimum savings period (originally five years) for the increased number of contracts that were concluded at the end of 2003.

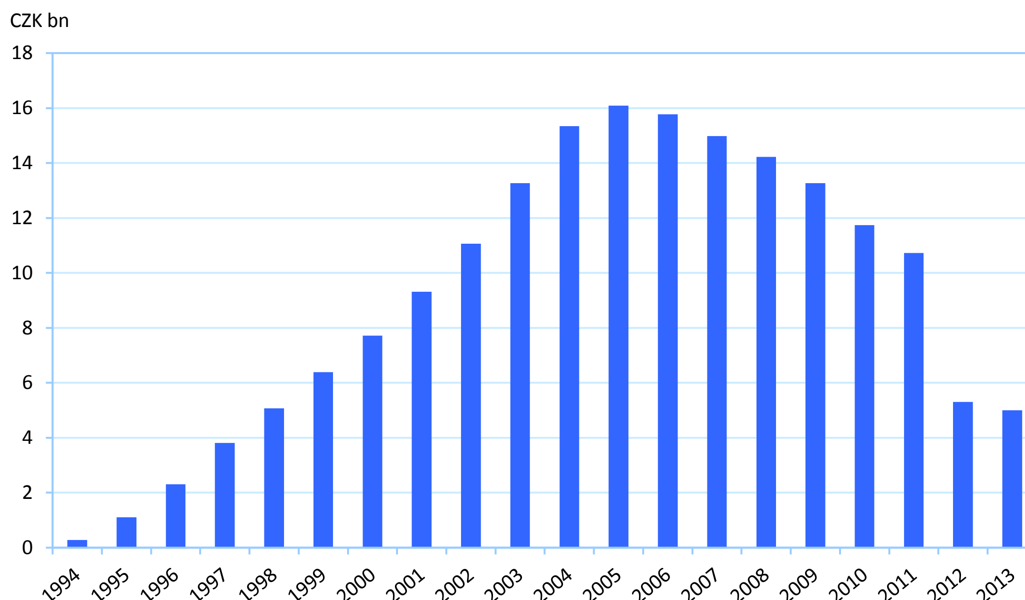
Graph 5.13: Percentage of deposits after the minimum saving period



Source: CNB - ARAD

State contributions totalling CZK 5.0 billion were paid in 2013 for building savings schemes, which is CZK 337 million (6.4%) less than in 2012. A more significant decline was recorded between 2011 and 2012 (a decrease of 50.7%) due to the consequences of the amendment to Act No 96/1993 Coll., on building savings and state contribution for building savings. Specifically, the annual amount of the state contribution was decreased to a maximum of CZK 2,000 effective on 1 January 2011. Since 1993, the government has paid out state contributions totalling approximately 183 billion to participants in building savings schemes (refer to Graph 5.14).

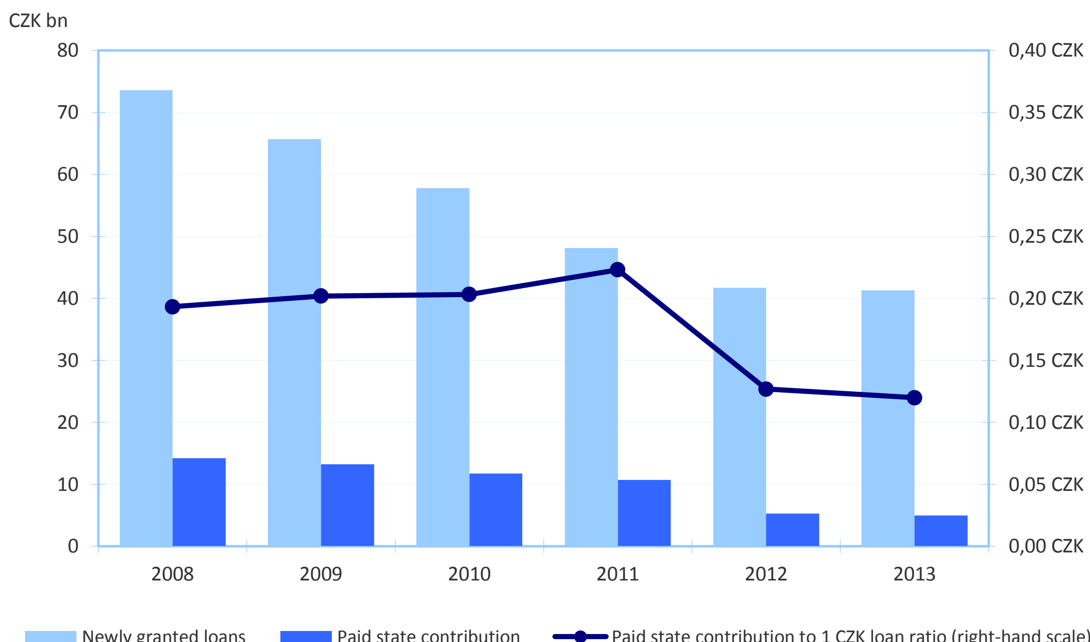
Graph 5.14: Paid state contribution



Source: MoF

Given that the state supports building savings schemes with funds from the state budget and because the purpose for which these funds are used is only proven at the time a loan is used, the state support may be interpreted as a contribution towards financing housing needs. The line in Graph 5.15 plots the amount of the state contribution allocated for each 1 CZK of the expenditure (i.e. loan) generated by the building savings bank sector and earmarked specifically to finance housing needs. In 2013 this amount was CZK 0.12, which is equal to only about half the value during the 2008 to 2011 period (when it was approximately CZK 0.20). It is expected that this coefficient will stabilise at a level above CZK 0.10 during the coming years.

Graph 5.15: Paid state contribution to loan ratio



Source: MoF

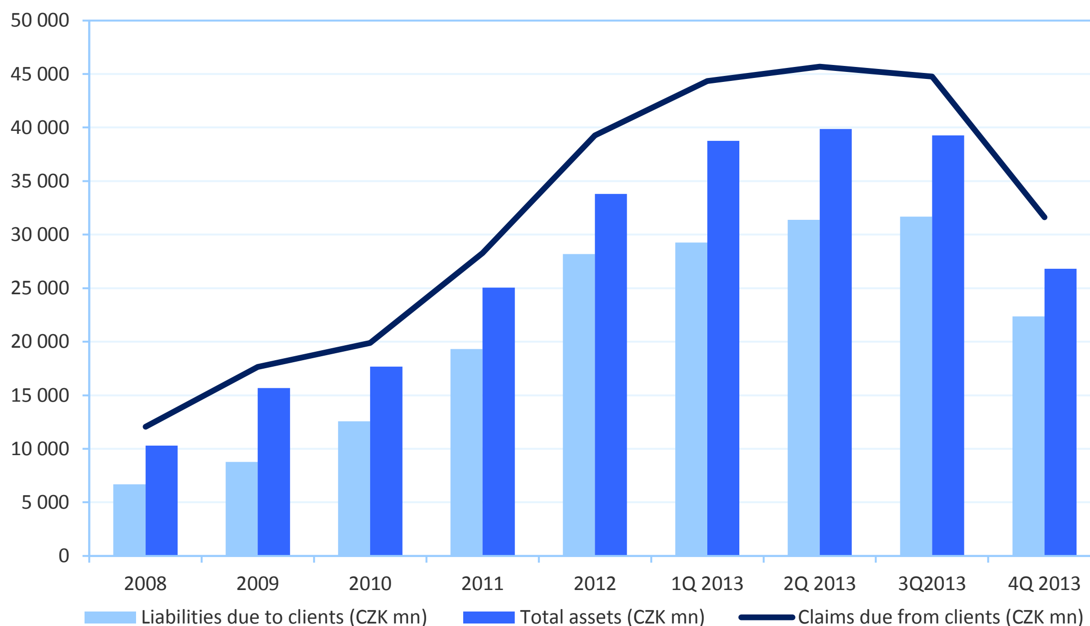
More detailed information about the building savings bank sector is updated and published quarterly on the MoF's website at www.mfcr.cz (refer also to Table P2.4 in Appendix 2).

5.9. Credit Unions

Without a doubt the most important event that occurred within the credit union sector in 2013 was the revocation of the operating permit of the largest credit union – Metropolitní spořitelní družstvo. The CNB took this step on 18 December 2013. This action significantly affected the data for the credit union sector at the end of 2013, as the data for the Metropolitní spořitelní družstvo is no longer included. For this reason the following graphs include the developments in each individual quarter of 2013. More detailed information about why this credit union's licence was revoked is providing in Chapter 4.1 – Financial Market Entities.

The profit after tax reported by the credit union sector decreased by approximately 279 million CZK when compared to the previous period. After profits of CZK 303.8 million in 2012, the sector reported a profit of CZK 25 million for 2013, however this figure has not yet been confirmed by an audit. The balance sheet total for the sector dropped from CZK 39 billion in 2012 to CZK 31 billion at the end of 2013. This represents a mere 0.6% of the balance sheet total for the banking sector. Graph 5.16 depicts this 19.4% year-on-year decrease in the credit union sector's balance sheet total, however the number of credit union members decreased by only 1.5% to 53,595 over the course of the year. It is necessary to once again stress the fact that the decrease was the result of the revocation of the operating licence of the Metropolitní spořitelní družstvo. If the members of this particular entity move their funds to other credit unions, this decrease may be only of a temporary nature. For this reason it may be more appropriate to illustrate the development in the credit union sector using the data from the third quarter of 2013, when the number of credit union members totalled 66,800, reflecting a year-on-year increase of approximately 33%. A comparable year-on-year increase, specifically 30%, can also be seen in the case of the sector's balance sheet total. The main reason behind this growth was the significant increase in the volume of deposits (reflecting a year-on-year increase of more than 16% as of the end of the third quarter). This result may be attributed primarily to the credit union sector's more aggressive interest policy. Whilst the average interest paid on client deposits by banks was about 1% in 2013, in the case of the credit unions it was at a level of 3.1%. This difference is reflected in the greater appeal that credit unions have for depositors, particularly as the funds deposited in credit unions are insured up to the same level as banks, i.e. EUR 100,000.

Graph 5.16: Main growth indicators for the credit union sector

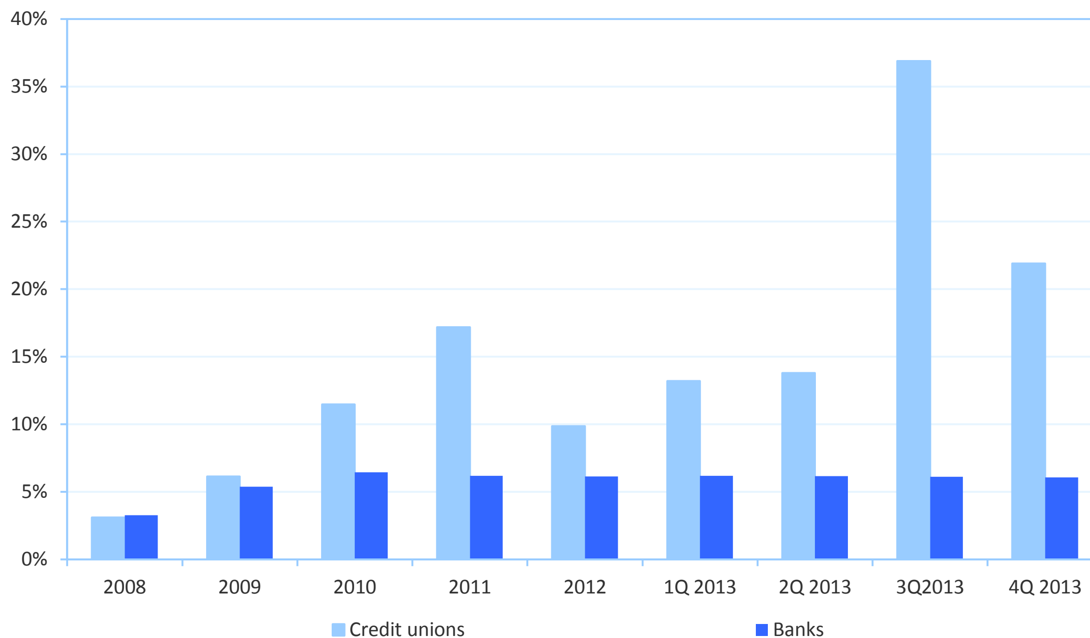


Source: CNB

As of the end of the third quarter, the total volume of loans provided within the credit union sector reflects a year-on-year increase of 10.6%. By the end of the year, due to the failure of the Metropolitní spořitelní družstvo, this volume had decreased by 24.9% to almost CZK 27 billion. Credit unions generally provide loans at higher interest rates as compared to banks – in 2013 the average interest rate for client loans charged by credit unions was 8.6% as compared to 4.6% in the case of banks. This plays a significant role in determining the structure of a credit union's client portfolio and borrowers are often recruited from the ranks of clients

who have been turned down by banks. The end result is that there are problems with the repayment of loans, as can be seen in the increase in the share of non-performing loans (refer to Graph 5.17). This particular indicator illustrates that the risk associated with the loan portfolio has increased from 3.1% in 2008 to 21.9% at the end of 2013. At the end of the third quarter of 2013, the share of non-performing loans was as high as 36.9%, particularly due to the Metropolitní spořitelní družstvo, which reported a 74.6% share of loans in default for the period. Within the banking sector, this indicator has fluctuated around a level of approximately 6% since 2010.

Graph 5.17: Non-performing loans



Source: CNB

In addition, during the 2008-2011 time frame, this deterioration in the loan portfolios of the credit unions has been accompanied by a decrease in their capital adequacy. During this aforementioned period, another warning sign could be found in the significant drop in the quick assets within the credit union sector in relation to the total assets. It is possible to explain this drop on the basis of the lower level of credit union deposits in banks, i.e. the decreasing level of their involvement in the interbank market, and the increasing level of loan saturation in relation to client deposits within the credit union sector. The deteriorating trend of both of these indicators was interrupted in 2012 and this break was further confirmed in 2013, as can be seen in the data provided in Table 5.9.

Table 5.9: Credit unions – selected indicators

As of 31 December	2008	2009	2010	2011	2012	3Q 2013	2013
Number of members of credit unions	39 942	47 952	34 003	44 687	54 402	66 800	53 595
Total assets (CZK mn)	12 057.3	17 649.1	19 890.3	28 274.9	39 254.4	44 754.8	31 621.5
Claims due from clients (CZK mn)	6 675.3	8 778.2	12 569.3	19 327.0	28 171.8	31 667.8	22 376.2
Liabilities due to clients (CZK mn)	10 290.9	15 673.4	17 668.3	25 060.1	33 819.0	39 265.9	26 825.8
Quick assets/Total assets (%)	32.2	25.5	17.6	13.1	14.3	18.3	18.6
Capital adequacy (%)	17.4	14.5	12.2	12.1	13.3	12.9	14.3

Source: CNB

In general, the rapid growth in the credit union sector can be credited to the large and medium-sized credit unions, whose balance sheet totals exceed CZK 1 billion and continue to increase over time. Thanks to their size and product portfolios, these credit unions are more like small banks. As compared to banks, however, credit unions suffer from certain competitive disadvantages. At the end of 2013 there were five such large credit unions in the market and their deposits represented over 90% of the sector's total deposits. These

entities continue to grow, even though the operating licences of two of the largest credit unions have been recently revoked, specifically Unibon's licence in 2012 and the licence of the aforementioned Metropolitní spořitelní družstvo in 2013. The growing instability of the medium-sized and large credit unions also presents a greater risk for the Deposit Insurance Fund. Just the reimbursement of the deposits of the failed Metropolitní spořitelní družstvo has been calculated at over CZK 12 billion, which represents almost half of all the Deposit Insurance Fund's available resources. As of May 2013, another large credit union – WPB Capital – is not allowed to accept deposits, disburse settlement shares, and enter into or extend existing loan agreements. On 7 April 2014 this credit union received the not-yet legally enforceable decision on the basis of which the CNB is revoking its licence to operate as a credit union. The credit union is planning to lodge an appeal against this decision within the legally allowed time frame.

As a result of the developments in the credit union sector and on the basis of the conclusions and recommendations of the IMF's Financial Sector Assessment Programme (FSAP), in the summer of 2013 the Ministry of Finance submitted a draft proposal for the Act on Credit Unions. Due to the dissolution of the Chamber of Deputies this draft was not discussed. This draft was resubmitted in 2014 and supplemented to include additional measures. The overall objective of the draft proposal for the legislation is to tighten the regulatory framework and thus stabilise the credit union sector, to limit the size of the individual entities of this sector with the aim of limiting the risk faced by the Deposit Insurance Fund. The individual measures contained in the draft legislation are described in Appendix 1, which covers the topic of financial market legislation.

5.10. Non-Bank Financing Providers

Non-bank financing providers present an alternative to credit institutions with regard to the options available for obtaining loan financing. At the end of 2013 their reported balance sheet totalled CZK 347.1 billion (refer to Table 5.10) and was not equal to even 10% of the balance sheet total for the banking sector. In addition, this sector's balance sheet total has declined by 22.8% during the time frame between the end of 2008 and the end of 2012. This downward trend was, however, broken in 2013, when this sector reported a slight increase in its balance sheet total (by 0.8 billion, or 0.2%). This did not halt the decrease in the volume of provided financing (a year-on-year decrease of CZK 6.9 billion, or 2.7%, and, as compared to the end of 2008, a drop of 30.2%).

This sector is usually (and also in terms of reporting) split into three segments: financial leasing companies, other lending companies, and factoring and forfaiting companies. From the perspective of the share of overall balance sheet total, the sector is dominated by financial leasing companies dominated (74.2%), followed by other lending companies (20.4%), and factoring and forfaiting companies (5.4%).

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

As at 31 Dec, (CZK bn)	2008	2009	2010	2011	2012	2013
Total assets [32]	448.9	404.2	352.3	356.1	346.3	347.1
Loans provided	357.7	299.0	260.8	266.3	256.6	249.7
Volume of total assets						
Financial leasing companies	309.5	282.5	265.2	265.1	259.3	257.6
Other lending companies	114.4	100.7	67.7	71.3	70.5	70.8
Factoring and forfaiting companies	25.0	20.9	19.5	19.7	16.6	18.7
Relative share of the sector's assets (in %)						
Financial leasing companies	68.9	69.9	75.3	74.4	74.9	74.2
Other lending companies	25.5	24.9	19.2	20.0	20.3	20.4
Factoring and forfaiting companies	5.6	5.2	5.5	5.5	4.8	5.4

Source: CNB – ARAD

The total asset volume of financial leasing companies has not changed in any significant way over the past few years in comparison with the other segments and in 2013 recorded a year-on-year decline of about 0.6% to CZK 257.6 billion. The number of provided loans decreased year-on-year by 5.0% to CZK 178.8 billion. This item thus represents about 69.4% of total assets. The volume of equity is approximately 24% of the balance sheet total. However, due to very specific characteristics of this sector and the different business model that is

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

used, this indicator is not fully interchangeable with capital, or more specifically, the capital adequacy of banks.

The balance sheet total for other lending companies grew slightly by 0.5% as compared to the slight decline that was reported for the previous year. As was the case in the previous year, the slight growth in the absolute value of the balance sheet total was mainly thanks to short-term loans, the volume of which increased by 5.6% year-on-year. Conversely, long-term loans recorded a decline of 3.6%. The total volume of loans recorded a year-on-year increase of 0.6%. The equity to total assets ratio was approximately 45.4%, which reflects a year-on-year increase of 1 pp. As was the case in the other segments, the other lending companies segment has experienced a decline in the balance sheet total between the end of 2008 and the end of 2012, specifically a drop of 38.4%. The volume of provided loans decreased by almost 40% during this period. The data for 2013 indicate that this downward trend has been interrupted.

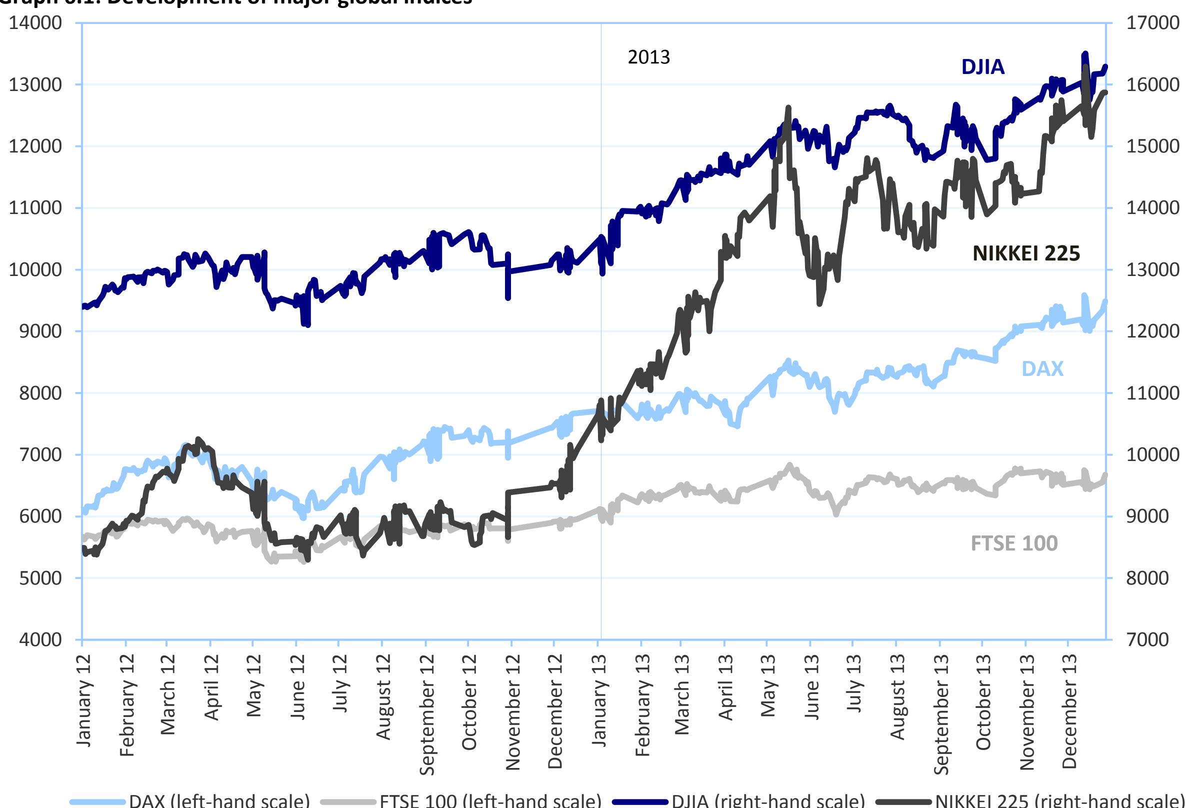
At the end of 2013 the balance sheet total for factoring and forfaiting companies was CZK 18.7 billion, which represents a year-on-year increase of 12.8%. This breaks the downward trend that started in 2008, when the balance sheet total for this segment started to gradually decline (although with different dynamics) from its maximum of CZK 26.0 billion at the end of 2007. Over the course of the next five years it declined by more than one third (36.3%) by the end of 2012. The lending activity in this segment is dominated by short-term loans granted to residents, which account for about 82.4% of asset volume. A year-on-year increase of 17.1% was reported for this category of loans. The volume of provided long-term loans continued to decrease and reached a level of less than CZK 0.2 billion.

6. CAPITAL MARKET

During 2013 the events in the capital markets were influenced primarily by many factors. The most significant of these is the activity of the central banks, which, in an effort to decrease the aversion to risk on the part of individual economic entities, supported investment in higher-risk assets, including shares. The performance of shares was also affected by the generally increasing profitability of companies and the performance of individual economies.

Of the advanced economies, by far the most acquisition-oriented central bank in 2013 was the Bank of Japan, which, over the course of the year, increased its balance sheet total by 55 trillion yen.[33] It was primarily thanks to this central bank's aggressive monetary policy that the Japanese NIKKEI 225 stock index increased its profit by 56.7% and thus added to the significant growth reported for the fourth quarter of 2012. Out of the stock indices of the advanced economies, the Japanese index the most profitable in 2013.[34] The American Dow Jones Industrial Average (DJIA) also developed very positively and reported year-on-year growth of 26.5%. In spite of a slow start during the first half of the year, the German DAX index recorded year-on-year growth of 25.5% and reached its historically highest value at the end of the year. It performance over the course of the year came close to that of 2012, when it grew by 29%. The British FTSE 100 also recorded satisfactory growth and increased by 14.4% year-on-year.

Graph 6.1: Development of major global indices



Source: Market organizers

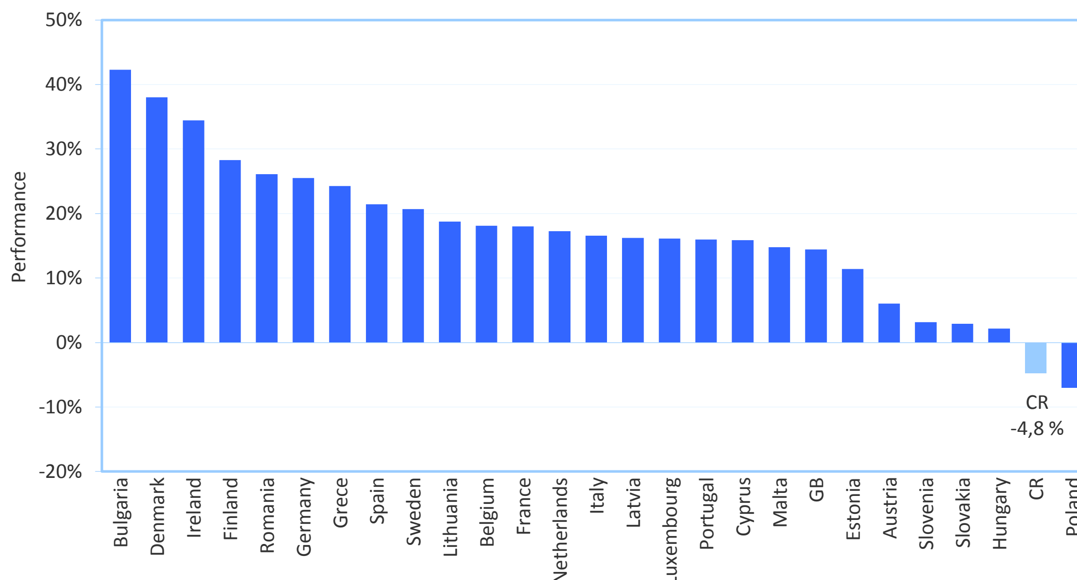
From the perspective of the European stock indices, their development continued on from that of the previous year and the overall results may be termed successful. In addition to the aforementioned German and British indices, significant growth was recorded by the Danish, Irish, and Finnish indices and even by the national indices in Greece and Spain. The best performance, however, was reported by the Bulgarian stock index, which added 42.3% to its value. Of the main stocks in the European Union, the worst results were reported in the countries of the Visegrad Four, particularly by the Czech and Polish stock indices, which were the only ones

[33] At the end of 2013 the ration of the Japanese central bank's asset to nominal GDP ration attained a level of 40%, which is the highest within the context of the most important central banks.

[34] The monetary expansion was also reflected in the significant weakening of the Japanese yen, which, in relation to both the dollar as well as the euro, reached a five-year minimum value. This of course had a positive effect on the development of the NIKKEI 225 index.

to report a year-on-year decline. The Czech index decreased by 4.8% and in Poland, the decrease was an even higher 7.0%. Conversely, both the Hungarian and the Slovakian indices reported slight growth of 2.1% and 2.9% respectively.

Graph 6.2: Performance of significant stock exchange indexes in the EU member states in 2013[35]



Source: FESE

6.1. Regulated Stock Market

The main PX stock index recorded a decline of 4.8% in 2013. The index fluctuated between 852.9 to 1,066.1 points over the course of the year. It reached its peak value at the very start of the year. Then gradually declined during the entire first six months to reach its lowest level at the end of June. This trend was subsequently reversed and, with only smaller fluctuations, the PX continued to strengthen up to the end of November. The previous growth of the index was partially corrected in December. The development in the PX index in 2013 was very comparable to that in 2012, when the first half of the year saw a general decline, followed by a period of general growth during the second half.

[35] ATX, Belgium: BEL 20, Bulgaria: SOFIX, Cyprus: FTSE/CySE 20, Czech Republic: PX, Denmark: OMXC 20, Estonia: OMXT, Finland: OMXH 25, France: CAC 40, Germany: DAX, Greece: FTSE/ATHEX 20, Hungary: BUX, Ireland: ISEQ, Italy: FTSE MIB, Latvia: OMXR, Lithuania: OMXV, Luxembourg: LuxX, Malta: MSE, Netherlands: AEX, Poland: WIG 20, Portugal: PSI 20, Romania: BET, Slovakia: SAX, Slovenia: SBI 20, Spain: IBEX-35, Sweden: OMXS 30, United Kingdom: FTSE 100. The graph does not include the development of the stock index in Croatia, which became a member state of the EU on 1 July 2013.

Graph 6.3: PX index development

Source: PSE

Looking at Table 6.1 it is obvious that after its growth in 2012 the PX index shows a year-on-year decline. Nevertheless, its value exceeds the level reported at the end of 2011.

