

# National Strategy for the Development of the Capital Market in the Czech Republic 2019 - 2023

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## Executive summary

The Government of the Czech Republic, by adopting this National Strategy, aims at supporting sustainable economic growth as well as increasing the national competitiveness through well-functioning capital markets. The Government believes that fulfilling this Strategy will help the Czech Republic move closer to the economies of Western Europe, by

- Improving the quality and resilience of savings of Czech households (including savings for retirement),
- Offering to small and medium-sized enterprises alternatives to bank financing and subsidies from the European Union,
- Increasing the number of jobs with high added value (enhancing the purchasing power of Czech citizens) and
- Increasing support of innovation (more investments in the innovative economy).

Unfortunately, the data indicate that there is a large gap between these overall goals and the current level of capital market operations in the country.

The Government of the Czech Republic considers that the capital market in the Czech Republic currently fails to sufficiently fulfil its main function – the efficient allocation of unutilised financial resources from savers and investors (households) towards enterprises who need to fund their development. Partly due to historical reasons, the traditional banking financing (deposits and loans) prevails today in the Czech Republic. Currently, the reliance on subsidies from the European Union also plays a significant role. Other obstacles to the development of the capital market in the Czech Republic are, in particular, conservative distribution of household assets, low savings for retirement, low awareness of enterprises about the possibility of financing their business and research through the capital market and an inadequate supply of domestic financial instruments available to retail investors, as compared to Western Europe.

Citizens older than 15 years of age, from 15 countries that joined the European Union before 2004, keep 14 % of their savings in the capital market and 30 % of their financial savings in the bank accounts. Czech citizens older than 15 years keep 12 % of their savings on the capital market (and another 7 % in pension products) and 51 % of their savings on the bank accounts. In this respect, Czech households do not adequately recognize that gains from long-term savings may at least overcome inflation and thus not lose their real value. The structure of the wealth of Czech households lags behind the average of the traditional EU states, despite a high level of savings (according to the World Bank, currently one of the highest in the European Union). Czech households, as compared to the European Union average of the traditional (western) EU states, do not yet sufficiently accumulate retirement funds.

Looking at the financing of Czech enterprises it is clear, that financing through bank loans is predominant (in 2016, the value of the loans was 25.5 % of the company's capital) compared to the share of listed shares (4.2 %) and bonds (3.6 %). The value of listed stocks has declined sharply over the past 10 years, after reaching 13.6 % at its peak in 2007. Most of the equity contribution derives from owners' own funds and reinvested profits. The share of financing through listed shares and bonds in the Czech Republic is one-half compared to the European Union average and one third compared to Germany or the United Kingdom. For small and medium sized enterprises (SMEs), research conducted by the Czech Chamber of Commerce in 2017 showed that there is little awareness concerning the alternative sources of financing and the possibility of external financing in general.

Even though the Czech capital market may seem smaller and less liquid in comparison to 15 states that acceded to the European Union before 2004, however, in the comparison to the member states that

acceded to the European Union afterwards it ranks at the top in terms of market capitalization to a GDP per capita and third in trading volume. This said, a decline in liquidity in recent years may be jeopardizing the interest of investors and issuers. For this reason also it is necessary to consider the necessary steps to make trading on the capital market more attractive, especially on the regulated market of the Prague Stock Exchange for large issuers and on other markets for small and medium-sized issuers.

Further efforts to develop the capital market in the Czech Republic must be underpinned by adopting several basic regulatory principles. One of these is a stable, predictable and well-designed regulatory environment. Another basic prerequisite is the “bottom up” approach, when changes in regulation primarily build upon the needs presented by the market, who is actively involved in the creation of legislation. At the same time, however, the need for investor protection must always be taken into account in order to promote fair and equitable treatment of participants and to deserve and obtain trust and confidence in the market.