Table 6.1: PX and PX-TR index values

		2008	2009	2010	2011	2012	2013
PX	as at 31 Dec	858.2	1 117.3	1 224.8	911.1	1 038.7	989.0
	Change (%)	-52.72	30.19	9.62	-25.61	14.01	-4.78
PX-TR	as at 31 Dec	949.1	1 307.4	1 500.8	1 181.3	1 397.9	1 389.4
	Change (%)	-50.97	37.75	14.80	-21.29	18.33	-0.60

Source: PSE

Within the context of an international comparison, the PX index still reports a very positive dividend profit level, which had an average value of 5.2% over the course of 2013.[36] In this respect, the PSE is one of the world's most profitable stock markets[37] and it wants to take advantage of this aspect in the future. The PSE is preparing to attract investors through its new Total Return Index (PX-TR), which it started to publish on 24 March 2014. The index was retroactively calculated back to 2006 and its development is specified in Table 6.1. This index aims to present a more realistic picture of the profitability of individual stocks. The base for the PX-TR index corresponds to that of the PX index, however, it also takes into account dividend payouts. For this reason, as is the case with the PX index, the development in the new index has an effect particularly on the shares issued by ČEZ, Erste Bank, Vienna Insurance Group, and Komerční banka, or, more specifically, on the level of their dividend profit. The year-on-year change in PX-TR index fluctuated at approximately zero and thus was stagnating.

As far as the individual stocks are concerned, the greatest growth was reported for the shares issued by Fortuna, which increased by 40%. If the value of their dividend is included, the total growth was approximately 60%. The shares issued by the spun cloth manufacturer Pegas NW also performed favourably and increased by 20.1%. Investor interest was also focused on financial stock, and both Erste as well as Komerční banka recorded profit growth of 15.0% and 10.3% respectively. At the other end of the spectrum, the shares issued by the NWR mining company reported a year-on-year drop of 75.7%, making them the most unprofitable stock of 2013. The decrease in energy prices led to a drop in the price of the shares issued by ČEZ, which lost 24.0% of their value in 2013.

[36] Dividend profit = dividend per share / market price per share

[37] Dividend profit of selected stock indices: Polish WIG – 3.7 %, German DAX – 2,8 %, British FTSE 100 – 3.5 %, American Dow Jones – 2.1 %.

Table 6.2: Companies included in the PX index

Millions of CZK	Market capitalisation	Trade volume	Share price 31.12.2012	Share price 31.12.213	Year-on-year change (%)
ERSTE GROUP BANK	300 000	26 431	607	698	15.0
ČEZ	278 141	64 746	680	517	-24.0
KOMERČNÍ BANKA	168 042	46 173	4 010	4 421	10.3
VIG	126 720	1 266	1 000	990	-1.0
TELEFÓNICA O2 C.R.	93 116	23 473	324	295	-8.8
UNIPETROL	30 464	1 193	175	168	-4.0
PHILIP MORRIS CR	20 245	2 417	10 700	10 579	-1.1
STOCK	18 990	48	-	95	-
CETV	9 870	2 574	110	73	-33.4
NWR	6 285	3 218	98	24	-75.7
FORTUNA	6 172	1 112	85	119	40.0
PEGAS NONWOVENS	5 464	1 364	493	592	20.1
ORCO	5 090	397	61	45	-27.5

Source: PSE

During the entire 2013 period 408 million shares with a total value of CZK 174.7 billion were traded. The downward trend in trading activity continued in 2013 and the average daily trade volume declined by 30.3% (refer to Table 6.3), thus adding to the similar rate of decline that was reported for the previous year (32.5%). As compared to 2008, investor activity has declined by almost 79.5%. ČEZ maintained its position as the most traded stock on the market, followed by Komerční banka, Erste bank, and Telefónica CR.

There was a very sharp decline of 99.7% in bond trading on the Prague Stock Exchange in 2013. This drop in traded bond volume is the result of the new definition of stock exchange transactions, which is associated with the implementation of the new Xetra system. Until the time the Xetra trading system was implemented, the term "stock exchange transaction" included block transactions (which make up 99% of all bond transactions) in addition to automatic transactions. With the introduction of the Xetra system, block transactions were terminated and replaced with OTC transactions. These transactions are reported in the statistics published by the Central Securities Depositary. The PSE's statistics now report only transactions completed in the Xetra trading system. AS recently as in 2012, bond transactions represented more than 70% of all trading on the Prague Stock Exchange.

Table 6.3: Trade value

Annual (CZK bn)			2010	2011	2012	2013	Year-on-year change (%)
PSE	Shares and investment units		389.9	371.0	250.6	174.7	-30.3
	Bonds		529.9	628.0	594.2	1.9	-99.7
	Derivatives	Futures	0.2	0.2	0.0	0.0	-
		Certificates and warrants	0.2	1.1	0.0	1.5	-
		Total	0.4	1.3	0.1	0.0	-
	Total		920.1	1 000.3	844.9	178.1	-78.9
RM-S			9.2	8.9	6.1	4.8	-20.7
Total			929.3	1 009.2	851.0	361.1	-57.6

Source: PSE, RM-S

Even in spite of the aforementioned drop in bond trading on the PSE, the number of registered bond issues increased during the year. Conversely, there was a slight decline in the number of registered share issues. The total number of individual stock issues traded on the stock exchange grew quite drastically in 2013 (refer to Table 6.4). This was primarily the result of the significant increase in the number of traded derivatives and other investment certificates. However, the volume of derivative trading on the Prague Stock Exchange remains marginal. The liquor manufacturer STOCK started to be traded on the PSE in October 2013 and enjoyed relatively favourable development. The shares issued by AAA Auto stopped being traded on the stock exchange during the summer. They are, however, still traded in the RM-System.

Table 6.4: Number of registered issues[38]

As at 31 Dec		2009	2010	2011	2012	2013
Shares		25	27	26	28	26
Bonds		116	106	95	98	110
Derivatives and other products	Futures	6	6	6	0	0
	Investment certificates	65	42	44	30	103
	Warrants	2	2	24	0	0
	Total	73	50	74	30	103
Total		214	183	195	156	239

Source: BCPP

In general, it is possible to say that the development on the stock exchanges in 2014 will once again be significantly affected by the monetary policy of the main central banks, or, more precisely, by changes in the way their non-standard monetary policy instruments are defined. Some believe that the shares issued in emerging markets have more of a long-term growth potential, however these have a higher risk of negative development if the scope of the non-standard measures implemented by the main central banks are limited. On the other hand, the valuation of shares in some developed economies does not truly correspond to the development in real values and it is therefore impossible to exclude the possibility of future price corrections. Specifically the PX index should be affected by the length of time that the foreign exchange interventions remain in effect as well as by the development in the economic variables. The unfavourable declining trend in the volume of traded shares could be reversed as a result of such things as, for example, the pension reform in Poland, which does not allow pension funds to invest in unregulated markets, or the aforementioned implementation of the PX-TR index that takes dividend profit into account.

The Power Exchange Central Europe (PXE), previously known as the Prague Energy Exchange, is a subsidiary of the Prague Stock Exchange and is used primarily for the trading of derivative contracts. In 2013 the trading volume on the PXE grew by 23.1% to EUR 1.161 billion. The volume of trading thus came close to the level in 2010, when it was EUR 1.171 billion. Therefore, as regards volume, the PXE plays an absolutely minor role within the context of the financial market. Once again, futures contracts held the most important position on the PXE and the previously already minimal spot trading volume dropped to absolute zero, just as it did in 2012.

Table 6.5: Main indicators of trading on the PXE

Indicator	Market	2010	2011	2012	2013	Year-on-year change	
						Abs.	(%)
Trading volume (EUR mn)	Futures	1 171.0	1 327.4	943.6	1 161.2	217.6	23.1
	Spot	3.9	1.7	0.0	0.0	0.0	-
	Total	1 174.9	1 329.1	943.6	1 161.2	217.6	23.1

Source: PXE

6.2. Securities Dealers and Asset Management

The trading volume in the securities dealer sector increased by 30% year-on-year to CZK 65.4 trillion. This significant increase in trading volume is due to the activities of non-bank securities dealers, who, in 2013, closed deals totalling CZK 17.4 trillion more than in 2012. The greatest growth was in the number of closing transactions completed for the clients whose assets they manage. As a result, the dominant position of bank securities dealers was significantly weakened, as they participated in only 70.7% of all transactions. In comparison, in 2012 the share of total closed transactions in which the bank securities dealers participated was at a level of 96%. Bank securities dealers are still however maintaining their dominant position with regard to the volume of transactions performed on own account. Non-bank securities dealers, together with investment companies, continue to hold a larger share with respect to managing their clients' assets.

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

Table 6.6: Selected indicators for the securities dealers sector[39]

As at 31 Dec (excl. derivatives, CZK bn)	2012	2013				Year-on-year change	
	Total	Bank securities dealers	Non-bank securities dealers	Investment companies[40]	Total	Abs.	(%)
Total number of licensed entities	67	28	36	7	71	4	6.0
Total value of executed transactions[41]	50 363.2	46 192.5	19 183.4	72.0	65 447.9	15 084.7	30.0
of which: on the basis of asset management contracts	681.6	74.4	16 403.4	72.0	16 549.8	15 868.2	2 328.1
of which: on the basis of other than asset management contracts	8 667.8	7 820.5	2 501.6	0.0	10 322.1	1 654.3	19.1
of which: on own-account basis	41 013.7	38 297.6	278.3	0.0	38 575.9	-2 437.8	-5.9
Value of managed funds	604.5	57.2	333.4	224.7	615.3	10.8	1.8
Value of clients' assets	2 724.9	2 340.1	417.4	225.4	2 982.9	258.0	9.5
Number of clients (according to contracts, in thousands)	876.0	705.6	203.4	0.7	909.7	33.7	3.9

Source: CNB

Asset Management

The volume of managed assets increased by 10.1% in 2013 to CZK 975.1 billion at the end of the year. The concentration on the asset management market has recorded a slight decline for the third year in a row. Although the three largest companies recorded an increase in the volume of assets, their market share decreased by 1.5 pp to 58.4%. As can be seen in Table 6.7, once again the smaller asset management companies and one medium-sized company reported higher relative levels of growth.

Table 6.7: Financial groups by value of assets under management

As at 31 Dec (CZK bn)	Value of assets under management		
	2012	2013	Change (%)
Generali PPF Asset Management a. s. + ČP INVEST investiční společnost. a.s.	221.5	230.5	4.1
Česká spořitelna (group)	163.8	176.7	7.9
ČSOB (group)	145.2	162.5	11.9
Komerční banka (group)	93.9	117.5	25.2
ING (group)	105.3	109.1	3.6
AXA Investiční společnost. a. s.	54.2	57.8	6.7
Conseq (group)	24.1	27.3	13.5
UniCredit Bank. a.s. + Pioneer investiční společnost. a.s.	18.4	21.8	18.4
AMISTA investiční společnost. a. s.	17.5	21.4	22.0
Raiffeisenbank a.s.	15.5	17.3	11.6
Others	26.0	33.2	27.4
Total	885.4	975.1	10.1

Source: AKAT

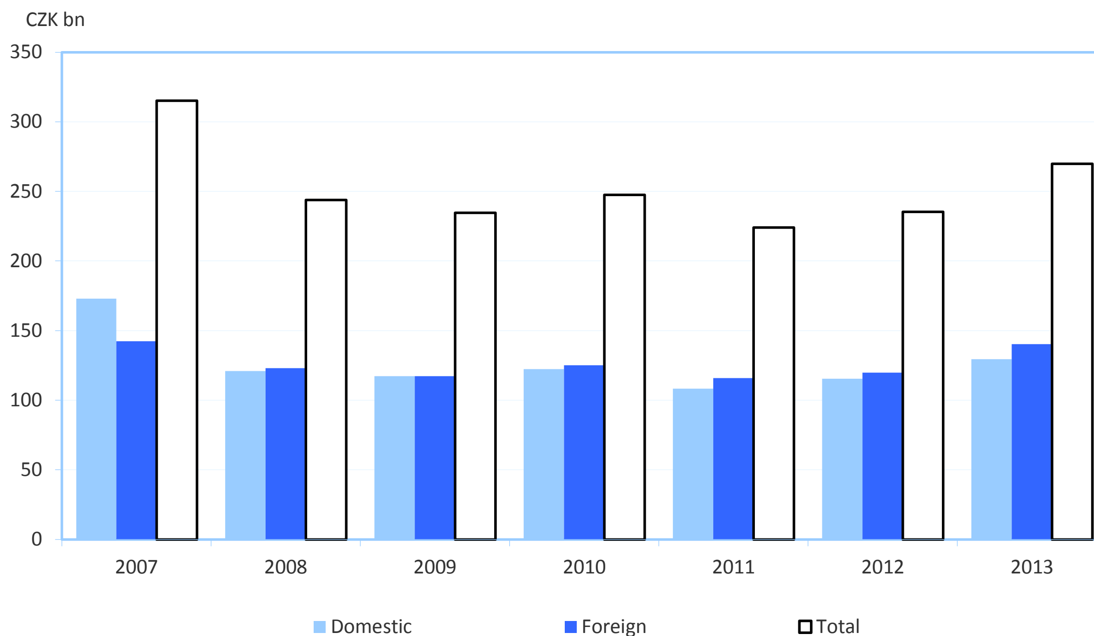
6.3. Investment funds

In 2013 the volume invested in collective investment funds grew by 14.7% (CZK 34.5 billion) and, at the end of the year, CZK 269.8 billion were invested in this category of funds. The value of the assets in foreign funds increased by CZK 20.5 billion as compared to only CZK 14 billion in the case of domestic funds. Therefore,

[39] Given that the value of derivative contracts is available only at the level of the value of the underlying assets, they are not included in the table.
[40] Investment companies that manage client assets.
[41] The total includes all closed transactions (sales and redemptions) executed on the PSE, RM-S, and foreign markets or as direct trades for shares, participation certificates, and bonds, and performed either on the client's account or on the security trader's account. The total does not include derivative transactions.

the apparent reversal of the previous trend that was seen in 2012, when domestic funds recorded a higher level of year-on-year growth than foreign funds for the first time since 2008, was not confirmed. Foreign funds still continue to hold a higher volume (CZK 140.4 billion) than domestic funds (CZK 115.4 billion), as is illustrated by Graph 6.4.

Graph 6.4: Allocation of investments in mutual funds by domicile



Source: AKAT

As can be seen in Table 6.8, mixed funds saw the greatest growth in volume in 2013 (an increase of CZK 15.7 billion), followed by equity funds (an increase of 11.2 billion). The volume of assets in mixed funds increased in all four quarters of 2013, and, as a result, from the perspective of volume of assets, mixed funds almost reached the level of equity funds, which experienced the greatest growth in assets during the second half of 2013. The increases in the volume of assets managed in both equity and mixed funds were primarily the result of the favourable development on the stock markets in developed countries during the second half of 2013. Funds of funds also fared well during the entire year. Real estate funds experienced the largest relative growth in assets; however, this is due to the low volume of assets they contain. The greatest outflow of resources can be seen in the case of money market funds (a decrease of CZK 5 billion). Guaranteed funds did not do well either. Bond funds, which acquired the greatest level of investor confidence in 2012, recorded only relatively slight growth in the volume of managed assets. However, bond funds continue to retain their dominant position amongst the various types of mutual funds in terms of the overall volume of managed assets.

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

As at 31 Dec (CZK bn)	2012			2013			Year-on-year change (%)		
Mutual fund type	Domestic	Foreign	Total	Domestic	Foreign	Total	Domestic	Foreign	Total
Bond	50.9	30.9	81.8	54.4	34.0	88.4	6.9	10.0	8.1
Equity	14.3	26.7	41.0	18.2	34.0	52.2	27.3	27.3	27.3
Mixed	23.8	12.0	35.8	26.3	25.2	51.5	10.5	110.0	43.9
Guaranteed	1.6	37.3	38.9	1.3	35.6	36.9	-18.8	-4.6	-5.1
Fund of funds	17.8	0.3	18.1	24.0	0.5	24.5	34.8	66.7	35.4
Money market	4.8	12.2	17.0	1.8	10.2	12.0	-62.5	-16.4	-29.4
Real estate	2.3	0.4	2.7	3.4	0.9	4.3	47.8	125.0	59.3
Total	115.4	119.9	235.3	129.4	140.4	269.8	12.1	17.1	14.7

Source: AKAT

The change in the volume of managed assets is influenced by two key factors: the increase in value achieved by the fund, and net sales. Net sales represent the change in fund assets resulting from the purchase and sale of investment units that do not have an effect on fund performance but only on the volume of assets. Looking at Table 6.9, which, due to the unavailability of data, provides information only about the sale and redemption of investment units in domestic funds, it is obvious that, from the perspective of net sales, domestic funds of funds recorded the best results in absolute terms followed by mixed funds. As regards an increase in value, equity funds and bond funds fared the best. However, due to the higher volume of managed assets, domestic bond funds show a much lower relative increase in value in 2013 as compared to equity funds. Money market funds recorded unfavourable development form the perspective of both aspects. To a certain degree, this is the result of the low interest rates for short-term investments and the growing popularity of savings accounts, which can be considered as a substitute for those collective investment funds that have a lower level of associated risk. It is very likely that the outflow of assets from monetary funds will continue in 2014 due to the continuing low interest rates.

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

(CZK bn)	Sales	Redemptions	Net sales	Change in the asset value	Change adjusted for net sales
Bond	19.6	19.1	0.5	3.5	3.0
Equity	4.4	3.6	0.8	3.9	3.1
Mixed	8.1	4.4	3.7	2.5	-1.2
Guaranteed	1.3	0.4	0.9	-0.3	-1.2
Fund of funds	13.7	4.5	9.2	6.2	-3.0
Money market	0.9	1.9	-1.0	-3.0	-2.0
Real estate	2.6	1.5	1.0	1.1	0.1
Total	50.7	35.4	15.3	14.0	-1.3

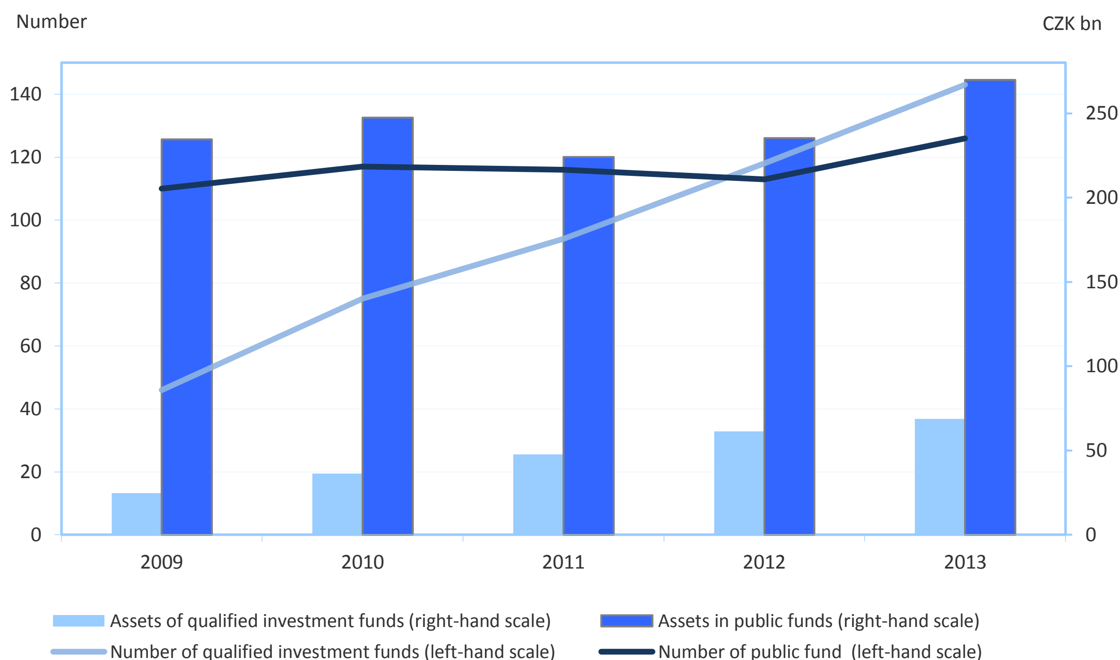
Source: AKAT

The assets kept in public mutual funds may continue to grow slightly, primarily in relation to the economic recovery that is starting to be apparent even on the capital markets. However, the question still remains regarding the effects of the extension of the time-exemption tax test for individuals from six months to three years, which entered into force on 1 January 2014. On the one hand, this tax measure will generally decrease the attractiveness of investments in the capital market; on the other, in the case of an actively managed portfolio, investing through funds as compared to the purchase of individual investments will be more advantageous (a change in the fund's portfolio will not affect the time-exemption test as opposed to a change in an investor's personal portfolio).

The volume of managed assets according to individual distributor for foreign funds and asset manager for domestic funds, including the year-on-year changes, are specified in Appendix 2, in Table P2.2 and Table P2.3 respectively.

In recent years moderately dynamic growth has been recorded for the sector of non-public funds (qualified investment funds). Over the past four years the number of these funds has increased by 97 (211%) and, since 2013, their number exceeds that of public funds. Although in 2013 the volume of the assets managed in qualified investment funds increased by CZK 7.2 billion to CZK 68.8 billion, this corresponds to only 25.5% of the volume of assets held in public funds, reflecting a 0.7 pp decrease when compared to 2012.

Graph 6.5: Structure of investment funds



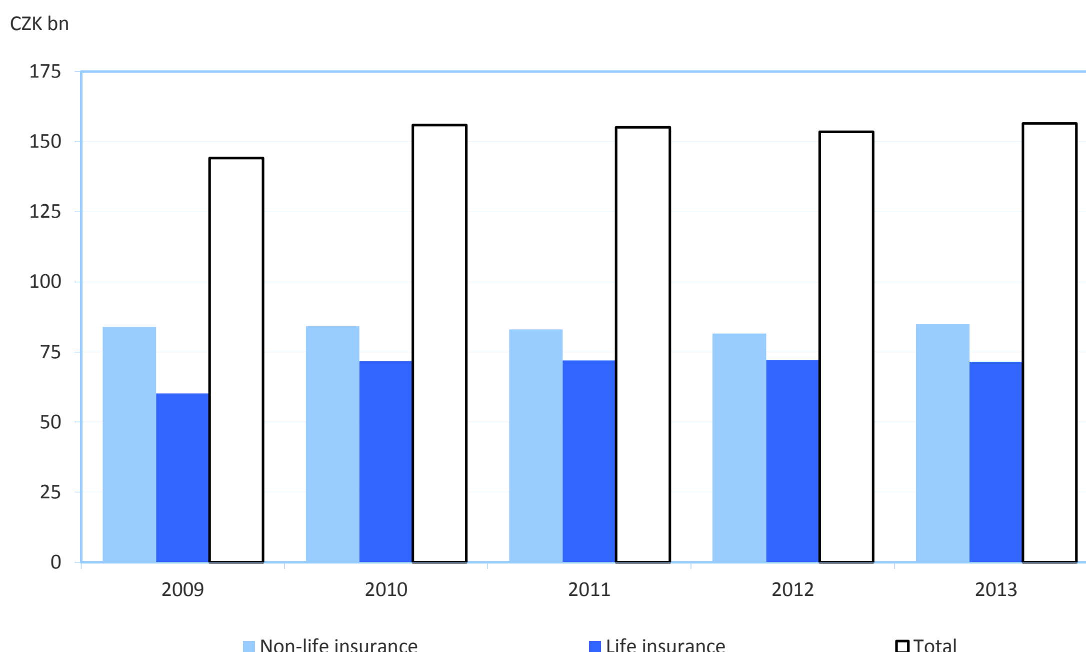
Source: AKAT, CNB
Note: Status at the end of period.

Within the context of a closer analysis of the development of qualified investment funds, it is difficult to differentiate between qualified investment funds established for the purpose of investment and funds that have been created for tax optimisation purposes – something that is very common. It is, however, possible to predict that both the number of qualified investment funds as well as the volume of assets managed in these funds will continue to grow, as, in August 2013, the Act on investment companies and investment funds entered into force. This legislation is aimed at promoting the attractiveness of entrepreneurial undertakings on the capital market within the Czech legal environment and it is therefore possible to expect that there will be more parties interested in qualified investment funds.

7. INSURANCE COMPANIES

In 2013 insurance companies successfully stopped the previous two-year downward trend in the collection of insurance payments, primarily thanks to the increase in the business conducted by Czech insurance companies abroad. In spite of this encouraging development, the mediocre results of the insurance market over the past few years are a reflection of the unfavourable economic development in the Czech Republic, albeit with a certain delay. The austerity measures in place in the business sector, combined with a higher level of unemployment and a stagnating level of disposable income, have resulted in a lower level of interest in insurance protection on the part of businesses and households. Gross premiums written increased by 1.9% to CZK 156.5 billion. [42] This value is comparable to the level reported in 2010, and, therefore, in spite of the indications that the trend is reversing, the insurance market may be characterised as stagnating for the past four-year period (refer to Graph 7.1).

Graph 7.1: The volume of gross premiums written



Source: CNB

The indicator of insurance penetration, which is the ratio of gross premiums written to nominal gross domestic product, achieved a level of 4% and was not significantly different from the values reported in previous years. It is not anticipated that this indicator will improve in 2014, as the insurance market is not expected to recover to a more significant degree until 2015 at the earliest. The insurance penetration indicator in the Czech Republic is below-average when compared with the advanced insurance markets of the developed Western countries. The insurance penetration per capita is also at about one third of the value reported in the EU member states.[43]

The proportionate market shares held by the two main sectors – life and non-life insurance – changed only slightly to the disadvantage of life insurance and were at the level of 46:54 at the end of the year. During the past years, in spite of the stagnating market, the share of life insurance had been increasing, thus bringing the structure of the Czech market closer to that found in advanced economies. Those countries report a share of life insurance equal to, on average, 60%. A higher share of life insurance (approximately 60%) is generally considered to be the unwritten ideal standard for the distribution between life and non-life insurance, although there may be deviations between the individual countries as a result of, for example, the structure of their national and private social security systems.

[42] The data in Chapter 7 – Insurance Companies specify the unreduced insurance market values, which differ from the data published by the Czech Insurance Association as they include lump-sum insurance premiums paid in their full annual amount.

[43] This is influenced not only by the lower level of accumulated wealth, but also due to different historical development and traditions. Insurance is still considered to be a non-essential expense in the Czech Republic, which, in the case of a stretched budget situation, can easily be reduced.

7.1. Development of Life and Non-Life Insurance

Within the non-life insurance sector, the gross premiums written indicator increased by 4.2% to almost CZK 85 billion. This development is primarily influenced by the situation in the main segments, i.e. motor vehicle and property insurance.

In the case of liability insurance for damage caused while operating a vehicle, which is the largest non-life product and has reached the very threshold of profitability over the past few years due to very high competitive pressure, the premium rates have stabilised and have even slightly increased. A comparable situation can be seen for accident insurance. The increase in the premium rates for liability insurance for damage caused while operating a vehicle is also partially the result of the new Civil Code and the associated repeal of the Ministry of Health decree that defined the rating scale for pain and social impairment resulting from damage to health. Since 1 January 2014, the circumstances of each individual case are taken into consideration when calculating the compensation for damage to health and death. In exceptional cases, a much broader range of persons will be able to claim a lump-sum settlement than has been the case until now, if they can prove that the death of an individual is a personal misfortune. It is expected that the number of court disputes will increase and that the settlement process will most likely be more complicated. In relation to this, the Supreme Court has prepared a methodology presenting a uniform interpretation of how to proceed when settling an insurance claim.[44]

In addition, starting in 2014, insurance companies have the obligation to contribute at least 3% of the premiums received for liability insurance for damage caused while operating a vehicle to the Damage Prevention Fund. This fund is managed by the Czech Insurers' Bureau and the contributions from the insurance companies are distributed amongst the fire and rescue services and other entities implementing projects to improve road safety. Starting in September 2013, the insurance companies are also required to pay the fire service a flat fee of CZK 5,600 for each, even partial, hour of intervention during a traffic accident as compensation for expenses. These regulatory provisions will undoubtedly be reflected in the premium rates charged for liability insurance for damage caused while operating a vehicle.

The ČKP has successfully been decreasing the number of uninsured vehicles. If the law is violated, the ČKP uses the contributions to the guarantee fund that is used to subsequently provide compensation for any damage caused by an uninsured vehicle. However, in spite of an intensive awareness-raising campaign promoting the necessity of having liability insurance for damage caused while operating a vehicle, a comparison of the ČKP's records with the motor vehicle register shows that a high number of vehicles remains uninsured.

There was a slight growth in the number of premiums written for property and liability insurance in the case of personal insurance; conversely, the premiums written in the business sector did not increase.

Table 7.1: Main indicators for the insurance sector

As at 31 Dec	2011	2012	2013	Year-on-year change	
				Abs.	(%)
Number of policies (in thousands)	27 909	26 880	27 321	441	1.6
of which: non-life insurance	19 233	18 278	19 258	980	5.4
life insurance[45]	8 676	8 602	8 063	-539	-6.3
Number of newly concluded policies (in thousands)	10 780	11 575	11 874	299	2.6
of which: non-life insurance	9 258	10 035	10 737	702	7.0
life insurance[45]	1 522	1 540	1 137	-403	-26.2
Total gross premiums written (CZK bn)	155.1	153.6	156.5	2.9	1.9
of which: non-life insurance	83.1	81.6	84.9	3.4	4.2
life insurance	72.0	72.1	71.6	-0.5	-0.7
Total gross claims paid (CZK bn)	85.2	88.2	100.6	12.4	14.1
of which: non-life insurance	43.1	41.8	49.2	7.5	17.8
life insurance	42.1	46.4	51.4	5.0	10.7
Total insurance penetration (%)	4.1	4.0	4.0	0.0	-

Source: CNB

[44] For more information, refer to www.nsoud.cz/JudikaturaNS_new/ns_web.nsf/Metodika.
[45] The number of life insurance policies does not include policies for supplementary insurance.