This Strategy includes proposals of measures, which are based on the analysis provided in the main body below, and shaped by the suggested regulatory approaches. These measures are categorized into 4 groups of target beneficiaries: (households, companies, market infrastructure and State):

**1) Measures to support households (investors):** adopting Long-Term Investments Account; make the investments in the investment funds more attractive upon the investor’s initiative; education of retail investors and investment consultant about capital market; creation of a web centre (signpost) for consolidated information on securities and their issuers; analysis of the availability of currency hedging; improving the flow of information from issuers to investors;

**2) Measures to support companies (issuers):** education of CFOs of small and medium-sized enterprises on the possibilities of financing through the capital market; improving the conditions for the functioning of the so-called business angels in the Czech Republic; analysis of the possibilities of the development of investment crowdfunding in the Czech Republic; analysis of the possibility of creating a simpler form of the joint stock company; standardization of provision of information by the issuers in English; internationalisation of financial reporting; introduction and implementation of the “corporate governance scorecard”; support of the money market development;

**3) Measures to support the professional participants of the capital market (market infrastructure):** the overall greater involvement of pension funds in the functioning of the capital market in the Czech Republic; making the sub-funds more attractive; support the XML format usage when requesting information from financial institutions (in particular, in relation to distrainers); analysis on the possibility of the modernisation of the register of dematerialised securities; removal obstacles to the creation, support for the trading of corporate bonds on the capital market; development and publication of instructions on the initial due diligence guidelines for foreign investment funds;

**4) Measures to support the Czech Republic (the State):** analysis of other options of the development of the government securities market; active involvement in pan-European and global initiatives; active involvement in the law-making process in European Union; securing internships for state officials and regulators; monitoring the criteria for obtaining the status of developed capital market according to MSCI; education of state-controlled companies about possibilities of financing through the capital market; making available translation of the laws regulating the capital market into English.

The Government of the Czech Republic believes that the implementation of these measures will help to develop the capital market in the Czech Republic and therefore the maximum possible effort should be made to achieve them by 2023. To this end, the Ministry of Finance is in charge of coordinating the

development of the Czech capital market and reporting annually to the government on how the individual measures are being implemented, by 31. December and on the changes in the monitored indicators in the last 12 months (for example, the market capitalization of the Prague Stock Exchange and the volume of trades on it, the way of financing Czech businesses and the composition of savings for Czech households).

## Introduction

This Strategy, adopted by the government of the Czech Republic, is aimed at supporting sustainable economic growth as well as increasing the competitiveness of our country's economy by means of a well-functioning capital market. A well-functioning capital market is one of the pillars of the national economy and has a direct impact on economic growth and creation of high-quality employment opportunities. A strong capital market supports the development of the national economy through an efficient allocation of capital (foreign as well as domestic) that can be used to finance business activities, create skilled and productive jobs, build infrastructure and finance innovative ideas. Thus, a healthy capital market contributes to the increase in the country's competitiveness and reflects the development of the national economy.

The aim of this National Strategy is particularly to evaluate the current state of the capital market, identify the areas with the greatest potential for improvement and adopt measures in such areas. Further reflection is necessary on a possible future approach to optimize the regulatory environment for investments and corporate funding. All this shall contribute to building a strong, healthy and competitive capital market for the country.

The development of this Strategy was co-ordinated by the Ministry of Finance of the Czech Republic (hereinafter referred to as “**MF**”), however, it was primarily based on suggestions from the Czech capital market representatives (in particular the Czech Capital Market Association (hereinafter referred to as “**AKAT**”), Prague Stock Exchange (hereinafter referred to as “**BCPP**”) and Czech Private Equity and Venture Capital Association (hereinafter referred to as “**CVCA**”), all of which corresponds to the “bottom-up” approach described below. These suggestions were subsequently discussed in a broader circle of stakeholders (including for example, representatives of the Czech Chamber of Commerce (hereinafter referred to as “**HK CR**”), the Association of Pension Funds of the Czech Republic hereinafter referred to as “**APS CR**”), and the Czech National Bank (hereinafter referred to as “**CNB**”), subjected to critical evaluation and eventually taken into account in the drafting or postponed to further discussions. The World Bank (using funding provided by the European Commission under the Structural Reform Support Programme) has also been involved in developing the Strategy by conducting its own independent analysis of the capital market in the Czech Republic, including international comparison, and issuing a number of recommendations to improve functioning of the Czech capital market. In preparing the Strategy, the main goal was to achieve the largest consensus, both in identifying specific problems and finding ways to solve them, however, not all proposals have been included.<sup>1</sup> For this reason, it is also proposed to revise the Strategy and, if necessary, amend it with other appropriate measures.