As compared to non-life insurance, there was a slight decline in the premiums written in the life insurance sector, specifically a decrease of 0.7% to CZK 71.6 billion. This development was influenced by the 3.1% drop in lump-sum premiums, which was not offset by the 0.8% increase in standard premiums. In general, the number of life insurance policies is decreasing, but the average insurance premium amount is increasing, thus leading to a slight improvement in the level of insurance protection. The situation is the opposite in the non-life insurance sector. However, there continues to be significant unused potential in the Czech insurance market, as the average annual premium is much lower (25%) than in the Western EU member states. There is an apparent inclination of insurance company clients to no longer view life insurance as a form of "advantageous savings product" and instead they place greater emphasis on insurance for the risks associated with their life and health.

As far as the product portfolio is concerned, there are some innovations in the insurance market, such as "savings ability insurance", which is comparable to the insurance cover against the inability to pay in the event of a drop in income. Other products are directly designed to be competitive with Pillar 2 of the pension system. These are traditional capital life insurance products designed for individuals for whom it is not beneficial to participate in Pillar 2 because of their higher age. The non-success of Pillar 2 and its unclear future have thus far not been reflected in any increased interest in life insurance and pension insurance products. It seems as if the majority of the public is waiting to see how the new government approaches the pension system reform.

Other innovations in the life insurance sector includes pricing that takes into account the client's lifestyle. It appears that this innovative approach was indirectly initiated by the EU's "Gender Directive", which prohibited the use of gender to determine life insurance risk factors. In 2013 men showed an increased interest in insurance as compared to 2012 as a result of this "unisex" approach, according to which it was generally expected that insurance premium rates would decrease.

In the case of capital life insurance with guaranteed growth, there was a decrease in the profitability of new policies suffer due to the CNB's decision to decrease the maximum technical interest rate[46] from 2.5% to 1.9 %, which was a reaction to the significant drop in interest rates on the financial market. The technical interest rate represents the guaranteed share of the yield from financial placement. It does not therefore include the increase in value of the total premium paid by the client, but only the share of the increase in the insurance reserve, i.e. the savings component of the premium.

From the medium-term perspective for the future development of the insurance market, the pro-growth factors include the gradually strengthening recovery of the domestic and foreign economies, new legislative initiatives (such as the creation of the Damage Prevention Fund, and the new risks ensuing from the new Civil Code, e.g. non-property damage, which will, however, also result in higher demands place on insurance settlement), and the potential of new opportunities associated with pension security and private health insurance. Conversely, the negative factors may include the limits placed on the commissions paid to intermediaries (i.e. the implementation of IMD II), the stricter conditions on the part of reinsurers, and the continuing unwillingness of the general public to obtain a higher level of insurance coverage against risk.

7.2. Economic Results of Insurance Companies

Within the context of the financial sector overall, the insurance market as a whole holds a fairly stable position. The balance sheet total reported by insurance companies increased by 2.2% to CZK 479.4 billion. This growth is the result of, amongst other factors, the necessary increase in the creation of sufficient technical reserves that will ensure that insurance companies are able to meet their obligations even in extraordinary situations. Profit generation lagged slightly behind in comparison to 2012; nevertheless, the profit after tax exceeds CZK 11 billion and may be considered as sufficient for the sector's further development. One of the reasons behind the decrease in after-tax profitability (a drop of 9.7%) is the more unfavourable balance in the technical reserve account for both the non-life as well as the life insurance sectors, which is primarily the result of a lower yield from financial placement as well as the increased costs associated with financial placement. Another risk factor for the future development of the sector may be the long-term faster growth of insurance settlement costs as compared to the increase in gross premiums written (refer to Table 7.1) For example, expert market forecasts state that the increased costs associated with the legal and regulatory changes for liability insurance for damage caused while operating a vehicle equal 10-20%.

[46] The CNB's Official Communication as published in the Bulletin of the Czech National Bank, Section 2/2013 dated 21 January 2013.

The value of the insurance technical reserves reached CZK 424 billion, reflecting a year-on-year increase of more than 5% (Refer to Table P2.8 in Appendix 2). The increasing financial demands for the settlement of insurance claims in both the non-life as well as the life insurance sectors require the creation of adequate technical reserves. In order to comply with legal regulations, these monetary resources must be placed in the appropriate types of assets that meet the criteria of safety, diversification, and profitability. Over 69% of the technical reserves are invested in debt securities and approximately 20% in equity securities.[47] The available solvency margin in the non-life insurance sector is more than four times higher than the required solvency margin, and, in the case of the life insurance sector, it is three times higher.[48]

The results of the insurance sector were negatively impacted by June's floods, which affected just about all of the Czech Republic, as well as by local thunderstorms and hailstorms during the summer. Natural disasters led to more than 92,000 insurance claims with damages totalling approximately CZK 9.3 billion. The negative impact that the floods had on the financial results of the insurance companies was significantly limited thanks to the high quality of catastrophe reinsurance. One of the positive aspects resulting from the floods is the fact that a number of households and enterprises have updated their property insurance, particularly for real estate, and have generally shown more interest in property and liability insurance.

In addition, the insurance companies have updated their flood maps, which make it much easier to appraise the risk of a particular area with regard to flash floods and flooding. Insurance companies use these maps to calculate the insurance premium rates, which vary according to risk zones 1 to 4. In addition, some objects in certain areas located directly next to a watercourse become very difficult to insure (Zone 4 has the highest level of risk). The tightening of the conditions for reinsurance contracts, which generally occurs following a more severe catastrophe, is not expected to occur in 2014 as a result of the sufficient reinsurance capacity of the reinsurance companies.

The financial results reported by insurance companies also reflect their success in the battle against insurance fraud. According to ČAP, over 10,600 suspicious cases were investigated in 2013 and insurance fraud totalling over CZK 1 billion was proven. The majority of the cases of insurance fraud uncovered by the insurance companies involved liability insurance for damage caused while operating a vehicle. Insurance fraud is committed not only by the insurer's clients, but also by insurance intermediaries acting independently or in conjunction with a client. According to international statistics, one out of seven claims reported by a client to an insurance companies involves insurance fraud of some sort. In the Czech Republic it is estimated that approximately 10% of the insurance settlements that are paid-out is disbursed without justification.

Thanks to the increasingly sophisticated detection systems developed using modern technology and very close mutual cooperation[49] insurers are successfully battling fraud, as is evidenced by the growing volume of monies that would have otherwise been unjustifiably paid out. Another innovative tool used to reveal insurance fraud is a voice analyser that is capable of determining the truth (or untruth) of the statements made by clients who are reporting an insurance claim.

7.3. Insurance Intermediation

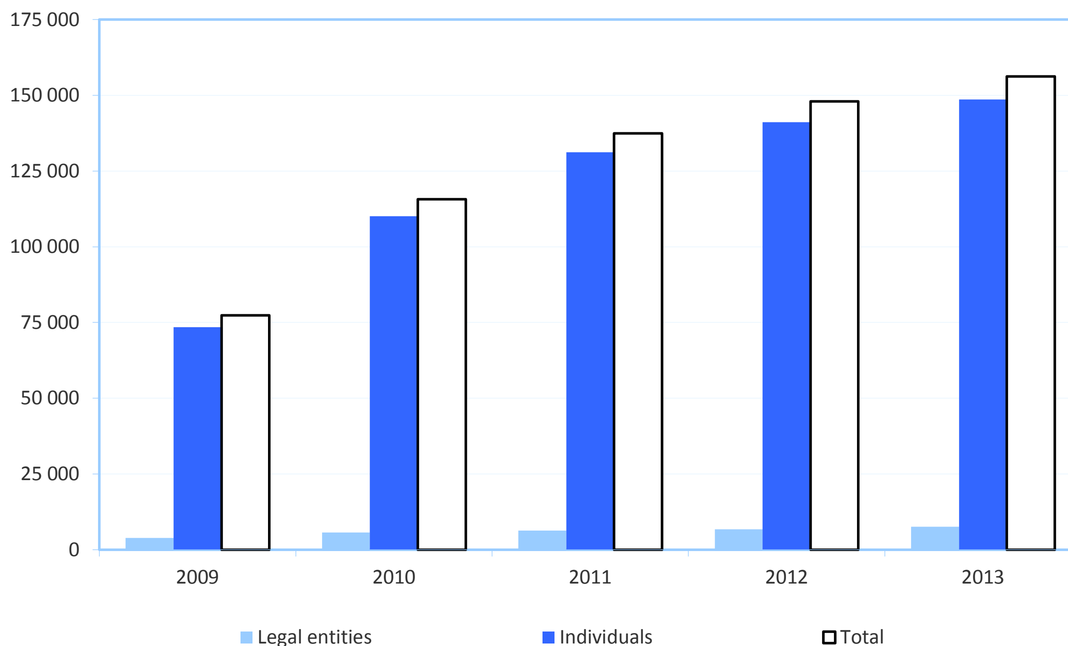
In the field of insurance intermediation the number of intermediaries continued to increase in the same way as in previous years. By the end of 2012, there were 156,200 insurance intermediaries and independent loss adjusters who had the relevant permit to perform insurance intermediation activities (refer to Graph 7.2). The number of licensed individuals greatly exceeds the number of legal entities (95% as compared to 5%).

[47] This also includes financial placement where the investment risk is borne by the policy holder and not by the insurance company.

[48] The most recent data available on the CNB's website is as of 31 December 2012.

[49] Using funds commonly invested by the insurance companies, ČAP has prepared the Information Exchange System for Suspicious Circumstances, which keeps track of all insurance claims. The member insurance companies can search the database and check if a claim has already been resolved elsewhere.

Graph 7.2: Number of insurance intermediaries



Source: CNB

Table 7.2: Number of insurance intermediaries by category[50]

Entity registered as at 31 Dec	2012			2013			Year-on-year change (%)		
	IN	LE	Total	IN	LE	Total	IN	LE	Total
TIE	12 285	309	12 594	12 374	304	12 678	0.7	-1.6	0.7
SII	90 755	2 449	93 204	96 046	2 688	98 734	5.8	9.8	5.9
EIA	34 588	284	34 872	36 480	301	36 781	5.5	6.0	5.5
IA	513	905	1 418	510	943	1 453	-0.6	4.2	2.5
IB	158	605	763	155	627	782	-1.9	3.6	2.5
ILA	79	117	196	94	119	213	19.0	1.7	8.7
FII (EU)	2 817	2 107	4 924	2 942	2 634	5 576	4.4	25.0	13.2
Total	141 195	6 776	147 971	148 601	7 616	156 217	5.2	12.4	5.6

Source: CNB

There was not enough time to complete the legislative process necessary for adopting the amendment to the Act on Insurance Intermediaries and Independent Loss Adjusters (Act No 38/2004) and to the Trade Licensing Act prior to the dissolution of the previous Chamber of Deputies. The draft was aimed primarily at simplifying the entire insurance intermediation system, clarifying the individual categories of intermediaries, and increasing consumer protection. The draft act will be resubmitted to the government during the first half of 2014.

At the level of the distribution networks, the CNB's Official Communication on a quality management and control system for the activities of insurance distribution networks, which was published in January 2014, will undoubtedly have an impact. In addition to the general requirements for the activities of insurance intermediaries, this Communication also defines the standard to be followed by insurance companies for managing the quality of their distribution network, including examples of specific control mechanisms and procedures. The quality control for the activities of internal and external distribution networks is being enhanced by the insurance companies as well as by the CNB. If an intermediary is found to be using unfair business practices the insurance companies terminate their business agreements with this intermediary, who also faces sanctions imposed by the supervisory authority (the CNB).

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

8. PENSION SYSTEM

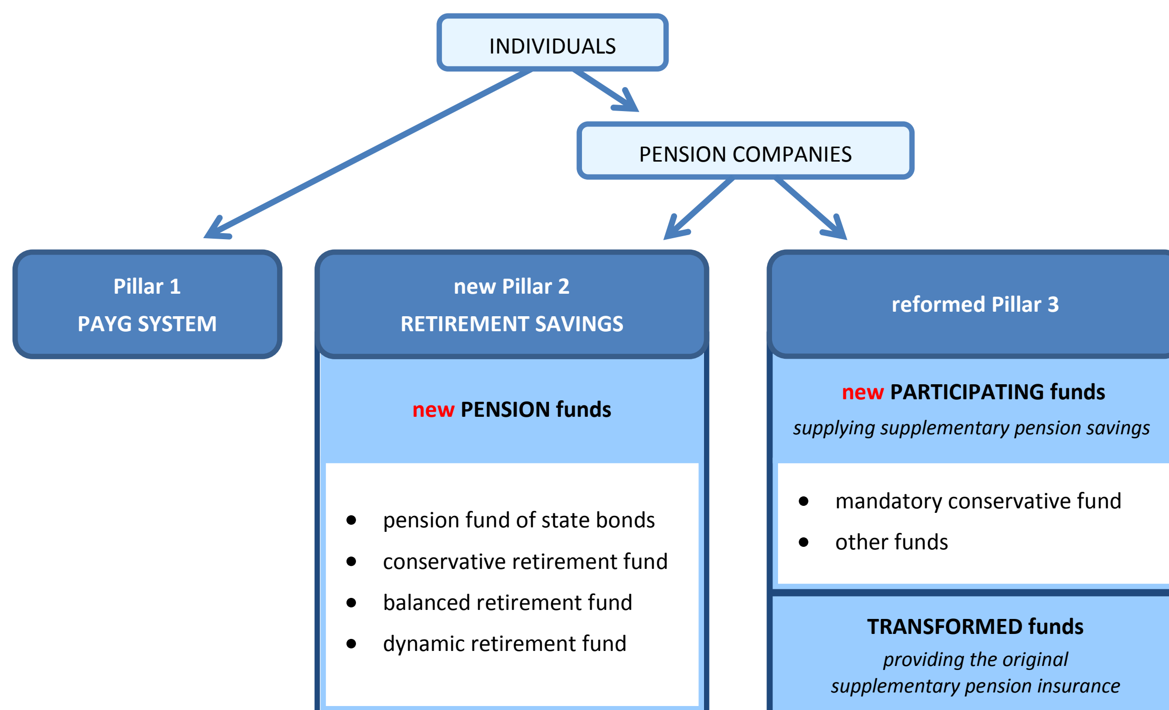
The entire structure and functioning of the Czech Republic's pension system underwent a significant change at the beginning of 2013. A retirement savings system was launched and is referred to as Pension Pillar 2. The original pension funds from the supplementary pension savings system, which functioned more or less in their original form since they were first created in 1994, were all closed as of 30 November 2012. Since 1 January 2013 all of the contributions towards voluntary pension savings made by new participants under Pension Pillar 3 are placed only in the new participating funds. This particular measure was already partially reflected in the sector's development in 2012 and continued to have an effect in 2013, particularly as regards the number of participants, the participant structure, and the amount of the average monthly contribution.

8.1. Pension System Reform

Discussions about the need to reform the pension system started in the Czech Republic in the 1990s, primarily due to the long-term unfavourable demographic development of the country's population and the consequent unsustainable nature of a pension system based solely on the national pay-as-you-go (PAYG) system. Given the Czech population's great dependence on the pensions disbursed by the state (Pillar 1) and the inadequate diversification of income for retirement, simply changing the parameters of the existing PAYG system (the "minor pension reform") was not sufficient and it was necessary to propose a modification that would expand the system as a whole (the "major pension reform").

The main objectives of the pension reform were defined as follows: to ensure the sustainable development of public finances; to distribute risk by lowering the level of dependence on Pillar 1; and to enforce the "achievement principle" and individual responsibility. In order to realise these objectives, the existing pension system was expanded to include the new retirement savings schemes, and Pillar 3 was modified, specifically the pension funds were reformed and a new supplementary pension savings scheme was introduced. Within this "new" Pillar 3, the pension companies manage the participating funds in which the contributions of the supplementary pension savings scheme participants are placed as well as the transformed funds, which contain the savings and contributions of the original supplementary pension insurance scheme participants. It is no longer possible to join the supplementary pension insurance scheme. The changes made to the pension system are aimed at attaining a higher potential for increasing the value of invested funds (through the abolition of the no-risk guarantee, the separation of the pension fund's assets from the savings of its clients, and the implementation of a regulatory framework for the remuneration paid to pension companies for managing their clients' assets), and at ensuring higher monthly participant contributions (by means of a modification in the parameters for the state contribution and possible tax relief). As a result of these changes, the Czech Republic's pension system has been a three-pillar system since the start of 2013 as depicted in Figure 8.1.

Figure 8.1: New structure of the pension system starting in 2013



Source: MoF

Pillar 1 represents the standard pension system, i.e. the mandatory pay-as-you-go system financed by the state. The basic underlying principle for this pillar is its regular financing, when the pensions disbursed to current retirees are paid from the state budget. The role of this pillar is to ensure that the individuals who have paid pension insurance for the majority of their life receive an adequate pension. The parameters of Pillar 1 were modified by the minor pension reform.[51]

Pillar 2 (retirement savings) represents the new option for pension savings in the form of funds. The basic underlying principle for this pillar consists of lifelong saving for retirement with a selected pension company at a level equal to 5% of gross salary for every given month (paid by the employee). Simply stated, this savings plan consists of transferring 3% of the employee's gross salary that is currently deducted for national pension insurance to a private individual pension account managed by a pension company under the condition that the employee pays an additional 2% of the base used to calculate the pension insurance deduction.[52] Participation in this pillar is voluntary; however, it is not possible to withdraw from the system once the contract has been registered in the Central Register for Pension Savings Contracts. The inability to reverse this step provides a guarantee that the purpose of Pillar 2 will be met, i.e. lifelong savings in order to ensure sufficient funds to supplement the pension received from the state. The funds in Pillar 2 cannot be the subject of a collection order during the entire saving phase. In the event of the participant's death during the saving phase, the funds that have been saved are included in the inheritance. Entry into this system is limited to individuals up to the age of thirty-five. Individuals who are over thirty-five who were interested in joining this system had to make their decision to participate in this pillar by 1 July 2013.

At the time the contract with the pension company is concluded, the participant will select an investment strategy based on his/her own risk profile. The legislation assigns to the pension companies the obligation to offer participants four types of retirement funds: dynamic, balanced, conservative, and a state bond fund. The legislation establishes limits for each type of retirement fund and also defines the maximum remuneration to

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

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

be paid for managing the assets and the maximum fees that can be charged in return for increasing the value of the assets. In order to eliminate the negative impact of fluctuations in the financial market, if a participant elects a dynamic strategy, the law assigns to the pension company the obligation to automatically move the resources into a more conservative retirement fund towards the end of the saving phase. The changing allocation of funds amongst the individual pension funds according to the participant's age is referred to as the "autopilot" method.

The law also limits some of the expenses a pension companies may incur, such as the remuneration for offering and intermediating a contract is limited to a maximum of 3.5% of the average wage, which in 2013 was approximately CZK 854.[53] The law also defines limits for the expenses outlaid for promotion, advertising, and sales support.

One of the measures to promote the safety of the funds is the separation of the participants' assets from those of the shareholders, i.e. the fund managers. As of the start of 2013, this rule also applies to Pillar 3. The funds in each of the individual retirement funds are managed by pension companies, the majority of whom were created through the transformation of the original pension funds that have been successfully operating in the Czech Republic's financial market for eighteen years. All operations are performed by the depositary on the basis of the pension company's instructions. The depositary must confirm that all the transactions comply with the law and is liable with its assets for performing an effective verification. There are therefore several levels of checks applied to the pension companies. If a pension company terminates its activities, the management of the retirement funds will be transferred to another manager on the basis of a CNB decision.

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

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

As can be seen in Table 8.1, there were ten pension companies active in Pillar 2 in 2013. Whilst all of them managed assets under Pillar 3 (see below), only six of them performed activities including the management of the retirement funds under Pillar 2 (refer to column 2 of Table 8.1).

Table 8.1: Number of funds of licensed pension companies in Pillars 2 and 3 as at 31 December 2013[54]

Pension company	Pillar 2	Pillar 3	
		TF	PF
AEGON Penzijní společnost. a.s.[55]	-	1	2
Allianz penzijní společnost. a.s.	4	1	4
AXA penzijní společnost a.s.	-	1	3
Conseq penzijní společnost. a.s.	-	-	5
Česká spořitelna - penzijní společnost. a.s.	4	1	3
ČSOB Penzijní společnost. a.s.. člen skupiny ČSOB	4	1	4
ING Penzijní společnost. a.s.	-	1	4
KB Penzijní společnost. a.s.	4	1	4
Penzijní společnost České pojišťovny. a.s.	4	1	4
Raiffeisen penzijní společnost a.s.[56]	4	-	3
Total	24	8	36

Source: APS CR

Pillar 3 (supplementary pension insurance and supplementary pension savings) consists of the voluntary saving of funds for retirement, which the state supports in the form of a state contribution and tax relief. Up to

53 For 2014, the remuneration for offering and intermediating a contract is limited to approximately CZK 861.
54 TF = transformed funds; PF = participatory funds
55 AEGON Penzijní společnost, a.s. has changed its name to Conseq důchodová penzijní společnost, a.s. in January 2014.
56 Clients of Raiffeisen penzijn společnost in Pillars 2 and 3 are transferred to the funds of Penzijní společnost České pojišťovny since March 2014.

the end of 2012, this function existed only under the supplementary pension insurance scheme, which continues to exist as a part of Pillar 3 in the form of the transformed funds. These are the funds to which the savings of the participants in the original supplementary pension insurance scheme were automatically transferred. At the same time, the conditions of their supplementary pension insurance contracts were retained (namely the no-loss guarantee, the ability to receive an early pension, and the conditions that make it possible to terminate the contract and receive payments). New participants are not allowed to join in the transformed funds, as the possibility of entering into a supplementary pension insurance contract ended on 30 November 2012. Since 1 January 2013, individuals interested in saving under Pillar 3 may only join the supplementary pension savings scheme, where the their savings are placed in one of the participating funds according to the participant's own choice. Participants in the supplementary pension insurance scheme, which the pension companies operate through the transformed funds, may switch over to the new supplementary pension savings system at any time and select the participating fund of their choice (i.e. select an investment strategy). As is the case with Pillar 2, the participants bear the investment risk associated with the participating funds, however, they have the opportunity to earn a higher yield.

The pension companies active under Pillar 3 are legally obliged to offer one conservative participating fund with the investment limits specified in the law. They may, however, offer a range of other participating funds with variously structured portfolios (within the limits defined in the law). Even in the case of the supplementary pension saving scheme, there is a mechanism in place to protect participants prior to the payout phase against any possible losses due to sudden fluctuations in the financial market. Specifically, this is the aforementioned autopilot method, under which the pension company will transfer all of the participant's funds to a mandatory conservative fund no more than five years prior to the time that the participant acquires the right to receive a pension. Some of the pension companies have also included strategic and/or life cycle funds in their offer under Pillar 3, for which the investment strategy is adjusted according to the participant's age. As the participant grows older, the strategy shifts from dynamic to conservative.

The amount of the state contribution changed in January 2013 for all participants regardless of whether their funds are allocated in the transformed funds or in the new participating funds. At the same time that the method for determining the amount of the state contribution in relation to the participant's contribution was changed, the amount of tax relief was also redefined. Table 8.2 provides a comparison of the old and new monthly state contribution and of the old and new possible tax relief for the participant under a 15% personal income tax rate (recalculated for a monthly basis[57]).

[57] The tax relief is calculated on an annual basis in relation to the contributions made by the participant over the course of the entire year. For the purposes of illustrating the relationship between the participant's monthly contribution and the total amount of state support, the tax relief specified in Table 2 was recalculated for a monthly basis.

Table 8.2: Monthly state contribution and tax allowance depending on the monthly participant's contribution (in CZK)

Monthly contribution of a participant	2012			2013		
	State contribution	Tax allowance	Total state support	State contribution	Tax allowance	Total state support
100	50	-	50	-	-	-
200	90	-	90	-	-	-
300	120	-	120	90	-	90
400	140	-	140	110	-	110
500	150	-	150	130	-	130
600	150	15	165	150	-	150
700	150	30	180	170	-	170
800	150	45	195	190	-	190
900	150	60	210	210	-	210
1000	150	75	225	230	-	230
1100	150	90	240	230	15	245
1200	150	105	255	230	30	260
1300	150	120	270	230	45	275
1400	150	135	285	230	60	290
1500	150	150	300	230	75	305
1600	150	150	300	230	90	320
1700	150	150	300	230	105	335
1800	150	150	300	230	120	350
1900	150	150	300	230	135	365
2000+	150	150	300	230	150	380

Source: MoF

Even if the participant's monthly contributions are less than the amount that establishes the right to claim the tax relief, they still have the opportunity to claim the tax relief for the year in question. Specifically, the law does not prevent the Pillar 3 participants from making an extra one-off contribution at the end of the year, which will bring their total annual contribution up to the level that makes it possible for them to claim the relief on their personal income tax return (up to the maximum amount of CZK 12,000).

As both the new participating funds as well as the transformed funds are managed by the pension companies in a manner comparable to that used for the retirement funds under Pillar 2, the aforementioned measures that protect the safety of the savings also apply to Pillar 3. The requirement for the separation of assets also introduced the regulation of remuneration for the management of the assets under Pillar 3. Therefore, the law defines the upper limits for the remuneration for offering and intermediating a contract for supplementary pension savings. These changes, combined with the removal of a guaranteed annual yield, should lead to higher returns for the new participating funds.

For the new participants in Pillar 3, including those participants of the original supplementary pension insurance system who choose to transfer their savings from the transformed fund to one of the new participating funds, the conditions for the payout phase of the supplementary pension savings have also changed. Five years prior to the time they become eligible to start receiving a retirement pension, the participants have the ability to either start collecting their pension in the form a retirement pension for a predefined period of time, or to pay a one-time premium in order to start collecting a lifetime annuity or fixed amount annuity payments for a specific period of time.[58] The ability to select a lump-sum distribution is conditional on reaching pension eligibility age.

8.2. Retirement Savings

At the end of 2013 the resources in the retirement funds, i.e. the new funds established under Pillar 2, totalled CZK 346 million. Over the course of 2013, almost 82,000 individuals[59] started to participate in the retirement savings scheme. The highest number (approximately 41,000) joined during the second

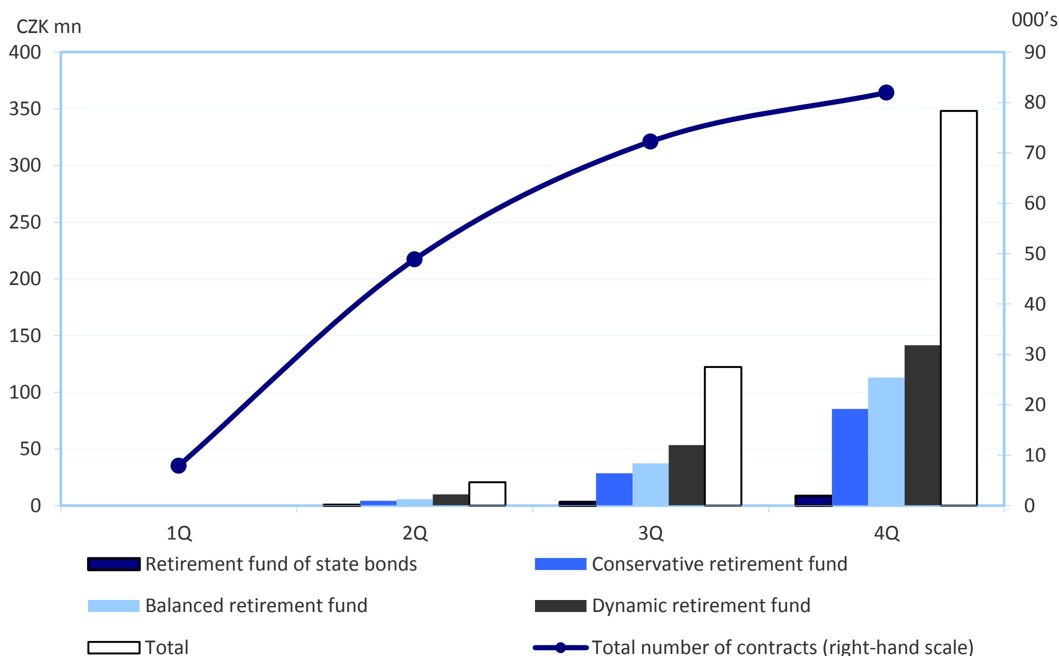
[58] The retirement age for men and women is the same according to their date of birth.

[59] The number of participants as of 31 December 2013 is taken from the data of the Association of Pension Societies of the Czech Republic (APS CR). According to the CNB's data, there are 103,824 participants in the retirement savings scheme.

quarter of the year as a result of the limitation for individuals over the age of thirty-five, who had to make the decision to participate in Pillar 2 by 1 July 2013. After this date, the number of new participants gradually declined. This was partially due to the results of the early elections held in October 2013, as the political parties of the current government coalition had already expressed their intent to abolish Pension Pillar 2 during their pre-election campaign. Although the way in which the retirement savings scheme will be terminated has not yet been announced, given the government's programme declaration, which mentions the plan to terminate Pillar 2, it is expected that only a very few participants will join this scheme in 2014.

As far as the placement of the participants' savings in the individual types of retirement funds is concerned (refer to Graph 8.1), it is obvious that the participants tended to select higher risk investment strategies, as, at the end of the year, 40.7% of all resources were placed in the dynamic retirement funds.

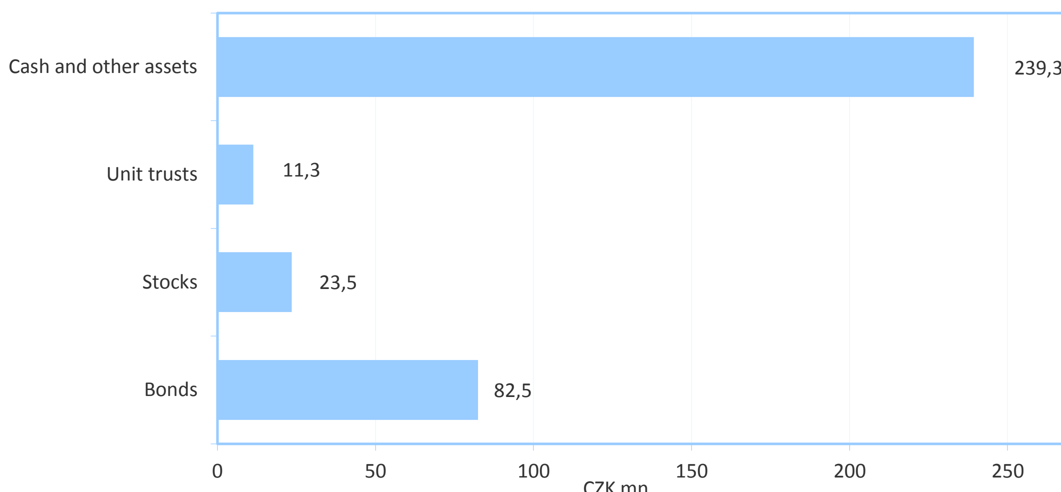
Graph 8.1: Volume of assets managed in different types of retirement funds at the end of quarter



Source: APS CR

However, at the moment the asset structure of the retirement funds does not fully correspond to the dominant position of the dynamic funds from the perspective of the placement of the participants' savings. Due to the short period of time during which the retirement funds have been functioning, the retirement funds do not yet have a sufficient volume of monetary resources that would allow them to maintain an adequately diversified risk portfolio, whilst at the same time making it possible invest more in higher risk assets in order to match the investment strategy selected by the participants. Although 6.6% of the total retirement fund assets are invested in stocks, the largest share of the portfolio is allocated in current and term accounts and other assets (67.1%) followed by bonds (23.1%).

Graph 8.2: Allocation of retirement funds assets as at 31 December 2013



Source: APS CR, CNB

8.3. Supplementary Pension Insurance and Supplementary Pension Savings

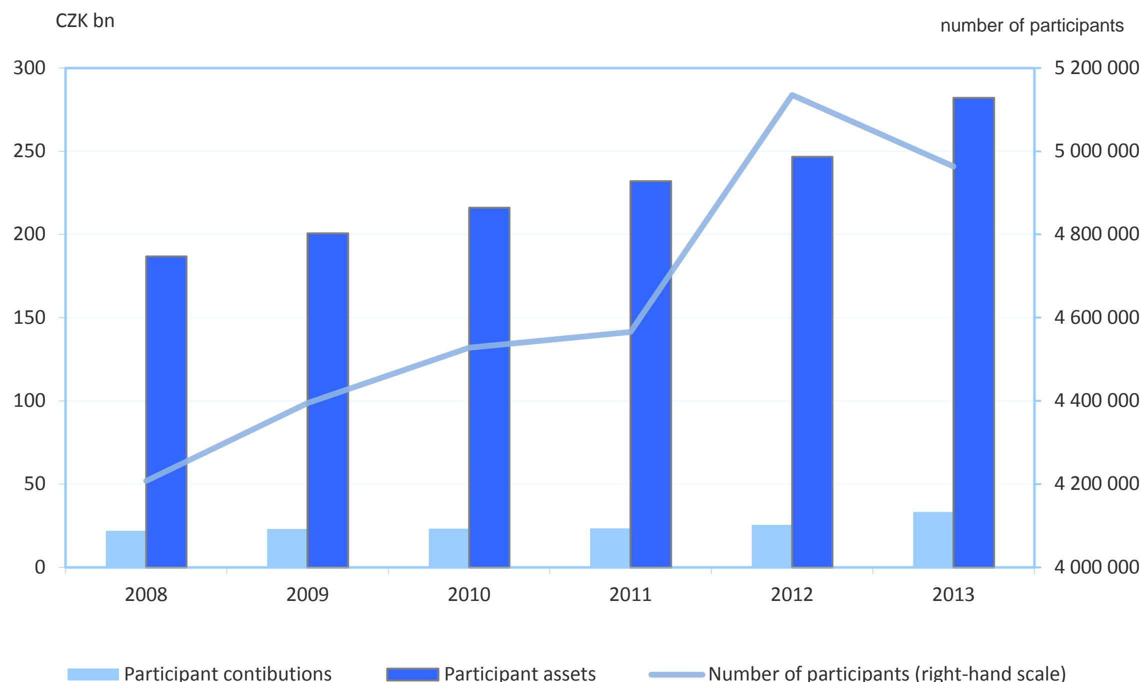
The monetary resources in the transformed funds and in the new participating funds totalled CZK 282 billion at the end of 2013, reflecting a year-on-year increase of 14.3%. Of this amount, assets totalling CZK 1.3 billion, i.e. 0.45% of all of the Pillar 3 resources, were managed by the pension companies under the new participating funds at the end of 2013. The relatively high growth rate for the assets in the Pillar 3 funds is due to the increase in the number of participants in 2012, when 493,000 of the 569,000 new participants joined Pillar 3 during the fourth quarter. This one-time high increase in the number of participants was directly related to the ability to enter into a contract according to the original conditions only until the end of November 2012. A number of participants entered into the supplementary pension insurance system at the last moment and thus ensured their ability to arrange an early pension, a no-loss guarantee, and more favourable conditions for withdrawing funds according to the original pension plans. However, they still retain the right to transfer to the new participating funds in the future.

Due to the entry of the large number of new participants in 2012, who would have otherwise gradually joined in the system over the next two or three years, the market is relatively saturated and the thus far gradual increase in the number of participants in the new participating funds is not sufficient to cover the decrease in the transformed funds participants. As a result, the number of participants in Pillar 3 decreased in 2013 by 172,000 to 4.96 million individuals.[60] As of 31 December 2013 there were 76,669[61] active supplementary pension savings contracts registered for the participating funds. In 2013 77,771 new participants entered into supplementary pension savings contracts; however, only 1,284 of the new participants transferred their savings to the participating funds from the transformed funds.

[60] This number of participants in the transformed funds is based on the data that the MoF receives on a quarterly basis from the individual pension companies. According to the data of the APS CR and the CNB, there were 4.87 million participants in the transformed funds as of 31 December 2013.

[61] This number of participants in the participating funds is based on the data that the MoF receives on a quarterly basis from the individual pension companies. According to the data of the APS CR, as of 31 December 2013 there were 91,027 participants in the participating funds; according to the CNB's data, there were 92,400.

Graph 8.3: Participant assets and contributions[62] and number of participants in Pillar 3 at the end of the given year



Source: MoF, APS CR

From the perspective of the age structure of the participants in Pillar 3, the “middle” generation (the 30-59 age group) continues to hold the dominant position with a 61.5% share. This group consists of persons of working age with statistically higher and more stable incomes, which provide a better environment to create financial reserves for retirement. The highest number of participants in absolute terms consists of people in their thirties. Looking at Table 8.3 it is obvious that there was a decrease in the number of participants from all age categories. The greatest decrease can be seen for the 18-39 age group, which, in the previous year, showed record growth. However, a comparison with 2012 would not be very illustrative, due to the entry of the extraordinarily high number of new participants. The decreases in the number of participants in the individual age groups may be explained primarily by more significant shifts of individuals from one age group to another and also partially as the result of the initial ill-considered entry of participants who subsequently changed their minds. In comparison to 2011, the number of participants aged up to 39 increased by 255,000.

Table 8.3: Participants in Pillar 3 by age

As at 30 Dec	2009	2010	2011	2012	2013	Year-on-year change	
						Abs.	(%)
18 - 19 yrs	23 433	22 150	19 569	67 014	28 143	-38 871	-58.0
20 - 29 yrs	530 382	537 701	526 835	718 693	667 795	-50 898	-7.1
30 - 39 yrs	927 964	965 683	977 023	1 127 029	1 082 619	-44 410	-3.9
40 - 49 yrs	839 614	867 483	885 169	996 302	1 002 963	6 661	0.7
50 - 59 yrs	1 008 265	998 104	973 152	989 126	965 540	-23 586	-2.4
60 - 69 yrs	729 339	765 997	786 776	814 754	786 819	-27 935	-3.4
70 - 79 yrs	267 966	292 809	311 402	328 867	334 139	5 272	1.6
80+	67 559	77 847	85 795	93 077	95 326	2 249	2.4
Total	4 394 522	4 527 774	4 565 741	5 134 862	4 963 344	-171 518	-3.3

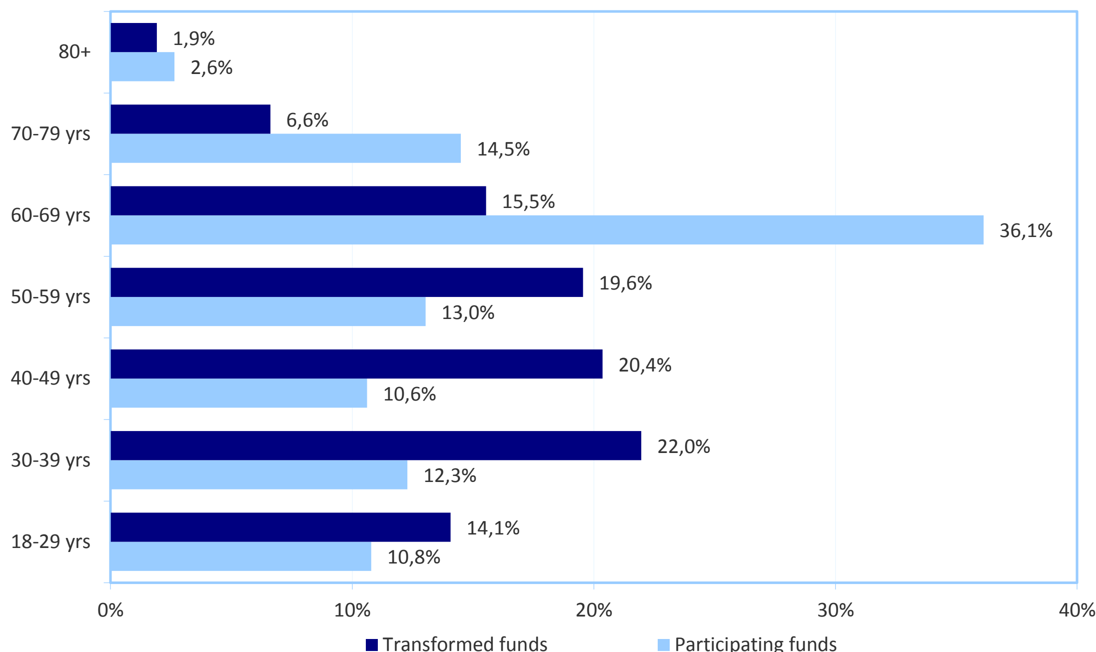
Source: MoF

Just about the only age category in which there was an increase in 2013 is the group of participants aged 70 and above. This is partially related to the fact that people aged 60 and above make up more than half of the participants in the new participating funds (refer to Graph 8.4). It is most likely that these participants are

[62] Participant contributions are reported without the contributions paid by employers for their employees.

using the supplementary pension savings scheme as a means for investing their available resources, which, as they have reached retirement age, they will be able to start withdrawing, together with the state contributions, after a five-year saving phase. In the case of the participating funds, it was expected that a higher level of interest would be expressed by people in the lower and middle age groups due to the ability to select a more dynamic investment strategy. However, for the most part, this particular group preferred to enter Pillar 3 in 2012, when the original supplementary pension insurance conditions were still in effect. Nevertheless, in 2013 the number of participants in Pillar 3 who are under the age of 29 increased by 8,274, which represents a greater growth than in either 2010 or 2011, when the number of participants in this age group decreased. It is therefore possible to say that the supplementary pensions savings product is of interest even to the youngest generation thanks to its more dynamic investment strategy and the restricted amount of associated fees and commissions.

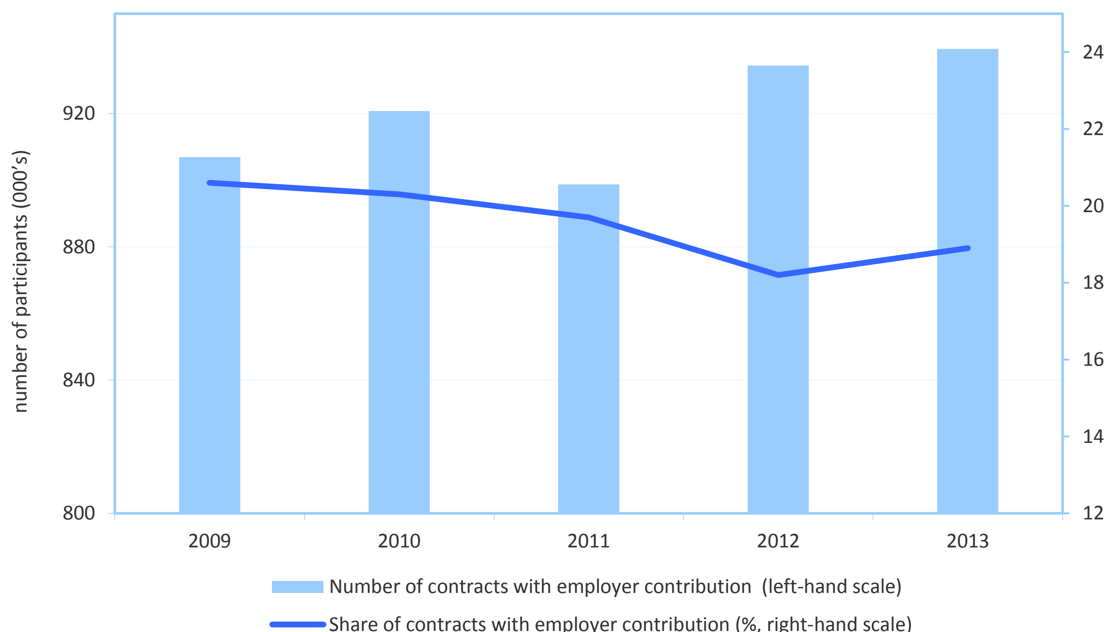
Graph 8.4: Age structure of participants in transformed and participating funds



Source: MoF

As can be seen in Graph 8.5, the number of participants for whom their employer also makes a contribution towards supplementary pension savings grew slightly in 2013 (by 0.5%) to 939,400. In relative terms and taking into account the decrease in the overall number of participants, this represents a reversal of the previous downward trend, as the share of participants with an employer contribution increased by 0.7 pp to 18.9%, However, as compared to the previous years, this is still a fairly low share, which may be explained by the austerity measures that are still in place in the business sector even though they are gradually being eased. Taking into account the fact that the employer’s contribution is often used to motivate and stabilise employees, it is most frequently found in the case of participants in the 35-59 age group. Conversely, it is not very common in the case of younger employees (due to higher fluctuation amongst other things).

Graph 8.5: Number of contracts in Pillar 3 with an employer contribution [63]



Source: MoF

One of the objectives behind the reform of Pillar 3 is to motivate the participants to save regularly and at a higher level through the new conditions for receiving the state contribution and the ability to claim tax relief (refer to Chapter 8.1). The average monthly participant contribution did indeed significantly increase (by 22.2%) in 2013 to reach CZK 568.[64] In the case of the new participating funds, the average contribution is even higher and equals CZK 749. As can be seen from the amount of the average contribution for each of the individual quarters of 2013 (Table 8.4), in the case of the participating funds the amount grew gradually over the course of the entire year with the exception of the third quarter. The relatively greater growth dynamics in the fourth quarter are due to the fact that a number of participants made an extra contribution at the end of the year in order to be able to claim the tax relief.

Table 8.4: Breakdown of average monthly contribution amount in transformed funds (TF) and participating funds (PF)

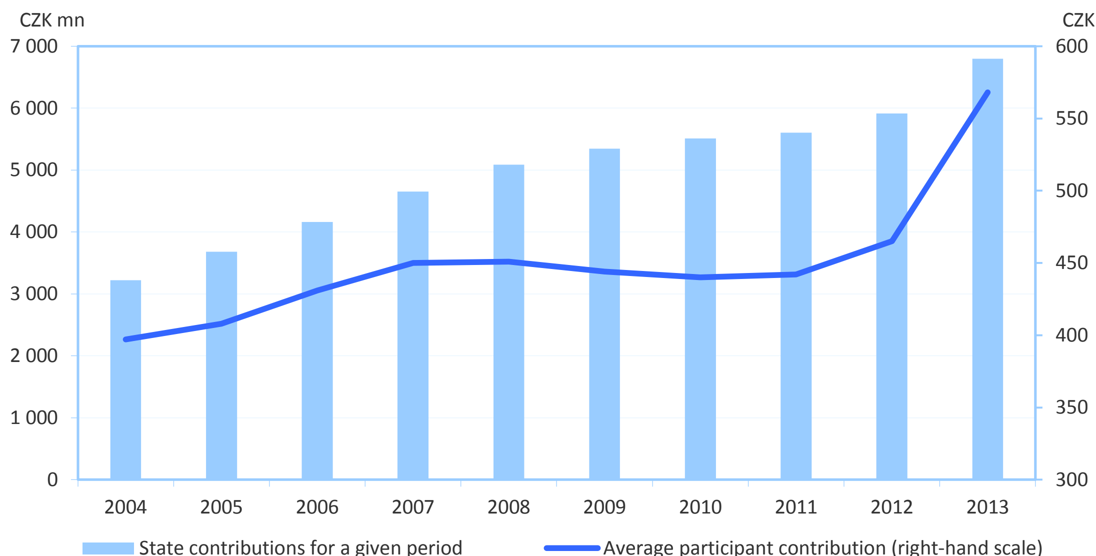
Average CZK/month		2009	2010	2011	2012	2013	2013				Year-on-year change	
							1Q	2Q	3Q	4Q	Abs.	(%)
TF	Participant contibution	443.9	439.6	441.7	465.0	568.0	531.1	547.5	557.0	638.0	103.1	22.2
	State contribution	105.2	105.0	105.4	108.0	117.0	113.3	116.0	118.0	120.4	9.0	8.3
PF	Participant contibution	-	-	-	-	749.0	671.6	743.8	719.9	859.2	-	-
	State contribution	-	-	-	-	143.0	135.5	146.1	148.5	141.8	-	-

Source: MoF

In relation to the higher average participant contribution in 2013 and the increasing number of participants at the end of 2012, the average state contribution paid per participant was also higher. The total direct support paid by the state in the pensions savings and supplementary pension savings sector increase by 16% in 2013 to a final total of CZK 6.9 billion. Of this amount, only CZK 0.1 billion was used for the state contributions for the participating funds.

[63] Status as at 31 December for each given year.
[64] This is the average for the full calendar year 2013 and it is thus lower than the average specified for the fourth quarter of 2013 in Table 8.4.

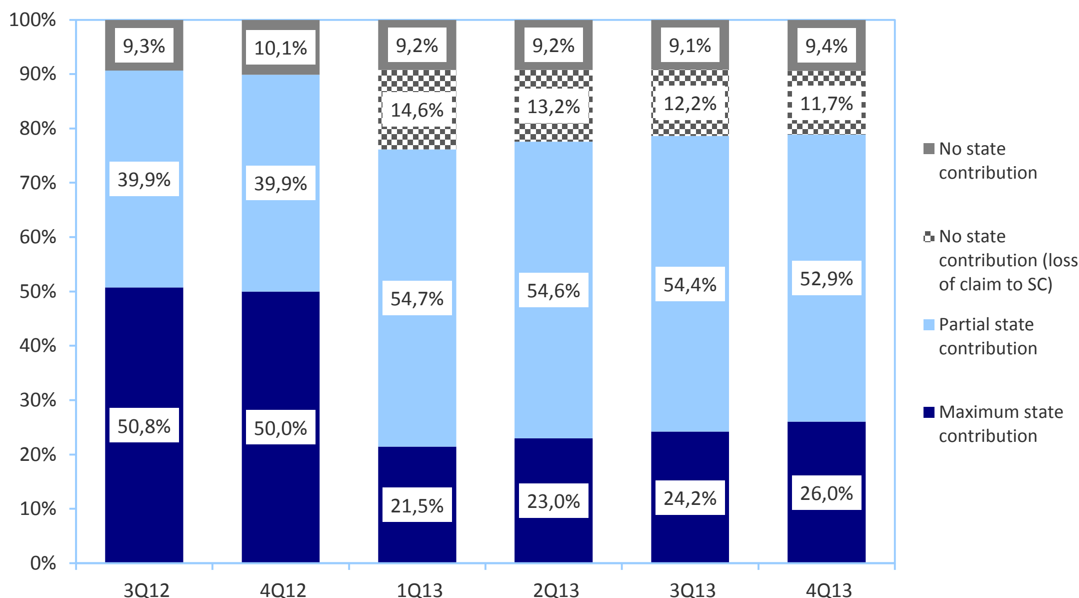
Graph 8.6: State contributions and average participant contribution for supplementary pension insurance



Source: MoF

Although many participants gradually increased their monthly contributions over the course of 2013, there is still room within the framework of the transformed funds to allow the future growth of the average participant contribution. As can be seen in Graph 8.7, which compares the share of supplementary pension insurance scheme participants according to the amount of the state contribution, i.e. none, partial, and maximum, it is possible to expect that a change in the behaviour of a certain group of participants in the transformed funds is yet to take place with regard to the amount of their contribution. This change in the participants' behaviour may come about in relation to an improvement in their financial situation as a result of the development in the overall state of the Czech economy.

Graph 8.7: Shares of supplementary pension insurance contracts with no, partial, and maximum state contribution (SC)[65]

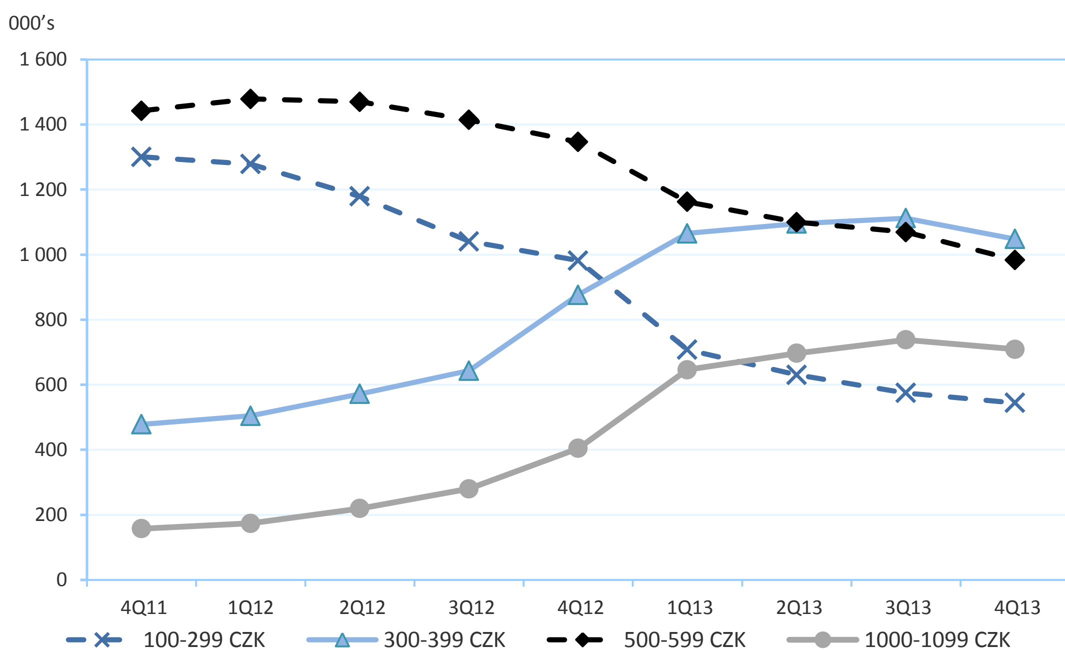


Source: MoF

[65] The data is based on the average number of contracts for the individual quarters for which the average participant contribution amount equals the specified value during the period in question. This is the average for the relevant three months, which may not correspond to the contributions made in the individual months and thus there may be some distortion in the data. The average number of participants does not include those contracts that are still registered as active, but for which no information was provided with regard to the application for a state contribution.

The changes in the shares of the participants who receive no contribution, only a partial contribution, or the maximum possible contribution from the state, which occurred during the individual quarters of the year were primarily the result of a change in the behaviour of those participants who, in 2012, paid monthly contributions at a level that would maximise either the relative or absolute value of the paid state contribution, i.e. a monthly contribution of CZK 100 or CZK 500 respectively. As can be seen in Graph 8.8, which tracks the development in the number of participants in selected ranges[66] according to the amount of their contribution, the downward trend in the number of participants with a monthly contribution of CZK 100-299, who lost their right to receive the state contribution on 1 January 2013, continued during 2013. It is safe to assume that some of the aforementioned participants increased their monthly contribution amount to at least CZK 300, as the number of participants in the transformed fund who make a contribution in the CZK 300-399 range continued to increase slightly. The number of participants in the CZK 500-599 range also decreased and it is possible to believe that they increased their contribution to at least CZK 1,000 in order to retain the right to the maximum possible state contribution. The slight decrease that occurred during the fourth quarter of 2013 in the number of participants whose contribution is in the CZK 300-399 range or in the CZK 1,000-1,099 range is the result of the payment of an extra contribution that participants made in order to decrease the tax base for their personal income tax return.

Graph 8.8: Development of the average number of supplementary pension insurance contracts in selected intervals according to the average participant contribution for a given quarter[67]



Source: MoF

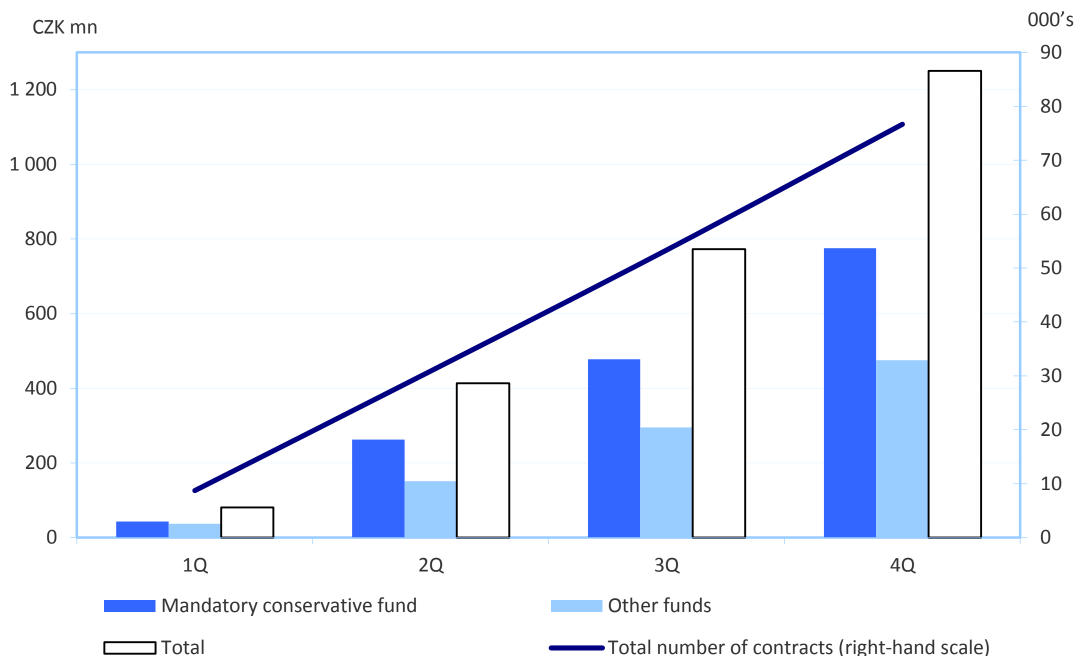
The participants in the new participating funds may now select from amongst various investment strategies. The pension companies generally offer two to five participating funds, ranging from a conservative fund that includes assets with the lowest associated level of risk (e.g. state bonds, treasury bills, money market instruments, etc.) up to dynamic (stock) funds with a significantly higher associated level of risk but with the possibility of a higher yield. As can be seen in Graph 8.9, unlike as compared to the participants in the retirement savings scheme, the majority of the participants in the supplementary pension savings system prefer to invest conservatively as, in terms of the placement of monies in the participating funds, the mandatory conservative fund, which has specific investment limits defined in the law, is the most popular.

[66] Graph 8.8 shows only those ranges of the average monthly participant contribution in which the greatest changes occurred in 2012 and 2013.

[67] The data is based on the average number of contracts for the individual quarters for which the average participant contribution amount equals the specified value during the period in question. This is the average for the relevant three months, which may not correspond to the contributions made in the individual months and thus there may be some distortion in the data. The average number of participants does not include those contracts that are still registered as active, but for which no information was provided with regard to the application for a state contribution.

Every pension company that offers supplementary pensions savings through the participating funds is obliged to offer this type of fund. The dominance of the mandatory conservative funds in terms of volume is, however, the result of the age structure of the participants. As was mentioned above, more than one half of the participants in the participating funds are over 60.

Graph 8.9: Volume of assets managed in different types of participating funds at the end of quarter



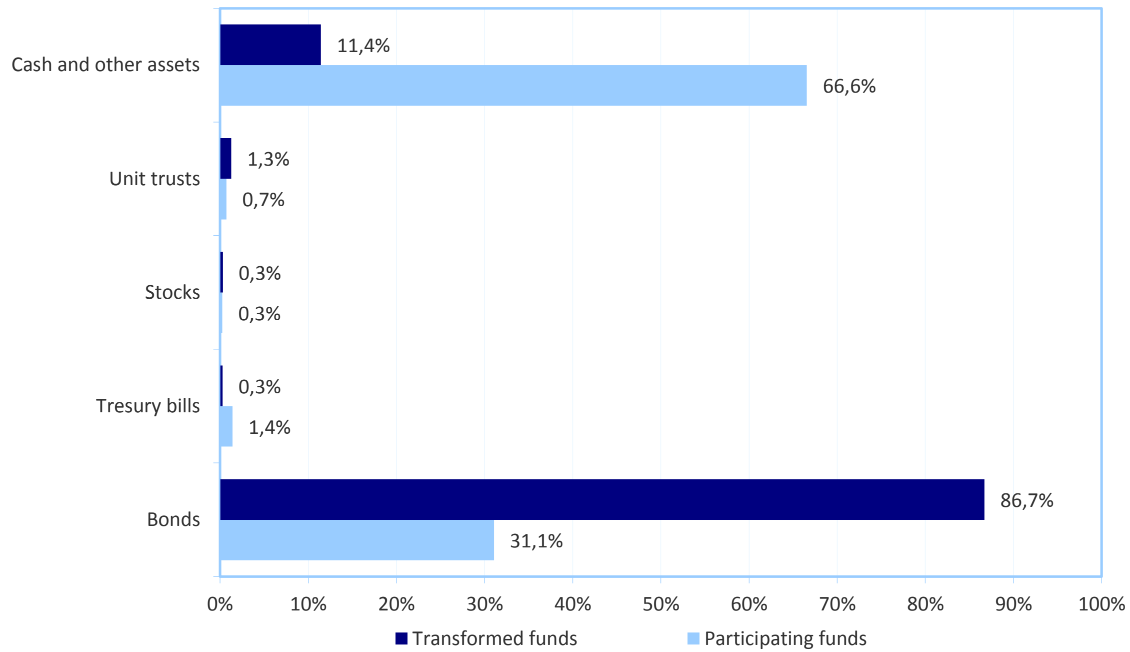
Source: APS CR

The investment portfolio for the transformed funds (refer to Graph 8.10) is retaining a very conservative nature, which is, however, due to the regulatory framework. When compared to 2012, the share of bonds grew by 2.7 pp to 86.7%. Approximately 11% of the total assets were placed in cash and other assets. The other possible options, including stocks, held only minority shares within the portfolio.

The easing of the investment limits for the new participating funds was intended to give the participants the opportunity to earn higher returns due the more dynamic investment strategies of these funds. However, in 2013 the investment portfolio structure of the participating funds was even more conservative than the asset allocation for the transformed funds (refer to Graph 8.10). The share of resources in current and term accounts and other assets equalled 66.6%. Bonds made up 31.1% of the total asset allocation. Stock did not equal even 1% of the total assets even though the resources invested into dynamic (stock) funds make up almost 5% of the total managed assets. One of the reasons for the significantly conservative portfolio profile of the participating funds is the majority placement of resources in the mandatory conservative funds. In addition, just like in the case of the retirement funds, the participating funds have been functioning for only a short period of time. As a result, some of the funds have not yet accumulated a volume of resources sufficient enough to allow them to implement an investment strategy in which assets would be invested in high risk instruments whilst, at the same time, ensuring an appropriately diversified level of risk. Given the developments in the bond market in 2013, moving the assets from bank accounts to bonds was not appealing either. However, it is possible to expect that, in the coming years, the share of the monies invested in higher-risk assets in the portfolios of these funds will also grow in conjunction with the gradual increase in the number of participants entering into the new participating funds.

Some of the more detailed information about the supplementary pension insurance and supplementary pension savings sector, which is published on a regular quarterly basis on the MoF website (www.mfcr.cz), is included in Tables P2.6 and P2.7 in Appendix 2.

Graph 8.10: Structure of allocation of assets of transformed and participating funds as at 31 December 2013



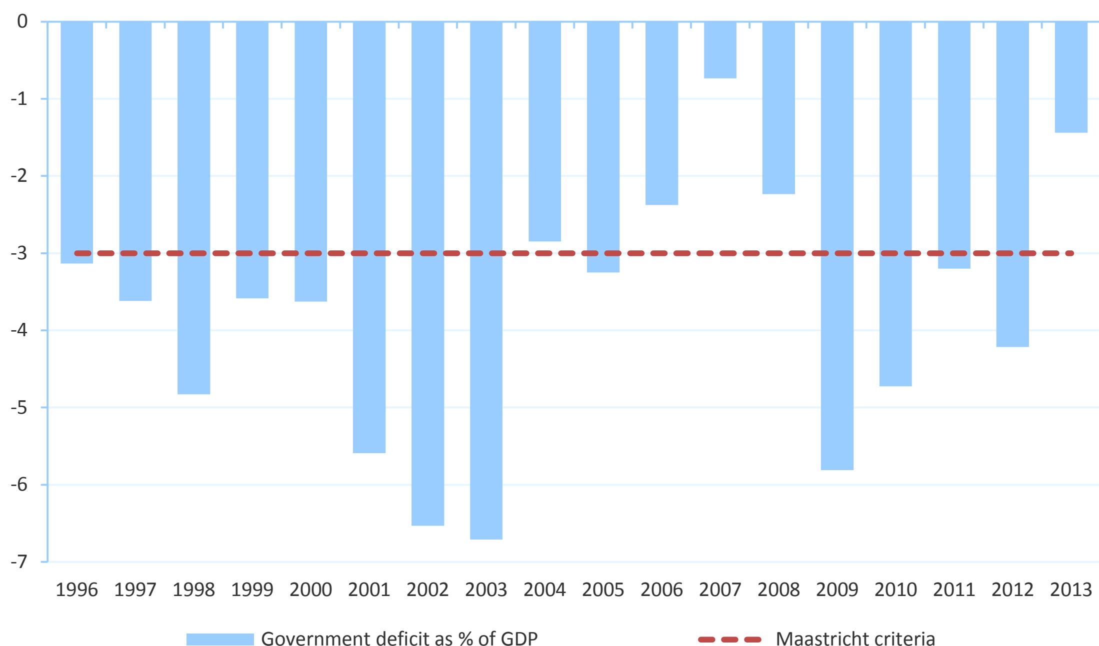
Source: APS CR, CNB

9. GOVERNMENT SECTOR

9.1. Economic Results of the Government Sector

According to preliminary CSO statistics, in 2013 the economic results in the government sector recorded a deficit equal to 1.5% of GDP. When compared to 2012, this reflects an improvement of 2.7 pp. However, after being adjusted to remove one-off operations that had significant fiscal impact (the CZK 59 billion property settlement with churches and the CZK 12 billion correction for ineligible European expenditure), the deficit in 2012 was equal to only 2.4% of GDP and thus there was an almost a 1 pp improvement in 2013. Taking into account the significantly deeper production gap in 2013, fiscal effort[68] was equal to 1.3 pp, which is comparable to the results of the two previous years.

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



Source: MoF

Total revenue increased by 2.4% in 2013. The main reason was the increase in tax income, which grew by 3% primarily as a result of the higher income from value added tax, as this particular item grew by 6% in conjunction with a 1.3% increase in household consumption. The explanation can be found in the 1 pp change implemented for both of the VAT rates, which, according to real impact, contributed approximately 0.4 pp to fiscal effort. Income from excise taxes decreased by 1.3% in 2013 despite a fairly high level of stockpiling at the end of the year. However, in addition to the changes in rates at the start of 2014, changes were also implemented in 2013 and the improved collection resulting from the stockpiling in 2013 was thus partially negated by the stockpiling in 2012. The year-on-year decline was caused primarily by the decrease in tax revenue from mineral oils.

The revenue from personal income tax increased by 3.7%, in spite of an almost 1% decline in the volume of wages and salaries. This development came about as the result of a number of discretionary measures, such as the solidarity tax imposed on personal income and the abolition of the basic tax discount for working pensioners. The overall discretionary effect was equal to approximately 0.2% of GDP. Social security contributions increased by 1.1% in 2013.

As far as corporate income tax is concerned, there was a year-on-year increase of 2.0%. The only significant change was the ability to decrease the total tax obligation by the amount of flood damage, however this had a relatively minor effect of not even 0.1% of GDP. Other tax revenue changed only very insignificantly over time.

[68] Fiscal effort is the year-on-year change in the general government structural balance, adjusted to remove the effects of the economic cycle and one-off operations.

There was significant year-on-year increase of 21.0% in property income. In 2013 CZK 6 billion was transferred from the state-owned enterprise Lesy ČR (Forests of the Czech Republic) to the national budget as income. The CSO acknowledged the majority of this amount as a standard dividend increasing the general government sector's income. Another effect resulted from a methodological change in the way that the dividends paid out to the government sector are recorded. In the past, only the net value (i.e. amount after tax) was recorded. Now the amount before taxes is recorded and the tax paid by the government sector is subsequently recorded as an expense. The cumulative amount of income transfers increased by 2.5% year-on-year.

In 2013 the **expenditure of government institutions** decreased by 3.9% in 2013. This is due to the aforementioned one-off operations (i.e. the compensation paid to the churches and the correction for the EU funds that had to be returned). If these factors are not taken into account, expenditure increased by a mere 0.2%.

Expenditure for government consumption reported a year-on-year increase of 1.7%, breaking a three-year downward trend. This development is primarily the reset of an increase in the general government's intermediate consumption (primarily the purchases of the goods and services of government units), which increased by 2.3% after three years of continuous decline. The wages paid to employees also increased year-on-year, specifically by 2.6% (with the exception of 2012, they had generally decreased). Another important component of government consumption consists of social benefits in kind (specifically the expenditure of health insurance companies for healthcare). This item increased by only 0.5%, which is historically the lowest growth recorded in the available time series. The main reason for this decrease is the fairly restrictive Reimbursement Decree from 2013, which significantly helped to slow down the expenditure of health insurance expenditures for healthcare.

In the case of property expenditure, there was a decline of 3.7% resulting from the interest expense associated with managing the national debt, which was positively reflected in the very small increase in indebtedness as well as in the fairly favourable development in government bond yields.

For the fourth year in a row, there was a decline in government sector investments, specifically by more than 12%. Given the development in accrual subsidies on the income side (a decrease of approximately CZK 2 billion), there was an associated decrease primarily in Czech investments. From the perspective of the subsectors, the greatest reduction in investment expenditure can be found at the level of the local government institutions. The decrease was slightly smaller in the case of the central government (where it can be seen primarily for the Road and Motorway Directorate). As a result, investments reached their lowest level of the past ten years. The overall effect of this decrease in investments on the deficit is more than 0.3% of GDP. Since 2009, the investments of the government sector have declined by almost 2.2% of GDP.

The capital transfers made by the government sector to other sectors also contributed to the decline in expenditure. In addition to the two aforementioned one-off operations, the decrease in the cost of the transfers from the State Environmental Fund within the context of the Green Investment Scheme also had a significant effect. Other expenditure transfers increased only slightly by 1.8% over the course of the year.

9.2. Economic Outlook for the Government Sector for 2014-2017

The MoF expects that the deficit will reach a level of 1.8% of GDP[69] in 2014, which is 0.3 pp worse than the results for the previous year, but still well below the Maastricht deficit criteria.

According to the most recent estimates, the government sector's revenue is expected to achieve growth of 2.8%, primarily as a result of the accrual of income transfers from the EU (mainly investment accruals). Tax income is expected to increase, but at a relatively limited level of 0.5% or possibly 1.0% if we include social security contributions.

As regards income, only a few small discretionary changes are planned for the tax area in 2014 and they are expected to have only a relatively minor effect. The first of these affects the personal income tax of non-residents from the EU, Norway, and Iceland and consists of a reduction in the child tax credit, which will have an effect of approximately CZK 2.5 billion. In the area of excise taxes, there will be a decrease in the tax rates for solar electricity and an increase in the tobacco tax. These two measures are expected to have

[69] Based on the macroeconomic forecast published as of 11 April 2014.

a cumulative effect of - CZK 2.3 billion. Another measure is being considered for the revenue side, specifically the sale of LTE licences[70] for CZK 8.5 billion.

As far as the expenditure side is concerned, the most important discretionary measure will increase the wages in the central government sector by 2%. Another measure will increase healthcare expenditure primarily as a result of the strengthening of inpatient care and to compensate for the reduced co-payment paid by the patients of healthcare facilities through increasing the contribution paid for those whose health insurance is paid by the state.

The medium-term perspective for the government sector for the 2015-2016 period forecasts an increase in the government sector deficit to 2.3% of GDP and 2.0% GDP for each of the two years respectively. A decrease in the deficit to a level of 1.7% of GDP is predicted for 2017, primarily thanks to the significant improvement in economic development and the higher level of tax income. In 2013 the Czech Republic successfully achieved the target values for the Maastricht convergence criteria for the government budget deficit and the government debt to GDP ratio. According to the most recent predictions, it is expected that these criteria will continue to be fulfilled during the entire period of the forecast.

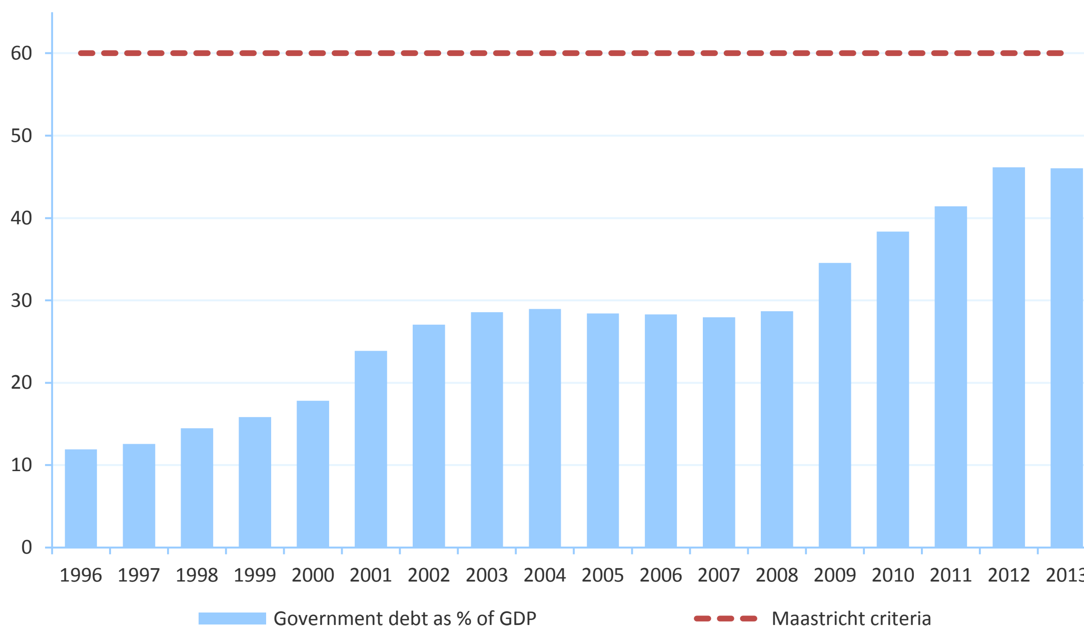
9.3. Government Sector Debt with an Emphasis on National Debt

In 2013 there was only a slight increase of approximately 0.7% in gross government debt. In relative terms this is a slight decrease of 0.2 pp from 46.2% of GDP in 2012 to 46.0% of GDP in 2013. The financing of the national deficit, which was much higher than the year-on-year difference in debt, led primarily to a decrease in government sector deposits, i.e. the use of the financial reserves created from the emissions in previous years (for the most part, in 2012).

According to the most recent estimates, it is expected that the amount of debt in relation to GDP will decrease by more than 1 pp in 2014 (primarily thanks GDP growth). As a result, there has been a significant improvement in the expected development of the Czech Republic's gross government debt as compared to the previous forecast. The main factor leading to this favourable development is the further inclusion of the government sector's liquidity system and its more effective management. The ratio indicating the effect of interest costs in relation to the change in debt is expected to remain constant and at almost the same level during the entire period. It will not even have a pronounced effect on the primary deficit. The forecast does not take into account privatisation income, because, at the time the predictions were prepared, the government had not yet made a final decision regarding the inclusion of additional key entities in the privatisation process.

[70] An LTE licence allows the operation of a wireless high-speed data transfer network (4G internet) using designated frequencies of the electromagnetic spectrum.

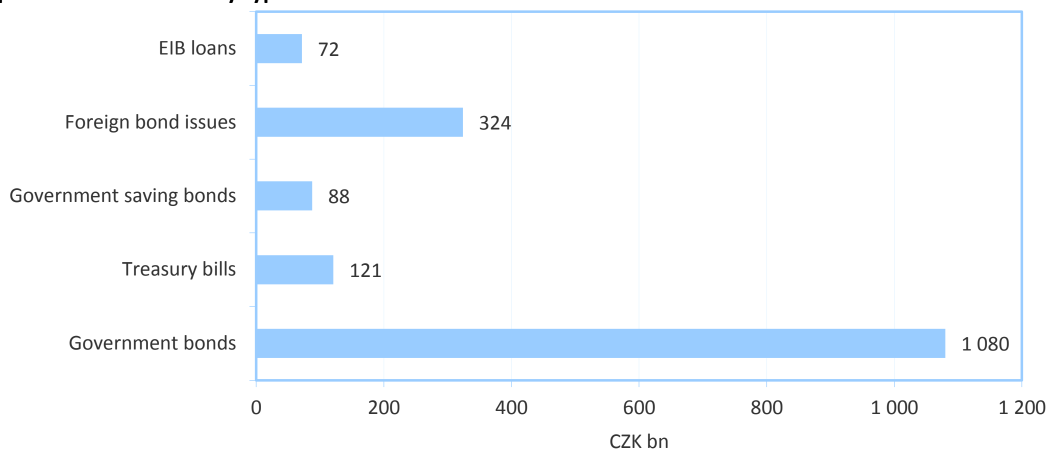
Graph 9.2: Development of government debt as a percentage of GDP since 1996



Source: MoF

Without a doubt, the most important component of gross government debt is the national debt. When preparing the strategy for managing this debt, primary focus is placed on refinancing risk, interest rate risk, and foreign exchange risk, which are the most common factors leading to uncertainty regarding financing. The stabilisation of these risk factors remains of crucial importance, particularly during a period of above-average volatility in the financial markets and increased uncertainty on the part of investors.

Graph 9.3: National debt by type of instrument at the end of 2013



Source: MoF

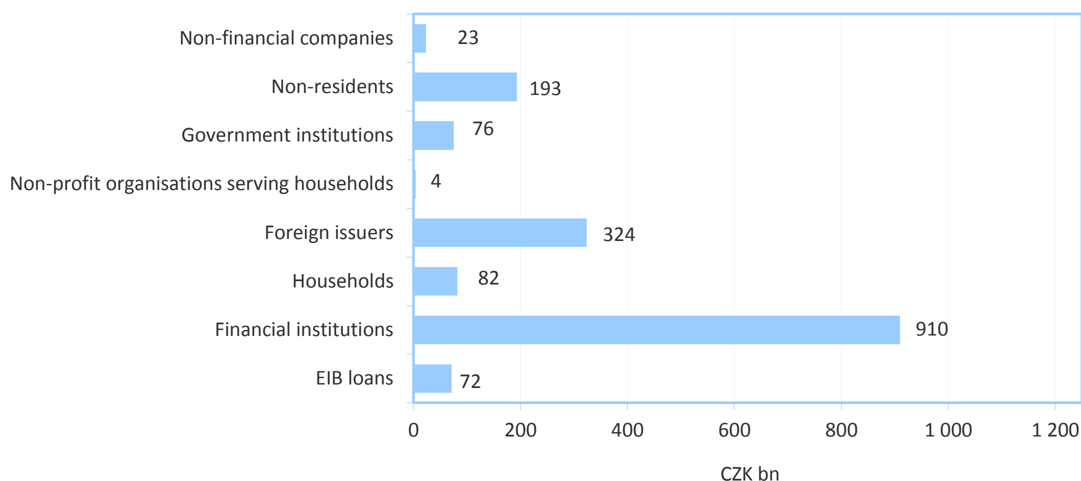
The ratio of short-term national debt to total national debt was 15.8% at the end of the year. This reflects a 2.1 pp decrease as compared to the end of 2012. This improvement was primarily the result of the approval of the amendment to Act No 218/2000 Coll. This amendment to the legislation on budgetary rules significantly expanded the CZK-denominated national treasury single account and allows the administration of the treasury single account in foreign currencies. The MoF is predicting that the short-term debt ratio will be at 13-15% during the next period. At the end of 2013 the medium-term national debt to total national debt ratio was at a level of 53.6%. According to the MoF's current objectives, the medium-term debt ratio should not exceed 70%. This target value has been defined for the entire forecast period.

The average maturity of national debt in 2013 ranged between five and six years. At the end of the year it was at 5.6 years. The target range for 2014 has been set at the same level as for 2013 and should be retained even in the upcoming years.

Interest rate risk is also of crucial importance from the perspective of managing national debt. Since 2006 a strategic target value has been defined on an annual basis for the share of the debt portfolio that has an interest fixation period of up to one year, i.e. the share of debt that is highly sensitive to fluctuation in the interest rates on the financial market in the coming year. The target range has been left at 30-40% for 2014 with the prediction that the value will be at about midpoint. This target value corresponds to the objective for the average fixation period for the national debt which has been set at four to five years. The share of the debt portfolio that has an interest fixation period of up to one year was equal to 35.4% of the total national debt at the end of 2013. From the perspective of debt structure, the ratio of variable interest national debt to total national debt was 16.8% at the end of 2013. This ratio should not exceed a value of 20% during the 2014 to 2017 time frame.

As far as currency exchange risk is concerned, the foreign currency exposure[71] of national debt in 2014 cannot exceed a limit of 15% + 2pp of the total national debt (with the exception of the short-term bridging of any unexpected depreciation in the domestic currency). At the end of 2013 this indicator was at a level of 9.4% and thus below the defined upper limit. The growth in this indicator when compared with 2012 is due to the weakening of the Czech crown in 2013 as a result of the foreign exchange interventions. At the end of 2013 the share of foreign currency exposure denominated in euros in relation to the total foreign currency exposure of the national debt was 89.4%, which reflects an increase of 2.0 pp when compared to the end of 2012. It is not expected that the foreign currency exposure will change in any significant way during the medium-term time frame.

Graph 9.4: National debt by creditor at the end of 2013



Source: MoF

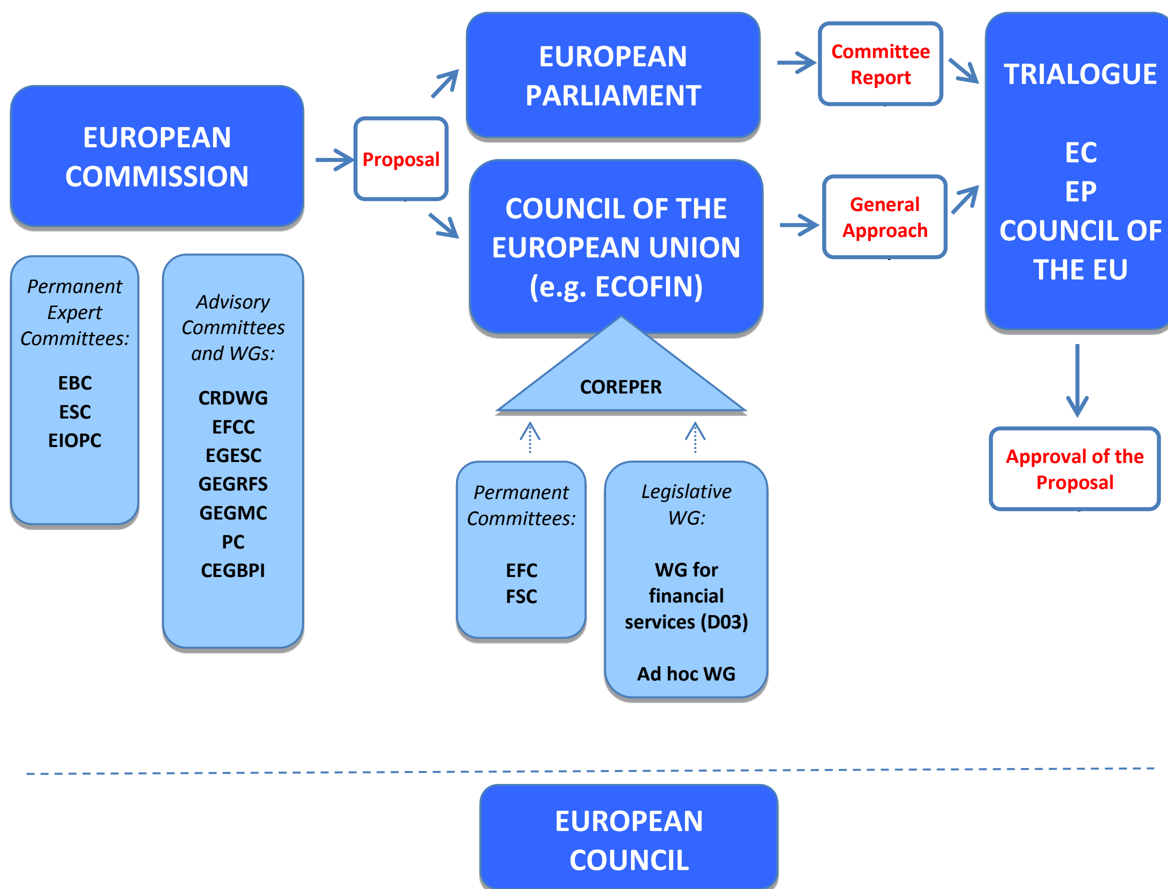
[71] The specified foreign currency exposure is the net value, i.e. taking into account guarantees and assets.

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

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

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

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



Source: Prepared internally

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

European Commission

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

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

European Banking Committee (EBC)

The EBC acts as the Commission's advisory body during the preparation of EU implementing acts in the banking sector. There were no EBC meetings held in 2013.

European Securities Committee (ESC)

The ESC is the Commission's advisory body which is responsible for preparing legislation associated with securities. The ESC plays an important part in fulfilling the objectives defined in the Action Plan for Financial Services and ensuring consistency during the implementation of EU legislation. One ESC meeting was convened in November 2013 to discuss the Commission's approach when evaluating the regulatory framework for the central counterparties in Japan and in the USA from the perspective of acknowledging these legal codes as the equivalent of European regulations.

European Insurance and Occupational Pensions Committee (EIOPC)

The EIOPC functions as the Commission's comitology council when discussion and approving implementing acts at Level 2. There were, however, no such acts discussed in 2013. The majority of the agenda originally falling within the competence of the EIOPC was transferred to the newly created Expert Group on Banking, Payments and Insurance, which meets in various configurations, i.e. for banking, payment services, and the insurance industry.

Other selected European Commission platforms

Capital Requirement Directive Working Group (CRDWG)

The CRDWG is involved in the preparation of regulations for the banking sector, or more specifically, the regulatory framework for credit institutions and certain types of investment firms. The aim of this group's work is primarily to take over the recommendations of the Basel Committee on Banking Supervision and to incorporate them into European legislation with the understanding that they will be revised in order to take into account the specifics of the European banking market. This working group did not meet at all in 2013.

European Financial Conglomerates Committee (EFCC)

The EFCC resolves expert issues associated with financial conglomerates. This committee's meetings include the participation of observers from Level 3 bodies, specifically from the EIOPA, EBA, and ESMA. Currently the EFCC is addressing the fundamental revision to the Financial Conglomerates Directive, which should follow once the applicable European legislation in the banking and insurance sectors is completed. As the regulatory framework for this areas has not yet been finished, this committee did not meet in 2013.

Expert Group of the European Securities Committee (EGESC)

This expert group met twice in 2013 (in March and in September). These meetings were focused on evaluating the main objectives of Regulation 2013/462/EU amending Regulation (EC) No 1060/2009 on credit rating agencies (CRA3), the implementation of the aforementioned regulation by ESMA, and the Commission's delegated act with regard to Regulation 2012/648/EU (EMIR).

Government Expert Group on Retail Financial Services (GEGRFS)

The GEGFRS deals with the issues associated with retail financial services. Its tasks are primarily based on the Green Paper on Retail Financial Services in the Single Market published in May 2007. The Commissions's legislative and non-legislative proposals are presented during the group's meetings as well as various topics that are at the expert discussion stage. This group did not formally meet in 2013.

Government Expert Group on Mortgage Credit (GEGMC)

The GEGMC addresses issues associated with the legal provisions for the mortgage market. Its tasks are primarily based on the Green Paper on Mortgage Credit published in 2005. This group did not meet in 2013. Starting in 2014, the GEGMC will start coordinating the transposition of Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

Payments Committee (PC)

The PC is the Commission's permanent advisory committee for issues associated with payment services legislation. The meetings of the PC are chaired by the Commission and the committee comprises

representatives from all of the EU member states. Representatives from the EFTA and EEA states, candidate states to the EU, and the ECB are invited to participate in the role of observers. The committee's agenda currently includes issues associated with Directive 2007/64/EC on payment services in the internal market, Directive 2009/110/EC on electronic money, Regulation (EC) No 924/2009 on cross-border payments in euros, and Regulation No 260/2012 establishing technical and business requirements for credit transfers and direct debits in euros. The Commission Expert Group on Banking, Payments and Insurance (CEGBPI) was created in 2013. In the future it will take over a portion of the PC's competencies, specifically in the area of legislative proposals and delegated acts. The PC will continue to function, however only as an advisory committee for the proper implementation of European legislation.

Commission Expert Group on Banking, Payments and Insurance (CEGBPI)
The Commission Expert Group on Banking, Payments and Insurance was created in 2013. Its objective is to provide the Commission with assistance and advice during the preparation of proposals and delegated acts associated with banking, payment services, and the insurance industry. This CEGBPI also functions as a platform for communication and the exchange of opinions between the institutions of the member states and the Commission.

In its configuration for the insurance industry, it addresses not only expert issues, but also discusses various political topics associated with insurance and occupational pension insurance, including intermediation in the insurance industry. The meetings of the expert group are held with the participation of representatives from the member state and the Commission. The representatives of the EIOPA supervisory authority and the countries of the EEA participate in the role of observers. In 2013 this working group discussed the results of the impact study completed for the package of measures for long-term guarantees according to the proposal for the Omnibus II Directive.[72.] Other topics addressed by this expert group include the impact of implementing risk-based solvency capital requirements under Solvency II on long-term investments; and the equivalence of the regulatory and supervisory regime in third countries (primarily the USA) with regard to Solvency II. The group also discussed the issue of postponing the deadline for the transposition and effectives of the Solvency II directive through the Quick Fix II directive, the revision to the directive on the activities of institutions for occupational retirement provision, and the status of the discussions regarding the directive on insurance mediation (IMD II).

In the future, the CEGBPI configuration for payment services will address the prepared legislative proposals and delegated acts by taking over this agenda from the Payments Committee.

In 2013 the groups configuration for the banking sector met twice. The main topic of the meetings concerned the progress of the member states with the implementation of the capital requirements directive (CRD IV) and the capital requirements regulation (CRR) as well as the assistance provided to the Commission during the preparation of reports and implementing acts, which is a task assigned to the Commission on the basis of CRD IV. At the start of 2014 the group was involved in the preparation of the delegated acts that will implement the required changes and supplement the provisions of the CRR, which defines liquidity and leverage requirements.

Council of the European Union / ECOFIN

The Council of the European Union (informally referred to as the Council of the EU) brings together the ministers from the EU member states, who meet and adopt legislative acts and co-ordinate the functioning of individual policies. The key tasks performed by the Council of the EU include approving the EU's legislation, co-ordinating the main direction of the economic policies of the member states, signing agreements between the EU and other countries, approving the annual budget, developing the EU's foreign and defence policies, and co-ordinating the co-operation between the judicial organs and the police authorities in the member states. The Council does not have any permanent members. Each of the member states sends its representative (minister) responsible for a particular area of policy to each of the Council's meetings. The Council thus meets in various compositions (there are ten in total) according to the area to which the discussed materials belong.

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

The ECOFIN Council is the Council of the EU configuration consisting of the economics and finance ministers from the EU member states (if budget issues are on the agenda to be discussed, the budget ministers also attend the meetings). The competencies of the Council include the adoption of measures in areas such as the coordination and supervision of economic policies; the monitoring of budgetary policy and the state of public finances in the member states; the euro as the single currency; taxes; the financial markets; the free movement of capital; and economic cooperation with third countries. In addition, every year the ECOFIN council works in conjunction with the European Parliament to prepare and approve the EU budget. The presidency of the ECOFIN Council rotates every six months according to a pre-approved sequence (the Czech Republic held the presidency during the first half of 2009, Ireland and Lithuania in 2013 and Greece in 1. half of 2014). As a rule, the ECOFIN Council meets once a month. In addition, the economics and finance ministers meet informally in the presiding country once during its term. The governors of the central banks also participate in these informal meetings.

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

In 2013 the activities of the ECOFIN configuration of the Council of the EU consisted of approving the General Approach documents for the Commission's proposals that were discussed by the Working Party on Financial Services as well as discussing the developments in the agendas for which discussions are still underway.

During the individual meetings, the ECOFIN Council:

- adopted a decision allowing eleven member states to implement a financial transactions tax through enhanced cooperation; took into consideration the presentation of the Irish Presidency's programme for economic and financial affairs, stating that, in the case of financial services, legislative proposals facilitating the creation of a banking union will have priority (22 January 2013);
- received information regarding the development of certain legislative proposals associated with financial services, specifically with regard to banking supervision, capital requirements for banks, bank recovery and resolution, markets in financial instruments, and market abuse (12 February 2013);
- confirmed the results from the political trialogue with the European Parliament regarding two proposals amending the EU rules for the capital requirements for banks and investment firms (5 March 2013);
- discussed the proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms; welcomed the compromise achieved with the European Parliament regarding the proposal for the mortgage credit directive; and expressed its support for the Single Euro Payment Area (SEPA) (14 May 2013);
- confirmed the General Approach that was agreed with regard to the newly proposed rules (regulation and directive) for the market in financial instruments and urged the presidency to initiate negotiations with the European Parliament on the basis of this General Approach with the objective of reaching an agreement during the first reading (21 June 2013);
- reached an agreement regarding the General Approach for the proposal for directive establishing a framework for the recovery and resolution of credit institutions and investment firms and urged the Presidency to initiate negotiations with the European Parliament and strive for the adoption of the directive during the first reading by the end of the year; and received information regarding the state of play of several legislative proposals, specifically the proposal for a directive for deposit guarantee schemes (the DGS Directive), the proposal for a regulation setting transparency rules for Packaged Retail Investment Products (the PRIPs Regulation), the proposal for a regulation and proposal for a directive for market financial instruments (MiFIR and MiFID), and the proposal for a regulation aimed at tackling insider dealing and the manipulation on the securities markets (MAR) (26-27 June 2013);
- took under consideration the presentation of the Lithuanian Presidency's working programme for economic and financial affairs, stating that, in the case of financial services, the tasks associated with the creation of the Banking Union have priority; and took under consideration the preliminary

agreement reached by the European Parliament with regard to the proposal for a regulation aimed at tackling insider dealing and the manipulation on the securities markets (9 July 2013);

- adopted the regulation establishing a single supervisory mechanism for credit institutions, thus establishing the first pillar of the European Banking Union (15 October 2013);
- adopted a statement in relation to bank assets quality reviews and stress tests, including backstop arrangements (measures in the form of state aid). The member states should use this statement as the basis for ensuring that the required measures are available at the national level, including resolution mechanisms and public backstops, which will make it possible to immediately respond to any deficiencies found in the forthcoming comprehensive assessments of banks and stress tests that the ECB will publish by November 2014. Other activities included discussions regarding the proposal for a regulation on a single resolution mechanism for credit institutions. ECOFIN also took under consideration the on-going work on proposals in the area of financial services, specifically the proposal for a regulation on central securities depositories, the proposed rules for financial instrument markets, the proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms, the proposal for a directive on deposit guarantee schemes, and the agreement that was reached with the European parliament enabling application of Solvency II legislation starting in 2016. (15 November 2013);
- updated its position regarding the proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms and the proposal for a directive on deposit guarantee schemes, taking into account the on-going negotiations with the European Parliament (10 December 2013);
- approved the General Approach to the proposal for a regulation on a single resolution mechanism for banks and urged the Presidency to initiate negotiations with the European Parliament with the objective of reaching an agreement during the first reading prior to the end of the current European Parliament's term of office (May 2014); and made the decision to establish an intergovernmental conference with the aim of entering into an intergovernmental agreement (IGA) for those aspects of a single resolution mechanism for banks that cannot be agreed within the context of EU law. This primarily concerns the issues associated with a single resolution fund for banks (18 December 2013).

At its meetings, the ECOFIN Council also addressed the preparatory tasks for the European Council summit and the preparation of a common position for the G20 summit.

In addition, two informal meetings of the ministers of finance and the governors of the central banks took place in 2013. The first of these was held in April during the Irish Presidency, and the second in September during the Lithuanian Presidency. The issues associated with the Banking Union were the subject of the discussion at both of these informal meetings.

Financial Services Committee (FSC) + Economic and Financial Committee (EFC)

The Financial Services Committee (FSC) and the Economic and Financial Committee (EFC) are two of the ECOFIN Council's permanent committees. The FSC provides a forum for the preliminary expert level discussion of issues associated with financial services and, together with the EFC, takes part in the preparations for the individual ECOFIN Council meetings. Representatives from the ministries of finance of the EU member states, the Commission, the ECB, and the European supervisory authorities (EBA, ESMA, and EIOPA) participate in the activities of the FSC. At the close of 2013 the FSC started to discuss changing the committee's working methods. Their objective is to focus their meetings more on current issues, to establish a closer link with the EFC, and to concentrate on a lower number of topics, which are, however, important from the perspective of overall regulatory strategy, including cumulative effects, etc.

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

The financial market topics discussed by this committee in 2013 included, amongst others, the issues associated with the Banking Union and the implementation of a single supervisory mechanism (SSM) and

single resolution mechanism (SRM) for credit institutions, the financial markets development, state aid in the financial sector, a common legal entity identifier (LEI), the comprehensive assessment of banks by the EBC and the EBA's stress tests, issues associated with the functioning of the European supervisory authorities and the European Systemic Risk Board, and any planned revisions to individual regulations. Both committees also participated in the preparation of a common position regarding the issues discussed by the Financial Stability Board (FSB) and at the G20 summits.

In 2014 the committees are continuing in their discussion of the issues associated with the implementation of a single resolution mechanism (SRM) for credit institutions, state aid in the financial sector, and financial markets development. They are also addressing the issues associated with financing for small and medium-sized enterprises, banking structural reforms (in relation to the Liikanen Report), the long-term financing of the economy, securitisation, and virtual currencies.

Working Party on Financial Services (D03)

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

The Council's Working Party on Financial Services discussed the following topics in 2013:

- the proposal for a directive amending the Prospectus Directive and the Solvency II Directive with regard to the powers of the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – referred to as Omnibus II. Trialogues were renewed in 2013 after the impact study on long-term guarantees was completed in July 2013. In November 2013 a consensus was successfully reached during these trialogues with regard to the text of the proposal for a directive;
- the proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms (referred to as the Bank Recovery and Resolution Directive, or BRRD); the General Approach was approved and trialogues subsequently initiated in June 2013; a political consensus with the European Parliament was reached in December 2013;
- the draft of the new directive on deposit guarantee schemes (DGS); trialogues took place in mid-2013 and, in December 2013, a political consensus was reached with the European Parliament;
- the proposal for a directive on credit agreements for consumers relating to residential immovable property (referred to as the Mortgage Credit Directive, or MCD). The trialogues were closed in 2013 and the different language versions of the proposal were prepared; the compromise text was approved by the European Parliament in December 2013;
- the proposal for a directive on the transparency and comparability of payment account fees, payment account switching, and access to basic payment accounts (referred to as the Payment Accounts Directive, or PAD);
- the proposal for a regulation on central securities depositories and securities settlement (referred to as the Central Securities Depositories Regulation, or CSDR);
- the directive and the regulation on markets in financial instruments (referred to as MiFID 2 and MiFIR). After a series of regular monthly meetings of the Working Party, COREPER approved the General Approach in June 2013. Trialogues were launched during the fourth quarter.
- the regulation on market abuse (referred to as MAR). Trialogues took place over the course of the year and the European Parliament approved the regulation in September 2013;
- regulation on key information for investment products (referred to as the PRIPs Regulation). After several meetings of the Working Party at the attaché level, COREPER approved the General Approach in June 2013 and trialogues were subsequently launched;
- the amendment to the UCITS IV Directive (referred to as UCITS 5). COREPER discussed this directive in December 2013 and approved the General Approach;
- the amendment to the transparency directive (referred to as TD2). Trialogues were underway in April and May 2013. The Directive was published in the Journal in November 2013.

Ad Hoc Working Party

The Ad Hoc Working Party met in parallel with the meeting of the Working Party on Financial Services meetings and addressed the following proposals:

- the proposal for a regulation on a single supervisory mechanism for credit institutions (the SSM Regulation); trialogues took place during the first half of 2013 and the final text of the proposal was subsequently approved;
- the proposal for a regulation on a single resolution mechanism for credit institutions (the SRM Regulation); the General Approach was approved in December 2013 and trialogues were launched.

Intergovernmental Conference

In relation to the discussions concerning the draft regulation on a single resolution mechanism for credit institutions (the SRM Regulation), an Intergovernmental Conference was convened, which discussed the proposal for the Intergovernmental Agreement (IGA) for a single resolution fund.

More information on the individual proposals that were discussed is provided in Chapter 10.3.

European Council

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

At its meeting in 2013, the European Council addressed, amongst other things, the issues associated with the discussions concerning certain legislative proposals pertaining to the creation of the Banking Union, particularly the draft regulations establishing a single supervisory mechanism (SSM) and a single resolution mechanism (SRM) for credit institutions and the draft directive establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD). The comprehensive assessment of banks that is being prepared was also discussed.

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

OECD

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

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

Committee for Financial Markets (OECD CMF)

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

CMF therefore provides a geographically broader platform for debate and the exchange of experience than is provided by other mechanisms, such as discussions between the member states of the European Union.

A very specific characteristic of the committee's activities consists of the regular meetings with representatives from the private financial sector, at which important topics of common interest to both the public as well as the private sectors are discussed, particularly development trends in the global financial market. The main topics discussed in 2013 continued to included issues associated with current market development around the world; experience in implementing financial sector reforms leading to stabilisation; the regulatory systems used by Systemically Important Financial Institutions; and the so-called implicit government guarantees towards the financial sector. In 2014 the CMF will, amongst other things, return to the topic of financing for long-term investments and for small and medium-sized enterprises, and the structural reform of the financial sector. It will also continue to discuss the development in emerging economies and its impact on financial stability at the global level.

Insurance and Private Pensions Committee (OECD IPPC)

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

In 2013 IPPC discussed: the global development of the insurance market; annuity issues (pension insurance); longevity risk (i.e. the risk of higher than expected growth in the middle-age group); the relationships between institutional investors and long-term investments, or, more specifically, the effect that the insurance sector has on long-term growth and stability. In addition, the IPPC addressed the topic of insurance against catastrophic risks and its financing; monitoring and transparency in the insurance sector; the procedures and assessments associated with the accession of Israel and Estonia to the OECD; and an assessment of Russia's preparedness for accession.

Working Party for Private Pensions (WPPP)

The WPPP addresses similar topics as the IPPC, however, it places greater focus on the pension fund sector, its asset managers, and the participants in private pension schemes. In addition to the aforementioned annuity issues, longevity risk, long-term investments, and accession processes, the WPPP also discussed the draft of the revised principles for the regulation of private pension schemes, and the issues associated with the classification of pension plan funds for statistical and methodological purposes. All of the Working Party's members also regularly cooperate in the collection and review of the data used in the statistical databases administered by the OECD. The secretariat and selected member states are working on a project to determine the adequacy of savings for retirement and how they are measured within the different conditions that exist in the individual selected countries.

International Network on Financial Education (OECD INFE)

The International Network on Financial Education is a platform comprising the institutions of the OECD member states (as a rule, the ministries of finance and the central banks). Its role is to create strategic documents at the global level. The Network's web pages[73] provide a gateway to information about financial education and the data, resources, research, and news from the individual member states. In May 2013, the CNB, acting in cooperation with the MoF, organised an INFE meeting and conference in Prague. In 2013, the INFE focused on the methodology used for measuring financial literacy, long-term savings and investments, online educational tools, financial inclusion, and involving the private sector in the financial educational process. The activities planned for 2014 include, amongst others, the creation of a set of core financial competencies for every individual age group.

[73] http://www.financial-education.org/
http://www.oecd.org/finance/financial-education/

G20

The G20 brings together the finance ministers and the central bank governors from nineteen countries[74] and the EU (which is represented by the presiding member state and the ECB). The G20 was established in 1999 as a forum in which the leading world economies are able to exchange their opinions regarding key issues related to the global economy. The Czech Republic is not a member of the G20 but is de facto represented by the representative for the European Union.

Russia was the presiding country in 2013. At the summit in St. Petersburg (September 2013) the leaders:

- evaluated the progress in the implementation of regulatory reforms in the financial market;
- reiterated their commitment with regard to the implementation of Basel III according to the approved time schedule;
- renewed their commitment to institute the reforms necessary to implement the key aspects recommended by the Financial Stability Board (FSB) and required in order to ensure the effective functioning of the resolution systems for banks;
- welcomed the publication of a list of global systemically important insurers (G-SIIs);
- welcomed the FSB's report regarding the progress in the reform of OTC derivatives;
- urged the national authorities and standard setting bodies to speed up the process that will decrease the dependence on credit rating agencies;
- welcomed the progress that has been achieved with regard to the supervision and regulation of shadow banking.

Global Partnership for Financial Inclusion (GPFI/G20)

In 2013, the MoF participated in the meetings establishing the Subgroup on Financial Consumer Protection and Financial Literacy within the framework of the GPFI platform, which unites the G20 member states as well as interested non-G20 countries. The Subgroup on Financial Consumer Protection and Financial Literacy builds on the activities of the Task Force on Financial Consumer Protection under the OECD, which has the objective of preparing international standards for consumer protection on the financial market, particularly as regards financial education and financial inclusion.

10.3. European Financial Market Legislation

Single Supervisory Mechanism for Credit Institutions (SSM)

On 18 April 2013, after reaching an agreement with the European Parliament, COREPER approved the final compromise text of both of the proposals[75] that will be used as the basis for establishing a single supervisory mechanism for the credit institutions in the eurozone and transferring the supervisory powers from the national authorities to the ECB. Those member states that are outside of the eurozone may join the system in a regime of close cooperation with the ECB and thus subject the banks in their territories to ECB supervision. The drafts were subsequently formally approved by the European Parliament on 12 September 2013 and by the Council on 15 October 2013. The single supervisory mechanism will function starting on 4 November 2014.

Single Resolution Mechanism (SRM)

In July 2013 the Commission submitted a proposal for a regulation establishing a single resolution mechanism (SRM) for credit institutions and which is intended to supplement the already approved single supervision mechanism (SSM). Thus a centralised mechanism for the eurozone will be implemented within the Banking Union with the aim of helping the banks that have been weakened as a result of the European debt crisis. Member states from outside of the eurozone will be able to participate on a voluntary basis. The Council approved the General Approach on 18 December 2013 and, at the same time, agreed that certain crucial matters associated with the single resolution fund that will be established on the basis of the SRM Regulation as well as other additional related provisions will be resolved in the form of an Intergovernmental Agreement

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

[75] The draft regulation amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), and the draft regulation conferring specific tasks on the European Central Bank concerning policies related to the prudential supervision of credit institutions.

(IGA) supplementing the SRM Regulation. The IGA is being discussed by an Intergovernmental Conference, in which all of the member states may participate. On 27 March 2014, the Council reached a political agreement with the European Parliament as regards the draft SRM Regulation. The draft was approved by the European Parliament on 15 April 2014. This will be followed by the formal approval of the Council. The IGA will have to be ratified by the national parliaments.

Crisis Management (BRRD)
Negotiations continued in 2013 regarding the proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms (referred to as the BRRD), which the Commission submitted in 2012. This directive aims to ensure the avoidance and resolution of crises in the case of selected entities on the financial market, specifically credit institutions and investment firms, and to thus ensure that the stability of the financial markets and public finances are protected (the costs associated with the measures should be borne primarily through the bail-in of shareholders and creditors). The Council approved the General Approach for the proposal on 26 June 2013 and initiated the negotiations with the European Parliament. On 11 December 2013 the Council successfully reached a political agreement with the European Parliament and COREPER subsequently approved the compromise proposal on 20 December 2013. The proposal was approved by the European Parliament on 15 April 2014. This will be followed by the formal approval by the Council. The deadline for transposition is 31 December 2014.

Guarantee Schemes (DGS and ICSD)
The proposal for a directive on deposit guarantee schemes (referred to as the DGS Directive) primarily aims to unify the functioning of national guarantee schemes in the banking sector and to provide better protection for depositors. As a result of the close links between this proposal and the draft BRRD, the negotiations regarding the DGS Directive were suspended in 2012 and were not renewed until July 2013. On 11 December 2013 the Council successfully reached a political agreement with the European Parliament and COREPER subsequently approved the compromise proposal on 20 December 2013. The draft was approved by the European Parliament on 15 April 2014. This will be followed by its publication in the Journal. The deadline for the transposition of the directive is twelve months after the publication of the directive in the Journal.

According to the Commission, the proposed amendment to the directive on investor compensation schemes (referred to as the ICSD) is a response to the developments and changes in the conditions on the capital market since the publication of the original text of the directive in 1997, and also to the necessity to remove the gaps in investor protection that have been discovered in practice. The General Approach was approved at the COREPER meeting on 23 November 2011. Since that time there has not been any significant progress in the negotiations. As in the case of the DGS Directive, it was necessary to wait for the final version of the BRRD. However, the negotiations have not yet been renewed.

Capital Requirements (CRDIV and CRR)
The aim of the provisions contained in the directive on capital requirements (CRD IV) and the regulation on capital requirements (CRR) is to strengthen the regulatory framework and to create the conditions that will ensure stability, safety, and the sufficient resilience of the banking sector and the overall financial system. They also aim to enhance the protection of consumer interests, support the integration of the internal banking services market, modernise the rules for prudent supervision, and strengthen the cooperation of the supervisory authorities. CRD IV and the CRR introduce a new concept for the regulatory framework referred to as Basel III, which was prepared by the Basel Committee on Banking Supervision in response to the crisis on the financial markets.

The tasks for completing the adoption process for the CRD IV and the CRR at the European level continued during the first half of 2013 and both were published in the Journal on 27 June 2013[76]. The deadline for transposing the CRD IV and the CRR into the national legislation was set as 31 December 2013. It is expected that the act implementing the CRD IV and the CRR will enter into force in mid-2014.

[76] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC; and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

Payment Accounts (PAD)

In May 2013 the Commission published its proposal for a directive on the transparency and comparability of payment account fees, payment account switching, and access to basic payment accounts (referred to as the Payment Accounts Directive, or PAD). The Council completed its General Approach in December 2013. Trialogues were underway from January to March 2014. The measures affect three specific areas: 1. Transparency and comparability of payment account fees – the objective is to make it easier for consumers to compare the fees charged by the payment service providers in the EU; 2. Payment account switching – the objective is to implement an easy and fast process for changing payment account providers; and 3. Access to basic payment accounts – the objective is to make it possible for all consumers in the EU to open a payment account that provides basic services (credit transfers, direct debits, cash withdrawals, and the use of a payment card) in any of the member states regardless of the consumer's member state of origin.

Alternative Dispute Resolution (ADR)

Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes (ADR), and Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes (ODR) were both published in the Journal on 18 June 2013. The directive and the regulation entered into force on 8 July 2013 and the member states are obliged to transpose the directive into their national legislation by 9 July 2015. With the exception of certain provisions, the regulation will become effective on 9 January 2016. As the issue involves general consumer provisions, the delegated owner of the ADR and ODR legislation is the Ministry of Industry and Trade. However, as the provisions also affect financial services, the MoF regularly provided its comments for both proposals, particularly with respect to the adequate obligation of traders to provide information about ADR entities and that ADR should serve to strengthen the consumer as the weaker contractual party and traders should not be able to initiate a dispute through an ADR entity. Starting in September 2013 the MoF has actively participated in ensuring the transposition and adaptation of the specified European regulations as a part of the working group under the Ministry of Industry and Trade.

According to the directive, consumers will be able to voluntarily submit, either offline or online, a domestic or cross-border dispute that arises between a consumer and a trader in connection with the sale of goods or the provision of services in any of the economic sectors to an entity providing out-of-court dispute resolution (ADR entity). The ADR entities will have to be able to accept online submissions (due to the implementation of the associated ODR regulation). The directive does not provide detailed provisions for the process that the ADR entities should follow. It does however establish that any procedural rules that are applied may in no way make the consumer's access to ADR more difficult. The proposal also defines certain minimum qualitative requirements for ADR entities, specifically with regard to impartiality, transparency, effectiveness, and fairness. The ADR process should be provided to the consumer either free of charge or for only a slight fee. The member states will have the option to either use already functioning ADR entities or to create new entities. The aim is to ensure that consumers have full access to alternative dispute resolution in various geographical areas and within the different sectors.

Consumer Credit Directive (CCD)

In 2013 the Commission initiated the review of the transposition of Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers and repealing Council Directive 87/102/EEC. The aim of the review is to determine how the directive was implemented, which of the regulatory options the member states selected, and whether or not it is necessary to modify the directive. For this purpose, the Commission initiated a series of meetings with the representatives of the member states who are involved in the issues associated with the transposition of the CCD.

Mortgage Loans (MCD)

The trialogues regarding the proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property (referred to as the Mortgage Credit Directive or MCD), which aims to unify and support the internal mortgage loan market, were completed during the first half of 2013. The draft directive in the version agreed with the European Parliament was approved at the level of COREPER II on 8 May 2013. The various language versions of the draft directive were prepared during the summer. The European Parliament approved the output text from the trialogues at its session held on 10 December 2013. The ECOFIN Council approved the proposal for the directive on 28 January 2014. On 4 February 2014 the directive was published in the Journal as Directive 2014/17/EU of the European Parliament and of the

Council on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

The main basic building blocks of the new directive, which, in many respects, contains provisions that are parallel to the legal provisions for consumer credit laid down in Directive 2008/48/EC, consist of the obligation to provide information (in advertising and during the pre-contract stage); rules regarding the annual percentage rate of charge; the assessment of the consumer's creditworthiness and the appropriateness of providing credit to the consumer, including access to the databases of borrowers; the consumer's right to early repayment of a loan; the requirements for the regulation of credit intermediaries, including a European passport for these entities; the requirements for adequate regulation and supervision of non-bank mortgage lenders, including requirements for the professional competence of persons dealing with the consumer. The directive also lays down provisions limiting the foreign exchange risk exposure of consumers in the case of foreign currency loans, the requirements for setting an upper limit for late penalties, and other requirements ensuring a certain tolerance on the part of a creditor towards a borrower in default.

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

The MoF still has serious doubts, particularly with regard to the defined regulatory framework for the bond and derivative market, as the Commission would de facto define all of the exemptions from the obligation to provide information about offers (pre-trade transparency) and information about closed deals (post-trade transparency) for all shares, bonds, and derivatives. This method of using delegated acts to define exemptions is inappropriate as it does not make it possible to regularly (at least on a monthly basis) recalibrate the entire system of exemptions according to fluctuating market liquidity (liquidity fluctuates primarily in the case of bonds). In addition, the entire regulatory framework can function without any negative effects only in the case of highly liquid financial instruments. In the case of less-developed markets and less liquid financial instruments, including state bonds, there might be a significant departure of investors, which would consequently lead to the liquidation of these small markets. During the negotiations the MoF successfully promoted partial individual changes in this area to reduce the impact of the regulation. Both acts will most likely be published in the Journal in September 2014.

Market Abuse (MAR)
On 20 October 2011 the Commission published a proposal for a regulation on insider dealing and market manipulation (market abuse, referred to as MAR), which will replace the current directive on insider dealing and market manipulation (market abuse), referred to as MAD. At the same time it published a proposal for a directive on criminal sanctions for insider dealing and market manipulation (referred to as CSMAD). Amongst other objectives, these legislative proposals aim to expand the regulatory framework to include two new types of trading facilities (MTF – multilateral trading facility and OTF – organised trading facility); strengthen the supervision of the commodity and emission permit markets; and establish a single framework for imposing sanctions. During the course of the discussions, the Czech Republic voiced its doubts about the inclusion of emission permits and commodities under the supervision of the financial market supervisory authorities. In addition, the Czech Republic promoted the retention of national discretion with regard to the automatic submission of list of inside traders. It is most likely that the MAR and CSMAD will be published in the Journal together with MiFID 2 and MiFIR in September 2014.

Transparency Directive (TD2)
On 26 October 2011 the Commission published a proposal for a revised transparency directive, which aims to increase the level of investor confidence thanks to equal transparency requirements for security issuers and investors throughout the entire EU. According to the submitted proposal, the key changes in the revised

transparency directive include the repeal of the requirement to publish interim management statements; a greater level of harmonisation with regard to notification of holdings of voting rights; more precise rules for the choice of a home member state in the case of issuers from third countries; the implementation of a new requirement for country-by-country reporting; and establishing a new framework for imposing sanctions. The trialogues for this directive were launched in June 2012. Further discussions were subsequently suspended due to the links between the transparency directive and a directive on accounting, which provides a general solution for the country-by-country reporting that is specified in the revised TD. The directive was published on 6 November 2013 as Directive 2013/50/EU.

Credit Rating Agencies (CRA3)

On 15 November 2011 the Commission presented a proposal amending the regulation on credit rating agencies and a proposal for a directive amending directives 2003/41/EC, 2009/65/EC, and 2011/61/EU in respect of the excessive reliance on credit ratings. One of the key elements of the regulation on credit rating agencies that is currently still in force is a single authorization and supervisory regime for credit rating agencies and the publication of ratings, which are used in those cases when the EU law requires an assessment of the quality of a certain financial instrument on the basis of ratings. With its new proposal, the Commission aims to reduce the excessive reliance of financial institutions on external ratings; to increase the transparency of credit rating agencies; to institute a rule for the obligatory rotation of credit rating agencies in the case of publishing ratings as a result of resecuritisation; and to implement civil law liability rules for credit rating agencies. In the case of the draft directive, the primary aim is to reduce the level of dependence on ratings by assigning to the fund managers the task of implementing measures that will ensure that they will not exclusively or mechanically rely on external ratings when assessing the quality of the asset values included in undertakings of collective investments in transferable securities (UCITS) and alternative investment funds (AIF). These EU legislative acts were published in the Journal on 31 May 2013 as Directive 2013/14/EU and Regulation (EU) No 462/2013.

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

On 7 December 2011 the Commission published a proposal for a regulation on European venture capital funds and a proposal for a regulation on European social entrepreneurship funds. These legislative proposals institute a "European passport" for funds managers who do not fall within the scope of the AIFMD ("below-threshold fund managers"). These regulations assign to the funds the obligation to invest at least 70% of their assets in small and medium-sized enterprises, which, according to the Commission, should have a positive effect on the access these enterprises have to financing. The Czech Republic has supported both of the proposals since the very start. The trialogues for these legislative proposals started in June 2012. However, due to the issues associated with third countries (particularly tax havens), they did not finish until December 2012. The regulations were published in the Journal on 25 April 2013 as Regulation (EU) No 345/2013 and Regulation (EU) No 346/2013 and took effect on 22 July 2013. The Czech Republic had adapted and transposed both regulations in Act No 240/2013 on investment companies and investment funds by 19 August 2013.

Revision of the UCITS IV Directive (UCITS 5)

On 3 July 2012 the Commission published a proposal for an amendment to the directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with respect to the activities of depositaries, the rules for remuneration, and sanctions (referred to as UCITS 5). This legislative proposal brings the UCITS provisions into line with the AIFMD with regard to the depositary regime and remuneration, and also into compliance with other legislative proposals for harmonising sanctions. The Czech Republic supports the maximum possible level of unification for the depositary regime according to the AIFMD and the UCITS Directive. It also agrees with the proposal to establish general requirements for the remuneration of individuals; however it is against defining rules at a very high level of detail. As far as the provisions for sanctions are concerned, it is necessary to prevent the provision to expand beyond the framework of the already approved regulations. It is expected that the amended directive will be published in the Journal in September 2014.

European Long-Term Investment Funds (ELTIFR)

On 26 June 2013 the Commission published a proposal for a regulation on European long-term investment funds (referred to as the ELTIF Regulation). The proposal for the regulation incorporates a common framework of rules of investment funds that intend to use the "ELTIF" designation, particularly with regard to their investment strategies, the realisation of assets, transparency requirements, and supervision to ensure

compliance with these rules. The ELTIF Regulation aims to facilitate the access European enterprises have to long-term financing and to expand the options for long-term investing not only for qualified investors. During the negotiations, the MoF is stressing the importance of protection for retail investors.

Money Market Funds (MMFR)
On 4 September 2013 the Commission published a proposal for a regulation on money market funds (referred to as the MMFR). The proposal for the regulation incorporates a common framework of rules of investment funds that intend to use the "money market fund" designation, particularly with regard to their investment strategies, the realisation of assets, capital reserves, and supervision to ensure compliance with these rules. The MMFR aims to strengthen the stability and liquidity of money market funds, particularly money market funds with a constant NAV per unit or share (CNAV MMF). During the negotiations the MoF will focus primarily on the proportionality of the proposal and on minimising the impact on existing money market funds.

Benchmarks
On 18 September 2013 the Commission published a proposal for a regulation on indices are used as benchmarks in financial instruments and financial contracts. The proposal is primarily a reaction to the manipulation with the LIBOR and EURIBOR interest rates benchmarks. The proposed regulation aims to improve the process used for defining benchmark values and managing conflicts of interest. It also has the objective of improving the quality of input data and the methodologies that are used by the administrators of benchmarks. During the negotiations, the MoF will continue to stress the issue associated with the scope of the regulation and in relation to countries outside of the EU.

Management of Alternative Investment Funds
The following were published in the Journal on 15 May 2013:

- Commission Implementing Regulation (EU) No 447/2013 establishing the procedure for AIFMs which choose to opt in under Directive 2011/61/EU ; and
- Commission Implementing Regulation (EU) No 448/2013 establishing a procedure for determining the member state of reference of a non-EU AIFM pursuant to Directive 2011/61/EU.

On 17 December 2013 the Commission published on its website a proposal for a delegated regulation specifying the definition of open-ended and closed-ended investment funds for the purpose of the AIFMD. This determination is of importance primarily with regard to liquidity management and the valuation of the assets and debt of a particular investment fund.

Supervision of Financial Conglomerates (FICOD 1)
On 10 June 2013 the deadline expired for the transposition into national law of Directive 2011/89/EU of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate (referred to as FICOD 1). The aim of this amendment is to improve the effectiveness of the supplementary supervision prior to the Commission's full review of Directive 2002/87/EC of 16 December 20002 on the on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC (referred to as FICOD). The deadline for transposing Article 4 of FICOD 1, which is associated with a change in the Solvency II Directive (2009/138/EC) does not expire until 31 March 2015.

The analysis of the fundamental revision of Directive 2002/87/EC and the conclusions from this analysis were summarised in a Commission Report published in December 2012. The Commission also took advantage of this opportunity to reply to the request for advice submitted by the Financial Conglomerates Sub-committee within the framework of the Joint Committee of European Supervisory Authorities. Based on this report, it appears that the Commission does not intend to publish the proposal for a new directive until such time that the rules are finalised in the separate directives for the banking and the insurance sectors. Taking into account the sizes of domestic financial institutions and considering that the majority of them are controlled by foreign parent companies, the Czech Republic does not consider the need for a fundamental revision of the directive to be acute and the MoF voiced its support for holding back legislative proposals until the provisions for the individual sectors have been stabilised.

Insurance Sector (Solvency II and Omnibus II)

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

The Solvency II directive has already been amended by Directive 2011/89/EU (referred to as FICOD 1), specifically in relation to the revision of Directive 2002/87/EC on the supplementary supervision of financial entities in a financial conglomerate. It was further amended by Directive 2012/23/EU (the Quick Fix) in order to prevent the Solvency II directive from taking effect on 1 November 2012, and by directive 2013/58/EU (the Quick Fix II), which postponed the transposition deadline for the Solvency II directive to 31 March 2015 and its effective date to 1 January 2016. (Some provisions will gradually take effect between 1 April 2015 and 1 July 2015.)

The implementation of the Solvency II directive is practically impossible without the changes to it that are defined by the directive amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (the Omnibus II directive). The purpose of Omnibus II is to adapt Solvency II within the context of the Lisbon Treaty and to reflect the establishment of the European supervisory authorities (particularly the European Insurance and Occupational Pensions Authority – EIOPA). The Omnibus II proposal also provides a solution to certain aspects exceeding the scope of the changes associated with the Lisbon Treaty and the creation of the EIOPA (namely the provisions for risk-free yield curves in relation to the long-term stability of insurance commitments with a long-term guarantee and other factors, such as an equivalent regime for the regulation and supervision of third country entities, and reporting). The discussions at the trialogue level stopped at the topic of long-term insurance guarantees, specifically with regard to the provisions that help to alleviate the effects of the artificial volatility of the financial position of insurance companies that offer products with long-term guarantees, resulting from fluctuations in asset values and the volume of commitments from valuations performed under the Solvency II regime. For this reason, in July 2012 the parties to the trialogue decided to commission an impact study concerning the provisions that address long- term insurance commitments. This study was completed by insurance companies, reinsurance companies, the supervisory authorities, and EIOPA during the first half 2013 and the resulting report of the Commission was made available in June 2013. The trialogues were then resumed and a political agreement was successfully reached in November 2013. It is expected that the final negotiations regarding the Omnibus II directive as well as its publication will take place during the first half of 2014, and the Commission will subsequently be able to submit the proposal for the measures at Levels 2 and 3 of the Lamfalussy Process, the preparation of which continued throughout 2013.

Insurance Mediation (IMD2)

In June 2012 the Commission published a proposed amendment to the directive on insurance mediation (IMD2). This legislative initiative reflects the need to resolve certain critical problems that arose in relation to the transposition of the original Insurance Mediation Directive from 2002 into the national legislation for this particular sector of the financial market. The Commission had already promised to perform a revision at the start of 2010 with regard to the links between the amendment and the Solvency II directive, the revision to the markets in financial instruments directive (MiFID), the prepared UCITS 5 directive, and the initiative regulation for packaged retail investment products (PRIPs). The proposal for IMD2 was finally published in mid-2012. Based on the results from the Commission’s review of the directive, it became apparent that there is a need to limit the existing level of variations that exist in the national provisions for insurance mediation, to strengthen consumer protection, to ensure the internally consistent and mutually neutral (with regard to products and distribution) regulation of financial services as a whole, to unify the approach towards supervision and administrative sanctions; and to simplify and clarify the regime for cross-border activities within the EU’s internal market.

During 2013 the Council’s working party did not hold any meetings regarding this legislative proposal. Whilst the proposal was being discussed by the European Parliament, more than 700 recommendations for changes to the text were proposed. On the basis of its own national legislative objectives, the Czech Republic fully supports the idea of revising the regulatory framework for insurance distribution as well as the main pillars of

the new directive. During the discussions that have taken place to date at the level of the Council's working groups, the Czech Republic has consistently drawn attention particularly to the need to clarify the characteristics of the individual types of insurance distributors in the amendment as well as the associated issues of an appropriate registration and supervisory regime. With regard to the proposal to expand the scope of the directive to also include the insurance products offered directly by the insurance companies, the Czech Republic (together with several other member states) believes that the name of the directive itself should be modified.

Key Information Documents for Investment Products (PRIPs)

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

The proposal for the regulation continued to be discussed at the level of the Council's working groups during 2013. The Council completed its General Approach in June 2013. At that point, the trialogues between the Council, the Commission, and the European Parliament were launched, however, they were not successfully completed by the end of 2013. A compromise solution was sought primarily with regard to the application of the regulation to pension products, and also as regards some of the specific items that the key investor information should include. The final approval of the regulation is expected by June 2014. Taking into account its own national conceptual objectives for regulating the distribution of financial services, the Czech Republic is a long-time strong supporter of the Commission's legislative initiative for PRIPs.

Financial Transaction Tax (FTT)

In September 2011 the Commission submitted a proposal for a directive on a common system for a financial transaction tax. Due to the opposition of some of the EU's member states, on 22 January 2013 the ECOFIN Council adopted a decision that allows eleven member states[77] to continue working on a financial transaction tax system within the scope of enhanced cooperation in accordance with Article 326 et seq. of the Treaty on European Union. The decision was adopted by a qualified majority vote. The Czech Republic, together with Luxembourg, Malta, and the United Kingdom abstained from voting. The discussions held by the states within the framework of enhanced cooperation have thus far not led to any tangible results. Although the Czech Republic's current position does not include the implementation of a financial transaction tax, the Czech Republic will actively participate in the negotiations and material discussions regarding the impact of a FTT on the financial market and will try to convince the countries involved in the enhanced cooperation process that they must very carefully consider what will be subject to the tax.

Single Euro Payments Area (SEPA)

In January 2014 the Commission published a proposed amendment for the SEPA regulation (Regulation No 260/2012) postponing the date on which all national payment systems for credit transfers and direct debits in euros must be terminated by a period of six months. This thus extends the transition period during which credit transfers and direct debits in euros may be performed outside of the SEPA system by the same six

[77] Austria, Belgium, Estonia, Germany, Greece, France, Italy, Portugal, Slovenia, Slovakia, Spain.

month period. The new date is now 1 August 2014 as opposed to 1 February 2014. The amendment to the regulation was approved by the Council and by the European Parliament in February 2014 as Regulation No 282/2014 with retroactive effect to 31 January 2014.

OTC Derivatives, Central Counterparties, and Trade Repositories (EMIR)
Regulation (EU) No 648/2012 of 4 July 2012 on OTC (over-the-counter) derivatives, central counterparties, and trade repositories is referred to as EMIR, or the European Market Infrastructure Regulation. Implementing measures are published for this regulation on a regular basis.

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

Central Securities Depositories (CSDR)
The proposal for a regulation on central securities depositories is a part of a recently popular trend in the regulation of the market infrastructure. The final version of this regulation was approved in January 2014 and the legislative proposal is now in the translation and linguistic correction phase. Its publication in the Journal is expected to take place in September 2014. The main objective of the regulation is to increase the security of settlement system operations and to remove the legal obstacles that exist due to the national provisions on the functioning of the systems and the central depositories as the operators of these systems, particularly the obstacles associated with differing provisions for settlement periods and the standards for central securities depositories from the perspective of prudential regulation and the ability to access to the national central securities depositories and the systems operated by them. In the long run, there should be a full dematerialisation or immobilisation of all securities held in the central securities depositories.

10.4. National Financial Market Legislation

Deposit Guarantees
In 2013 activities continued with regard to the amendment to Act No 21/1992 on banks, in relation to the transposition of the Directive of the European Parliament and of the Council on deposit guarantee schemes. The deadline for the transposition is twelve months after the publication of the directive in the Journal, however, this publication has not yet taken place.

Crisis Management in the Financial Sector
In 2013 work was underway on a draft bill on the recovery and resolution of banks and investment firms (working title) and on the draft bill amending certain other legislation in relation to the draft bill on the recovery and resolution of banks and investment firms, specifically within the context of the transposition of the Bank Recovery and Resolution Directive (BRRD). The deadline for the transposition is 31 December 2014; however the directive has not yet been published in the Journal.

Building Savings Schemes
The Government's draft bill containing certain conceptual amendments to Act No 96/1993 on building savings schemes (such as the requirement of a justified purpose in order to receive the state contribution and a product concept for building savings schemes that will allow standard banks to offer this product as well) has been ready for discussion by the Chamber of Deputies since April 2012. The first reading did not take place until February 2013. The second reading was halted due to the dissolution of the Chamber of Deputies in August 2013. For this reason the changes have not been implemented.

Credit Unions
In 2013 the MoF submitted a draft bill amending Act No 87/1995 Coll. on Credit Unions and certain related measures, and supplementing Act No 586/1992 Coll. of the Czech National Council on income tax, as amended. This draft bill was approved by Government Resolution No 390 of 29 May 2013. This draft bill temporarily allowed the gradual transformation of large and medium-sized credit unions into banks and provided these institutions with the ability to obtain a banking licence under a regime that has less stringent equity requirements. According to the draft bill, the credit unions that did not take advantage of the

opportunity to change into banks would have to operate under a stricter regulatory framework than before. The draft bill defined the upper limit for credit union balance sheet totals to CZK 5 billion. Additional proposals included an increase to the mandatory contribution of a portion of a credit union's profit to the risk fund and the doubling of a credit union's contribution to the Deposit Guarantee Fund. However, this draft bill was not discussed due to the dissolution of the Chamber of Deputies. Given the deteriorating situation in the credit union sector, the draft bill was expanded and resubmitted for discussion during the first half of 2014.

Czech National Bank

Work was started on preparing an amendment to Act No 6/1993 Coll. on the Czech National Bank, as amended, with the objective of removing existing deficiencies in national legislation that had been identified by the European Central Bank, thus bringing this act into compliance with the provisions of the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks and of the European Central Bank. The draft bill also removes some of the deficiencies in the current version that the CNB encountered in practice after the Czech Republic's accession to the EU and after the integration of the supervision over the financial market in the Czech Republic. The draft bill was further supplemented to include provisions for financial stability and macro-prudential policies in response to the Recommendation of the European Systemic Risk Board on the macro-prudential mandate of national authorities (ESRB/2011/3) of 22 December 2011. The act was published in the Collection of Acts on 2 August 2013 and entered into force on 17 August 2013 (Act No 227/2013 amending Act No 6/1993 Coll. on the Czech National Bank, as amended, and other related legislation).

Transposition of CRD IV/CRR

Activities associated with the implementation of CRD IV[78] and CRR[79] continued in 2013 in the form of a draft bill amending certain acts in relation to the access to the activity of banks, credit unions, and investment firms and the prudential supervision of these institutions. This draft bill was submitted to the Government on 6 September 2013. It was approved by the Government on 22 January 2014 and forwarded to the Chamber of Deputies. The second reading took place on 30 April 2014.

The draft bill aims to strengthen the regulatory framework and create the conditions for ensuring the stability, safety, and sufficient resilience of the banking system and the overall financial system.

The most important changes introduced by the draft bill include the implementation of capital reserves with the objective of strengthening the capital adequacy of banks, credit unions, and investment firms (further referred to as "institutions"). In addition, the responsibility for supervising the liquidity of the banks from one member state that operate in another member state is being transferred from the supervisory authority in the host state to the supervisory authority in the home state starting on 1 January 2015 in relation to the implementation of new liquidity standards.

The draft bill implements requirements that must be met by the members of the statutory organ and the supervisory authority or, as applicable, the management board of the institution as well as new requirements for the institutions' management and control systems. No less importantly is the deletion of those parts of the amended acts that contain requirements that are newly addressed in the CRR, which is a directly applicable legal regulation and thus makes it impossible to keep these provisions in the national legislation.

Investment Companies and Investment Funds

A legislative package containing Act No 240/2013 Coll., on investment companies and investment funds, its accompanying Act No 241/2013 Coll. (on amendments to certain legislation in relation to the adoption of the Act on investment companies and investment funds and in relation to the directly applicable regulation of the EU laying down the settlement of certain derivatives); and the implementing regulations for Act No 240/2013 (comprising two Government Regulations and six CNB decrees) entered into force on 19 August 2013. These implementing regulations consist of Government Decree No 242/2013 Coll. on the provision of key investor information for special funds and the methods for providing communications and the statutes of special funds in other than hardcopy format; Government Regulation No 243/2013 Coll. on the investing of investment

[78] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

[79] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

funds and techniques for their effective management; CNB Decree No 244/2013 Coll. on the more detailed regulation of some rules laid down by the Act on investment companies and investment funds; CNB Decree No 245/2013 Coll. on the inspection duties of the depositary of UCITS fund; CNB Decree No 246/2013 Coll. on the statutes of collective investment funds; CNB Decree No 247/2013 Coll. on applications submitted in accordance with the Act on investment companies and investment funds; CNB Decree No 248/2013 Coll. amending Decree No 233/2009 Coll. on applications, the approval of individuals, and the methods for proving professional competence, trustworthiness, and experience, as amended; and CNB Decree No 249/2013 Coll. on the reporting of information to the CNB by the managers and administrators of investment funds and foreign investment funds. The primary purpose of the Act on investment companies and investment funds is to transpose the Alternative Investment Fund Managers Directive (AIFMD) into national legislation. However, it also introduces a number of conceptual changes, such as expanding the range of legal forms for investment funds, and separating the legal provisions for the management and administration of an investment fund. Government Regulation No 243/2013 Coll. on the investing of investment funds and techniques for their effective management was amended by Government Regulation No 11/2014 in response to the problems and ambiguities resulting from the adoption of the above-specified legislative package. This amendment takes effect as of 1 February 2014.

Bonds

On 14 August 2013, the MoF submitted a draft bill amending Act No 190/2004 Coll. on bonds, as amended, for the inter-ministerial review process. The main objective of this draft bill is to clarify the legal status of hybrid debt securities, i.e. securities with the repayment of a principal bounded to certain condition, which may or may not occur, is met (e.g. the issuer ceases to exist). The draft bill also reduces the volume of required information for a bond indenture and brings the enhanced material definition of a bond, and clearly defines the types of bonds. This draft bill was submitted to the Government, which approved it at its meeting on 11 December 2013. On 6 January 2014 the draft bill was forwarded to the Chamber of Deputies as Bill ST 73. The first reading took place on 14 February 2014 and the second reading on 30 April 2014. It is expected that the amendment will take effect during the second half of 2014.

Distribution of Financial Services

In 2013 the Chamber of Deputies discussed the Government bill amending Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters and an amendment to the Trade Licensing Act. However, in August 2013 (after the second reading of the bill), the Chamber of Deputies was dissolved and the legislative process remained unfinished. These circumstances resulted in a complicated situation, specifically in relation to the recodification of private law and the associated repeal of the first section of the act on insurance contracts, which included the provisions laying down the obligation of insurers to provide information during the pre-contract stage. The proposed amendment to the Act on insurance intermediaries and independent loss adjusters included the required provisions (based on the appropriate directives) and it was presumed that, in this respect, it would replace the repealed Act on insurance contract as of 1 January 2014. The MoF reacted to the unfinished legislative process by preparing a draft bill amending certain financial market legislation. The third part of this bill incorporates the obligation of insurers to provide information in the Act on insurance intermediaries and independent loss adjusters, and, from the perspective of context, these provisions are identical to the provisions in the repealed section of the Act on insurance contracts.

In addition to this draft bill, the MoF started to prepare the resubmission of the amendment to the Act on insurance intermediaries and independent loss adjusters. This amendment should contextually follow up the previous submission of the bill in 2013. The main pillars of the amendment consists of the new system for the classification of insurance intermediaries, changes in the registration process and the supervisory framework, new provisions for the system used to verify professional qualifications, measures to prevent conflicts of interest, and increasing the level of information provided to clients.

In relation to the amendment of Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters and the amendment of the Trade Licensing Act, the MoF will publish the outline for a new act on the distribution of financial services, which will unify the rules for offering and intermediating financial products. The main objective of the new legislative provisions is to ensure the overall improvement of consumer protection in the financial market and to unify the conceptual and procedural institutional principles used for regulating the distribution of financial services (business licence, professional qualifications, rules for customer relations, out-of-court resolution of disputes, etc), across all of the individual sectors and for the various distribution channels.

Consumer Credit

The amendment to Act No 145/2010 Coll. on consumer credit and amendments to certain related legislation was published in the Collection of Acts on 25 February 2013 as Act No 43/2013 Coll. The amendment eliminates some of the most critical unfair practices that occur on the consumer credit market in the Czech Republic and ensures an improved level of consumer protection as well as protecting the principles of responsible lending. In particular, this includes the prohibition of the use of bills of exchange in relation to consumer credit; the prohibition of using overpriced phone numbers starting with a "9" when providing or intermediating consumer credit; and the creditor's obligation to provide consumer credit only if the consumer's creditworthiness has been duly confirmed and it is obvious that the consumer will be able to repay the credit. It also defines in much more detail the relationship between consumer credit intermediaries and consumers. A consumer is allowed to withdraw from any consumer credit intermediation agreement without any penalties within fourteen days of the date the contract is concluded. The amended legislation also transposes into national legislation Directive 90/2011/EU providing additional assumptions for the calculation of the annual percentage rate of charge, in order to attain the highest possible reporting value and level of comparability of this credit indicator for any consumer credit for which not all of the parameters required for calculating APR are known in advance (e.g. credit cards, revolving credit, overdraft loan, etc.).

Pension Reform

A number of legal regulations took effect on 1 January 2013, which amend and supplement the legal provisions for Pillars 2 and 3 of the pensions system as adopted in 2011. Specifically these include Act No 426/2011 Coll. on retirement savings, Act No 427/2011 Coll. on supplementary pension savings, and Act No 428/2011 Coll. amending certain legislation with regard to the adoption of the Act on retirement savings and the Act on supplementary pension savings.

Two additional acts, which were drafted as the result of the need to create a mechanism for transferring insurance premiums to pension Pillar 2, took effect on the same date, specifically Act No 397/2012 Coll. on pension insurance premiums, and Act No 399/2012 Coll. amending certain legislation with regard to the adoption of the Act on pension insurance premiums.

Act No 403/2012 Coll. amending Act No 427/2011 Coll. on supplementary pension savings schemes and other related legislation contains the provisions for "pre-retirement pensions". The purpose of this act is to allow individuals who will reach retirement age in no more than five years to start collecting pensions from the supplementary pension savings system during a period when it might be difficult for them to find a job. The ability to start collecting the pre-retirement pension also includes some additional benefits as regards public health insurance and state pension insurance. In addition, a number of CNB Decrees adopted in relation to the above-specified acts also took effect on 1 January 2013.

Insurance Sector

Act No 99/2013 Coll. amending certain insurance and supplementary pension insurance legislation with regard to the withdrawal of the exemption from the principle of equal treatment under EU law took effect on 25 April 2013. Its aim is to bring the legal code of the Czech Republic into compliance with the ruling passed down by the Court of Justice of the European Union in Case C-236/09 (Test v. Achats – 2012/C11/01), which terminates the exception that has thus far existed in Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services. As a result of this amendment the use of gender as a factor for calculating insurance premiums and payout amounts for insurance purposes or for any associated financial services for individual types of insurance cannot lead to differences in insurance premiums or insurance payout amounts.

The following act took effect on 1 September 2013: Act No 160/2013 Coll. amending Act No 168/1999 Coll. on liability insurance for damage caused while operating a vehicle and amendments to certain related legislation (the Motor Vehicle Third Party Liability Act), as amended; Act No 238/2000 Coll. on the fire rescue service of the Czech Republic and amendments to certain related legislation, as amended; and Act No 586/1992 Coll. on income tax, as amended. The purpose of these amendments is to expand the obligation of insurers to contribute towards the expenses of the Fire Rescue Service and Voluntary Fire Brigades from the premiums received for liability insurance for damage caused while operating a vehicle and the obligation to create and manage a Damage Prevention Fund to be used for avoiding damage caused by the operation of a vehicle.

The following act took effect on 17 August 2013: Act No 228/2013 Coll. amending Act No 377/2005 Coll. on the supplementary supervision of banks, credit unions, insurance undertakings, and investment firms in financial conglomerates, and amendments to certain related legislation (the Financial Conglomerates Act), as amended; and Act No 277/2009 Coll. on the insurance industry (The Insurance Act), as amended. The purpose of this act is to transpose the provisions of Articles 1 and 2 of Directive 2011/89/EU (FICOD 1).

Foreign Exchange

Act No 277/2013 Coll. on foreign exchange activities took effect on 1 November 2013. The new legislation includes the comprehensive treatment of both private law as well as public law provisions associated with the provision of foreign exchange activities. The topics handled by this new act are no longer included in the foreign currency act.

10.5. Non-Legislative Financial Market Activities of the MoF

Anti-Debt Alliance (ADA)

The MoF participates in the activities of the Anti-Debt Alliance, which is an expert platform comprising representatives from various state institutions and non-profit organisations. The Alliance was established in May 2011 on the basis of an initiative of the Ministry of the Interior’s Department of Crime Prevention; Probation and Mediation Services; and the Association for Probation and Mediation in Justice. The goal of the Alliance is to find solutions to the problems associated with over-indebtedness, which could lead to the repeated committing of crimes. The Alliance aims to connect with partners, including organisations from abroad, who are involved in the same issues and to follow up their comparable activities and to use their experience and analyses in order to create proposals that will minimise over-indebtedness and the associated risk.

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

In 2013 the Alliance’s activities within the framework of the working groups and round tables focused primarily on the issues associated with the register of borrowers, the creation of a recovery fund, and unfair business practices in the area of debt relief. The Alliance also discussed topics regarding the institute of voluntary debt relief which is a legislative initiative of the Ministry of Justice.

In addition to continuing with the activities specified above, in 2014 the Alliance intends to address additional issues, such as the legislative provisions for voluntary settlement as an alternative to debt relief within the context of insolvency proceedings, the abolition of the right to claim compensation for legal representation in the case of negligible receivables collected through paper claims, the regulation of late penalties for consumer loans, and legislative provisions for the register of borrowers.

Financial Education

In 2013, the Working Group on Financial Education (WGFE) continued its long-term activities. The WGFE is a platform for the exchange information and opinions of relevant representatives from the public and private sectors. The members of the WGFE try to find a common approach for improving the financial literacy of the Czech population. The members of the WGFE comprises representatives from the MoF, the MoE, the CNB, the MIT, the MLSA, and the MI as well as representatives from professional associations active in the financial market, organisations that implement educational projects (primarily NGOs), consumer groups, and education professionals.

In the meeting of the WGFE that was held on 25 March 2013 its members adopted the objectivity principles, which define a strict limit on financial education and advertising.

The tasks for creating an internet portal entitled "Why to get financially educated?", which is designed for both the professional as well as the general public, were started in 2013. This portal aims to provide a single point for accessing information about the functioning of the financial markets and links to interesting websites, calculators, and advice boards, where the reader will be able to obtain free assistance regarding his/her personal and/or financial situation. The MoF plans to launch these web pages during 2014.

Brochures on ZISIF

In relation to the effective date of the legislative package containing Act No 240/2013 Coll. on investment companies and investment funds (ICIF Act), and the associated regulations (refer to Chapter 10.4), the MoF has prepared a set of materials in the form of informative electronic brochures which succinctly and clearly summarise the conditions for funds conducting business activities in the Czech Republic after the aforementioned legislative package enters into force. The brochures are available in Czech and in English on the MoF's website (www.mfcr.cz), and can be accessed by following the links Themes – Capital Market – Investment Funds.

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LIST OF ACRONYMS AND ABBREVIATIONS

abs.	absolute
ADA	Anti-Debt Alliance (Aliance proti dluhům)
ADR	Alternative Dispute Resolution
AIFMD	Alternative Investment Fund Managers Directive
AKAT	Czech Capital Market Association (Asociace pro kapitálový trh)
APR	Annual Percentage Rate of Charge
APS CR	Association of Pension Societies of the Czech Republic (Asociace penzijních společností České republiky)
ARAD	Czech National Bank´s time series database
bn	billion
BRRD	Bank Recovery and Resolution Directive
CA	current account
CMF	Committee for Financial Markets
COREPER	Committee of Permanent Representatives
CPI	Consumer price index
CRA	Credit Rating Agencies Directive
CRD	Capital Requirements Directive
CRDWG	Capital Requirement Directive Working Group
CRR	Capital Requirements Regulation
CSDR	Central Securities Depositories Regulation
CZK	International currency code for the Czech crown
ČAP	Czech Insurance Association (Česká asociace pojišťoven)
CNB	Czech National Bank
CZ	Czech Republic
ČS	Česká spořitelna. a. s. (commercial bank)
ČSOB	Československá obchodní banka. a. s. (commercial bank)
CSO	Czech Statistical Office
D03	Working Party on Financial Services
DGS	Deposit Guarantee Schemes
DIF	Deposit Insurance Fund
DIJA	Dow Jones Industrial Average
EAPR	effective annual percentage rate
EBA	European Banking Authority
EBC	European Banking Committee
EBRD	European Bank for Reconstruction and Development
EC	European Communities /European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ECON	Committee on Economic and Monetary Affairs
EEA	European Economic Area
EFC	Economic and Financial Committee
EFCC	European Financial Conglomerates Committee
EFTA	European Free Trade Association
EGESC	Expert Group of the European Securities Committee
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EIOPC	European Insurance and Occupational Pensions Committee
ELTIFR	European Long-Term Investment Funds
EMIR	European Market Infrastructure Regulation
ESC	European Securities Committee
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board

EU	European Union
EUR	International currency code for the euro
EuSEF	European Social Entrepreneurship Funds
EuVECA	European Venture Capital Funds
FA	Financial Arbitrator
Fed	Federal Reserve System (central bank of the USA)
FESE	Federation of European Securities Exchanges
FICOD	Financial Conglomerates Directive
FSB	Financial Stability Board
FSC	Financial Services Committee
FSAP	Financial Sector Assessment Program
FTT	Financial Transaction Tax
GEGMC	Government Expert Group on Mortgage Credit
GEGRFS	Government Expert Group on Retail Financial Services
G20	Group of Twenty Finance Ministers and Central Bank Governors
GDP	Gross Domestic Product
HICP	Harmonized Indices of Consumer Prices
ML	Mortgage loan
HUF	International currency code for the Hungarian forint
IBRD	International Bank for Reconstruction and Development
ICS	Investor Compensation Schemes
ICSD	Investor Compensation Schemes Directive
IMD	Insurance Mediation Directive
incl.	including
INFE	International Network on Financial Education
IORP	Institutions for Occupational Retirement Provision Directive
IP	insurance policy
IPPC	Insurance and Private Pensions Committee
KB	Komerční banka. a. s. (commercial bank)
KIID	Key Investor Information Documents
LTE	Long Term Evolution
LTRO	Long-Term Refinancing Operation
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
max	maximum
MCD	Mortgage Credit Directive
MEYS	Ministry of Education, Youth and Sports of the Czech Republic
mn	million
MoF	Ministry of Finance of the Czech Republic
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MIT	Ministry of Industry and Trade of the Czech Republic
MI	Ministry of the Interior of the Czech Republic
MMFR	Money Markets Fund Regulation
MLSA	Ministry of Labour and Social Affairs
MRD	Ministry of Regional Development of the Czech Republic
NAV	net asset value
No	number
NPL	non-performing loans
ODR	Online Dispute Resolution
OECD	Organisation for Economic Co-operation and Development
OL	overdraft loan
OTC	over-the-counter
OTF	Organised Trading Facility
p.a.	per annum
PAD	Payment Accounts Directive
pp	percentage point

PC	Payments Committee
PF	participating fund
PIT	personal income tax
PLN	international currency code for the Polish zloty
PRIPs	Packaged Retail Investment Products
PSE	Prague Stock Exchange
PXE	Power Exchange Central Europe
PX-TR	Total Return Index
RM-S	RM-Systém
SEPA	Single Euro Payments Area
SRM	Single Resolution Mechanism
SC	state contribution
SSM	Single Supervisory Mechanism
STGF	Securities Traders' Guarantee Fund
TD2	Transparency Directive
TF	transformed fund
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
USA	United States of America
USD	international currency code for the United States dollar
VAT	value added tax
WPPP	Working Party on Private Pensions
WGFE	Working Group on Financial Education

APPENDIX 1: FINANCIAL MARKET LEGISLATION

The following changes were made to the financial market legislation of the Czech Republic and of the European Union in 2013:

P1.1. Cross-Sectoral Financial Market Regulations

1) European legislation and other initiatives published in 2013:

- Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (referred to as ADR);
- Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (referred to as ODR).

2) Pending European legislation (including legislation published after 31 December 2013) and other initiatives of the European Commission:

- Proposal for a Directive of the European Parliament and of the Council of 6 June 2012 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 88/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (referred to as BRRD);
- Proposal for a Regulation of the European Parliament and of the Council of 3 July 2012 on key information documents for investment products (referred to as PRIPs);
- Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (referred to as MCD);
- Preparation of a fundamental revision of the Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (referred to as FICOD 1).

3) Acts that took effect in 2013:

- Act No 43/2013 Coll. of 31 January 2013 amending Act No 145/2010 Coll. on consumer loans and amendments to certain related legislation (in effect as of 25 February 2013, some provisions as of 1 January 2014);
- Act No 228/2013 Coll. of 20 June 2013 amending Act No 377/2005 Coll. on the supplementary supervision of banks, credit institutions, insurance undertakings, and investment firms in financial conglomerates, and on amendments to certain related legislation (the Financial Conglomerates Act), as amended, and Act No 277/2009 Coll., the Insurance Act, as amended (in effect as of 17 August 2013).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2013):

- Draft bill on a framework for the recovery and resolution of credit institutions and investment firms (expected to take effect since January 2015);
- Draft bill amending certain legislation in connection with the adoption of the Act on a framework for the recovery and resolution of credit institutions and investment firms (expected to take effect since January 2015);

  These acts will transpose into national law the directive of the European Parliament and of the Council establishing a recovery and resolution framework for credit institutions and investment firms.

5) Secondary legislation:

- None.

P1.2. Capital Market Legislation

1) European legislation and other initiatives published in 2013:

- Directive 2013/14/EU of the European Parliament and of the Council of 21 May 2013 amending Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision, Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on alternative investment funds managers in respect of over-reliance on credit ratings (part of CRA3);
- Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC (referred to as TD2);
- Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds (referred to as EuVECA);
- Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (referred to as EuSEF);
- Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies;
- Commission Delegated Regulation (EU) No 759/2013 of 30 April 2013 amending Regulation (EC) No 809/2004 as regards the disclosure requirements for convertible and exchangeable debt securities;
- Report from the Commission to the European Parliament and the Council on the evaluation of the Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps.

2) Pending European legislation (including legislation published after 31 December 2013) and other initiatives of the European Commission:

- Proposal for a Directive of the European Parliament and of the Council of 12 July 2010 amending Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes (referred to as ICSD);
- Proposal for a Directive of the European Parliament and of the Council of 20 October 2011 on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (referred to as MiFID2);
- Proposal for a Regulation of the European Parliament and of the Council of 20 October 2011 on markets in financial instruments and amending Regulation (EMIR) on OTC derivatives, central counterparties and trade repositories (referred to as MiFIR);
- Amended proposal for a Regulation of the European Parliament and of the Council of 25 July 2012 on insider dealing and market manipulation (market abuse) (referred to as MAR);
- Amended proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation (referred to as CSMAD);
- Proposal for a Regulation of the European Parliament and of the Council of 26 June 2013 on European long-term investment funds (referred to as ELTIF);
- Proposal for a Regulation of the European Parliament and of the Council of 4 September 2013 on money market funds;
- Proposal for a Regulation of the European Parliament and of the Council of 18 September 2013 on indices used as benchmarks in financial instruments and financial contracts;
- Proposal for a Regulation of the European Parliament and of the Council of 29 January 2014 on structural measures improving the resilience of EU credit institutions (referred to as BSR);
- Proposal for a Regulation of the European Parliament and of the Council of 29 January 2014 on reporting and transparency of securities financing transactions (referred to as SFT).

3) Acts that took effect in 2013:

- Act No 134/2013 Coll., on certain measures to increase the transparency of joint stock companies and on the amending of other acts entered into force (in effect as of 20 June 2013);
- Act No 240/2013 Coll., on investment companies and investment funds (in effect as of 19 August 2013);
- Act No 241/2013 Coll., amending certain acts in relation to the adoption of Act on investment companies and investment funds and to the adoption of directly applicable European Union legislation laying down the settlement of certain derivatives (in effect as of 19 August 2013).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2013):

- Proposal for an Act, amending Act No 190/2004 Coll., on bonds, as amended (expected to take effect on 1 July 2014);
- Proposal for an Act, amending Act No 240/2013 Coll., on investment companies and investment funds (expected to take effect on 1 January 2015).

5) Secondary legislation:

- Government Regulation No 242/2013 Coll., on key investor information of a special collective investment fund;
- Government Regulation No 243/2013 Coll., on investment fund investments and techniques and instruments used for the purpose of portfolio management;
- Government Regulation No 11/2014 Coll., amending Regulation No 243/2013 Coll., on investment fund investments and techniques and instruments used for the purpose of portfolio management;
- Decree No 208/2013 Sb., amending Decree No 231/2009 Coll., on the requisites and manner of keeping a transactions and orders book of an investment firm, and on the principles of keeping records of received and transmitted orders of an investment intermediary;
- Decree No 244/2013 Coll., on more detailed regulation of some rules set out by the Act on investment companies and investment funds;
- Decree No 245/2013 Coll., on control duties provided by UCITS fund depositary;
- Decree No 246/2013 Coll., on collective investment fund prospectus (statute);
- Decree No 247/2013 Coll., on applications according to the Act on investment companies and investment funds;
- Decree No 249/2013 Coll., on reporting by a manager and an administrator of an investment fund or foreign fund to the Czech National Bank;
- Decree No 474/2013 Coll., on the remuneration of liquidators, forced administrators and insolvency administrators of some service providers on the capital market and on the reimbursement of their cash expenditures.

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

1) European legislation and other initiatives published in 2013:

- Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (referred to as CRDIV);
- Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (referred to as CRR);
- Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (referred to as SSM);
- Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European

Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013 (part of SSM).

2) Pending European legislation (including legislation published after 31 December 2013) and other initiatives of the European Commission:

- Proposal for a Directive of the European Parliament and of the Council of 12 July 2010 on Deposit Guarantee Schemes (referred to as DGD, revised version);
- Proposal for a Regulation of the European Parliament and of the Council of 10 July 2013 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (referred to as SRM);
- Proposal for a Regulation of the European Parliament and of the Council of 29 January 2014 on structural measures improving the resilience of EU credit institutions.

3) Acts that took effect in 2013:

- Act No 227/2013 Coll. amending Act No 6/1993 Coll. on Czech National Bank, as amended, and other related legislation (in effect as of 17 August 2013).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2013):

- Draft bill amending Act No 21/1992 Coll. on banks, as amended. The act will transpose into national legislation the Directive of the European Parliament and of the Council on deposit guarantee schemes (expected to take effect since March 2015);
- The Draft bill amending certain acts in connection with defining access to the activities of banks, credit unions and investment firms and supervision on these activities. The draft legislation implements Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRDIV), as well as Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR) (expected to take effect on 30 June 2014);
- Draft bill amending Act No 87/1995 Coll. on credit unions and some related measures and the Act of the Czech National Council No 586/1992 Coll. on the income tax, as amended (expected to take effect on 1 January 2015).

5) Secondary legislation:

- Proposal for a Decree of the Czech National Bank on the performance of the activity of banks, credit unions and investment firms replacing Decree 123/2007 Coll. stipulating the prudential rules for banks, credit unions, and investment firms. The draft secondary legislation implements certain aspects of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRDIV), as well as Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR) (expected to take effect on 30 June 2014).

P1.4. Payment Services and Market Infrastructure Legislation

1) European legislation and other initiatives published in 2013:

- None

2) Pending European legislation (including legislation published after 31 December 2013) and other initiatives of the European Commission:

- Proposal for a Directive of the European Parliament and of the Council of 8 May 2013 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (referred to as PAD);
- Proposal for a Directive of the European Parliament and of the Council of 24 July 2013 on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC (referred to as PSD);
- Proposal for a Regulation of the European Parliament and of the Council of 24 July 2013 on interchange fees for card-based payment transactions (referred to as MIFR);
- Proposal for a Regulation of the European Parliament and of the Council of 9 January 2014 amending Regulation EU No 260/2012 as regards the migration ti EU-wide credit transfers and direct debits (referred to as SEPA).

3) Acts that took effect in 2013:

- Act No 277/2013 Coll. on currency exchange activities (in effect as of 1 November 2013);
- Act No 278/2013 Coll. amending some acts in connection with the adoption of Act on currency exchange activities (in effect as of 1 November 2013).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2013):

- Draft bill amending some acts in the financial market (amendment to the Act on payments, Act on restriction of cash payments and Act on insurance intermediaries (expected to take effect on 1 January 2015).

5) Secondary legislation:

- Decree No 315/2013 Coll. on currency exchange activities (in effect as of 1 November 2013);
- Decree No 31/2014 Coll. amending Decree No 141/2011 Coll., on the performance of activities of payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers (in effect as of 15 March 2014).

P1.5. Insurance and Private Pension Systems Legislation

1) European legislation and other initiatives published in 2013:

- Directive 2013/58/EU of the European Parliament and of the Council of 11 December 2013 amending Directive 2009/138/EC (Solvency II) as regards the date for its transposition and the date of its application, and the date of repeal of certain Directives (Solvency I).

2) Pending European legislation (including legislation published after 31 December 2013) and other initiatives of the European Commission:

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

3) Acts that took effect in 2013:

- Act No 426/2011 Coll. on retirement savings (in effect as of 1 January 2013, some provisions as of 1 January 2012);

- Act No 427/2011 Coll. on supplementary pension savings (in effect as of 1 January 2013; § 29-73, § 94-97, § 170-200 as of 28 December 2011; § 86 as of 28 June 2012; § 74-83, §84 par. 1, 2, and 4, § 85 and 87 as of 1 November 2012);
- Act No 428/2011 Coll. amending certain legislation with regard to the adoption of the Act on retirement savings and the Act on supplementary pension savings (in effect as of 1 January 2013, Part 19 as of 1 January 2012, Art. XII Item 18 and Art. XIII as of 28 December 2011);
- Act No 397/2012 Coll. on retirement savings premium (in effect as of 1 January 2013) and Act No 399/2012 Coll. amending certain legislation with regard to the adoption of the Act on retirement savings premium (in effect as of 1 January 2013, partly as of 12 December 2012);
- Act No 403/2012 Coll. amending Act No 427/2011 Coll. on supplementary pension savings and other related legislation (in effect as of 1 January 2013);
- Act No 99/2013 Coll. amending certain insurance and supplementary pension insurance legislation with regard to the withdrawal of the exemption from the principle of equal treatment under the European Union law (in effect as of 25 April 2013);
- Act No 160/2013 Coll. amending Act No 168/1999 Coll., Motor Third-Party Liability Insurance Act, as amended, Act No 238/2000 Coll. on fire rescue service of the Czech Republic and amending certain laws, as amended, and Act No 586/1992 Coll. on income tax, as amended (Part 1, Art. I Item 1 and 2 and Part 2 Art. II in effect as of 1 September 2013, other provisions as of 1 January 2014).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2013):

- Draft bill amending Act No 277/2009 Coll., the Insurance Act, as amended, and certain other related legislation (expected to take effect on 1 January 2016, certain provisions on 1 April 2015 and 1 July 2015);
- Draft bill amending Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters and the Trade Licensing Act (Insurance Intermediaries and Loss Adjusters Act), as amended, and certain other related legislation (expected to take effect on 1 April 2015).

5) Secondary legislation:

- Decree of the Czech National Bank No 341/2012 Coll. defining the scope of activities for retirement fund depositary and participation fund depositary (in effect as of 1 January 2013);
- Decree of the Czech National Bank No 423/2012 Coll. on increasing the pensions paid from a pension insurance contract (in effect as of 1 January 2013);
- Decree of the Czech National Bank No 424/2012 Coll. amending Decree No 433/2009 Coll. on the methods, form, and requirements for the mandatory submission of reports by insurance and reinsurance undertakings, as amended by Decree No 359/2010 Coll. (in effect as of 1 January 2013);
- Decree of the Czech National Bank No 425/2012 Coll., on the submission of information by pension companies to the Czech National Bank (in effect as of 1 January 2013);
- Government Regulation No 361/2012 Coll. on the provision of key information to participants of the supplementary pension savings and retirement savings (in effect as of 1 January 2013);
- Decree of the Czech National Bank No 40/2013 Coll. establishing the requirements for pension insurance offer (in effect as of 1 March 2013).

APPENDIX 2: SUPPLEMENTARY TABLES

Table P2.1: Loans by type

As at 31 Dec (CZK bn)	2011	2012	2013	Year-on-year change	
				Abs.	(%)
Overdrafts and debit balances of current accounts	143.3	142.9	143.6	0.7	0.5
Consumer loans (excl. overdrafts and debit balances of current accounts)	186.7	185.3	187.0	1.7	0.9
Housing loans excl. mortgages	143.8	138.6	132.2	-6.4	-4.6
Mortgage loans for residential properties	710.1	747.6	789.5	41.8	5.6
Mortgage loans for non-residential properties	114.8	116.6	120.2	3.6	3.1
Other loans	415.5	415.8	515.2	99.5	23.9
Investment loans	554.4	577.5	585.4	7.9	1.4
Bridge loans	4.0	2.7	2.6	-0.1	-5.2
Trade receivables	31.7	33.0	39.1	6.1	18.5
Total	2 304.3	2 360.1	2 514.8	154.8	6.6

Source: CNB – ARAD

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

As at 31 Dec 2013	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
ČSOB Asset Management. a.s.. investiční společnost	69.6	49.6	12.4
ING Investment Management (C.R.). a. s.	15.4	11.0	6.9
Conseq Investment Management. a. s.	13.5	9.6	43.6
Česká spořitelna. a. s.	11.6	8.3	16.0
Raiffeisenbank a.s.	8.7	6.2	-4.4
UniCredit Bank Czech Republic. a. s.	7.8	5.6	110.8
INVESTIČNÍ KAPITÁLOVÁ SPOLEČNOST KB. a. s.	4.5	3.2	-10.0
Pioneer investiční společnost. a. s.	3.8	2.7	52.0
ČP INVEST investiční společnost. a. s.	2.6	1.9	23.8
Citibank Europe plc. organizační složka	1.6	1.1	33.3
Other members of AKAT	1.3	0.9	160.0
Total	140.4	100.0	17.1

Source: AKAT

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

As at 31 Dec 2013	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
Investiční společnost České spořitelny. a.s.	54.7	42.3	9.4
INVESTIČNÍ KAPITÁLOVÁ SPOLEČNOST KB. a. s.	27.7	21.4	8.2
ČP INVEST investiční společnost. a. s.	15.5	12.0	17.4
Pioneer investiční společnost. a. s.	8.0	6.2	-1.2
AXA Investiční společnost. a. s.	7.0	5.4	32.1
ČSOB Asset Management. a.s.. investiční společnost	6.5	5.0	-9.7
REICO investiční společnost České spořitelny. a. s.	3.1	2.4	47.6
J&T INVESTIČNÍ SPOLEČNOST. a.s.	2.5	1.9	19.0
Raiffeisen investiční společnost a.s.	1.8	1.4	-
PROSPERITA investiční společnost. a. s.	1.0	0.8	11.1
Conseq Funds investiční společnost. a.s.	0.8	0.6	0.0
AKRO investiční společnost. a.s.	0.6	0.5	20.0
Others	0.2	0.2	-
Total	129.4	100.0	12.0

Source: AKAT

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

As at 31.12.		2008	2009	2010	2011	2012	2013
New building savings contracts	number	705 463	575 292	532 765	410 461	433 093	449 588
	change (%)	21.7	-18.5	-7.4	-23.0	5.5	3.8
Average target value for new building savings contracts with private individuals	value (CZK th.)	302.8	308.7	300.5	346.2	366.1	370.8
	change (%)	6.3	1.9	-2.7	15.2	5.7	1.3
Building savings contracts in savings phase	number	5 070 510	4 926 183	4 845 319	4 550 468	4 316 999	4 066 684
	change (%)	-1.2	-2.8	-1.6	-6.1	-5.1	-5.8
Paid state contribution	value (CZK bn)	14.2	13.3	11.7	10.7	5.3	5.0
	change (%)	-5.0	-6.7	-11.5	-8.6	-50.7	-6.4
Average state contribution paid per building savings contract for the relevant year	value (CZK)	2 927.0	2 776.0	2 631.0	1 324.0	1 312.0	---
	change (%)	-5.3	-5.2	-5.2	-49.7	-0.9	---
Saved amount	value (CZK bn)	401.1	415.2	430.1	433.4	435.0	429.1
	change (%)	4.2	3.5	3.6	0.8	0.4	-1.4
Loans in total	number	971 176	988 353	993 357	956 659	894 358	815 160
of which: building saving schemes	number	569 870	565 485	564 633	552 999	521 312	471 441
bridging [80]	number	401 306	422 868	428 724	403 660	373 046	343 719
	change (%)	3.0	1.8	0.5	-3.7	-6.5	-8.9
Loans in total	value (CZK bn)	227.4	267.5	293.4	293.1	282.2	261.4
of which: building saving schemes	value (CZK bn)	42.9	48.9	53.1	55.8	55.7	51.7
bridging [80]	value (CZK bn)	184.5	218.6	240.3	237.3	226.5	209.7
	change (%)	26.8	17.6	9.7	-0.1	-3.7	-7.4
Ratio of loans in total to saved amount	ratio (%)	56.7	64.4	68.2	67.6	64.9	60.9

Source: MoF calculation from building savings banks data

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

Table P2.5: Allocation of pension fund assets

As at 31 Dec (market prices, CZK bn)	2008	2009	2010	2011	2012	2013	Share in 2013 (%)
Bonds	144.8	171.6	195.3	214.2	235.9	256.9	86.6
Treasury bills	6.4	2.2	1.1	0.6	6.8	0.9	0.2
Shares	5.7	3.5	1.9	1.0	0.6	0.9	0.4
Unit certificates	6.2	6.9	8.7	5.7	3.1	3.8	2.3
Money and other assets	28.4	31.5	25.2	26.0	26.8	34.9	10.5
Total	191.5	215.7	232.1	247.5	273.2	297.4	100.0

Source: APS CR

Table P2.6: Main development indicators for the supplementary pension insurance in transformed funds

As at 31.12.		2008	2009	2010	2011	2012	2013
Supplementary pension insurance contracts [81]	number	4 207 236	4 394 522	4 527 774	4 565 741	5 134 862	4 886 675
	change (%)	6.9	4.5	3.0	0.8	12.5	-4.8
New supplementary pension insurance contracts	number	590 490	524 867	495 516	457 033	1 128 020	-
	change (%)	0.7	-11.1	-5.6	-7.8	146.8	-
Supplementary pension insurance policies with employer contribution	number	1 222 639	1 261 525	1 284 736	1 271 934	1 317 563	1 339 000
	change (%)	8.2	3.2	1.8	-1.0	3.6	1.6
State contributions for a given period	value (CZK bn)	5.1	5.3	5.5	5.6	5.9	6.8
	change (%)	9.4	5.1	3.1	1.7	5.6	15.0
Participant contributions [82]	value (CZK bn)	21.9	23.0	23.2	23.4	25.5	33.0
	change (%)	8.3	4.9	1.1	0.9	8.8	29.3
Average monthly state contribution	value (CZK)	104.9	105.2	105.0	105.4	108.0	117.0
	change (%)	1.0	0.3	-0.2	0.4	2.5	8.2
Average monthly participant contribution	value (CZK bn)	450.5	443.9	439.6	441.7	465.0	568.0
	change (%)	0.2	-1.5	-1.0	0.5	5.3	22.2

Source: MoF

[81] Data reflects number of policies, which are not closed in the relevant records.
[82] Participant's contributions are reported without the contributions paid by employers for their employees.

Table P2.7: Main development indicators for the supplementary pension savings in participating funds

As at 31.12.		2013
Supplementary pension savings contracts [83]	number	76 669
	change (%)	-
New supplementary pension savings contracts	number	77 771
	change (%)	-
of which transfer from supplementary pension insurance [84]	number	1 284
Supplementary pension savings policies with employer's contribution	number	13 461
	change (%)	-
State contribution for a given period	value (CZK bn)	0.1
	change (%)	-
Participant contributions [85]	value (CZK bn)	0.3
	change (%)	-
Average monthly state contribution	value (CZK bn)	143.0
	change (%)	-
Average monthly participant contribution	value (CZK bn)	749.0
	change (%)	-

Source: MoF

[83] Status at the end of period; data reflects number of policies, which are not closed in the relevant records.
[84] Participant assets were transferred from transformed fund to participating fund according to § 191 Act 427/2011 Coll.
[85] Participant contributions are reported without the contributions paid by employers for their employees.

Table P2.8: Placement of insurance technical reserves

As at 31 Dec (CZK bn)	2012			2013			Abs. change			Year-on-year change (%)		
	LI	NLI	Total	LI	NLI	Total	LI	NLI	Total	LI	NLI	Total
Debt securities	182.8	67.3	275.1	193.2	71.8	285.8	10.4	4.6	10.7	5.7	6.8	3.9
Of which: Bonds issued by the member state or its national central bank	111.2	48.9	173.6	111.4	50.7	171.7	0.2	1.8	-1.9	0.1	3.7	-1.1
Bonds issued by banks of Member States	15.6	4.7	22.2	19.6	5.0	28.3	4.0	0.4	6.1	26.0	7.9	27.4
Listed bonds issued by corporations	14.6	3.7	24.1	15.9	5.9	26.9	1.3	2.3	2.8	9.1	62.7	11.6
Treasury bills	0.9	1.9	3.0	0.5	0.9	1.6	-0.4	-1.0	-1.4	-42.7	-50.4	-47.7
Listed municipal bonds	1.0	0.0	1.1	1.2	0.5	1.7	0.2	0.4	0.6	14.6	1 046.3	53.6
Mortgage bonds	17.3	5.6	24.4	22.7	6.7	30.3	5.4	1.1	5.9	31.3	19.6	24.0
Bonds issued by EIB, ECB, EBRD or IBRD	6.7	0.8	7.5	6.3	0.6	6.9	-0.4	-0.2	-0.6	-6.4	-22.3	-8.2
Foreign debt securities traded on any regulated market of OECD Member States	13.8	1.8	16.8	13.7	1.5	16.0	-0.1	-0.3	-0.8	-0.7	-16.3	-4.8
Equity securities	49.8	7.4	78.6	56.0	8.3	85.7	6.3	0.9	7.1	12.6	12.7	9.1
Of which: Llisted shares	5.1	0.9	6.7	4.4	0.5	5.5	-0.7	-0.4	-1.2	-14.3	-41.2	-17.9
Securities by mutual funds complying with EC regulations	32.6	3.1	38.1	37.2	4.1	44.0	4.5	1.0	5.8	13.9	32.6	15.2
Credits, loans and other receivables	0.0	0.0	0.6	0.0	0.0	1.5	0.0	0.0	0.9	-	-	159.2
Other receivables	0.6	1.1	2.5	0.6	1.1	2.4	-0.1	0.0	-0.2	-8.9	-1.7	-5.9
Bills	0.0	0.1	0.2	0.0	0.0	0.0	0.0	-0.1	-0.2	-	-100.0	-100.0
Real estate	0.3	2.2	4.9	0.3	2.4	5.1	0.0	0.2	0.2	-1.0	9.9	4.2
Deposits and certificates of deposits or depository bonds	5.9	6.8	24.4	5.8	4.7	24.3	-0.2	-2.1	-0.1	-2.7	-30.8	-0.4
Items and works of artistic/cultural value	0.0	0.2	0.3	0.0	0.2	0.3	0.0	0.0	0.0	-	1.3	0.0
Receivables from reinsurance companies	0.5	12.7	18.4	1.3	12.7	22.1	0.8	0.0	3.7	181.9	-0.2	20.1
Derivatives	-0.2	0.0	-2.0	-1.6	-3.5	-3.2	-1.4	-3.5	-1.3	-	-	65.3
Other financial placement	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-	-	-
Financial placements total	239.6	97.8	403.1	255.5	101.2	424.0	15.9	3.5	20.9	6.6	3.6	5.2

Source: CNB

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