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<sup>1</sup> Given that many of the submitted proposals are closely linked to issues rigorously discussed within stand-alone platforms, the aim while working on this Strategy is to concentrate solely on the proposals that would not overlap with the issues dealt by these platforms or on aspects of the proposals that are not fully covered by these platforms (taking into account other priorities of the platforms than the development of the capital market in the Czech Republic) or at least to refer to these platforms in this Strategy in order to emphasize their importance for the development of the capital market in the Czech Republic. The typical examples of such a topics include:

- the reform of the pension system, which was the subject of lengthy discussions of the so-called retirement committees (<http://www.duchodova-komise.cz/>; <https://www.mpsv.cz/cs/2228>),
- the review of the National Strategy for Financial Education (<http://www.mfcr.cz/cs/o-ministerstvu/verejne-diskuze/2017/konzultace-k-revizi-narodni-strategie-fi-29322>, <https://www.mfcr.cz/cs/o-ministerstvu/verejne-diskuze/2018/navrh-revidovane-narodni-strategie-finan-31870>),
- the discussion on the Strategy for the National Ownership Policies (<http://www.mfcr.cz/cs/aktualne/tiskove-zpravy/2017/mf-odmita-deklarovane-duvody-neschvaleni-27321>), which has not yet been concluded at the time of this writing,
- the initiative to set up the The Fund of Funds of The European Investment Fund (<https://www.mpo.cz/cz/podnikani/financni-nastroje/eif/fond-fondu-op-pik--234577/>)

## ***Why it is necessary to adopt the National Strategy for the Development of the Capital Market in the Czech Republic***

Every economy – developed and developing alike – should adopt its own strategy for the development of its capital market. For example, in the last few years, strategies for the development of the capital market (or financial market in general) have been introduced in many countries, such as Ireland<sup>2</sup>, Luxembourg<sup>3</sup>, Slovakia<sup>4</sup>, Bulgaria<sup>5</sup>, Hungary<sup>6</sup>, and Latvia<sup>7</sup>.

In the Czech Republic, such a long-term strategy does not exist yet, discounting the Government's National Economic Council from 2011<sup>8</sup> and the initiative “the Czech Republic – the financial centre of Europe<sup>9</sup>”. Introducing this National Strategy is in line with reports such as the Vienna Initiative (March 2018)<sup>10</sup>, the AFME (November 2016)<sup>11</sup> and the European Commission (November 2016)<sup>12</sup> finding the level of the development of the capital markets in Central and Eastern Europe insufficient. The European commission has been trying to promote the development of the capital markets in all the European Union (hereinafter referred to as “EU”) since February 2015, as part of the so-called Capital Markets Union<sup>13</sup> (CMU).

This National Strategy is also in line with the World Bank's<sup>14</sup> October 2017 analysis of the capital market in the Czech Republic, which included a series of recommended measures for boosting the development (this analysis was financed by the European Commission at the request of the Czech Republic within the Structural Reform Support Programme<sup>15</sup> (SRSP)).

The premise underlying all of these initiatives is that the absence of a basic vision of the Czech Republic for the capital market hinders the effectiveness of the involvement of the capital market in

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- the reviews in the fields of taxation (<http://www.mfcr.cz/cs/o-ministerstvu/verejne-diskuze/2016/verejna-konzultace-k-prvni-resenim-pro-26405><https://www.mfcr.cz/cs/verejny-sektor/dane/moje-dane/aktualni-informace>, <http://www.mfcr.cz/cs/o-ministerstvu/verejne-diskuze/2016/verejna-konzultace-k-prvni-resenim-pro-26405>)
  - transposition of the long-term shareholder engagement directive (<https://www.mfcr.cz/cs/soukromy-sektor/bankovnictvi-a-platebni-sluzby/platebni-sluzby-a-vyporadani-obchodu/aktuality/2017/konzultace-ke-smernici-o-podpore-dlouhod-29423>, <https://www.mfcr.cz/cs/soukromy-sektor/bankovnictvi-a-platebni-sluzby/platebni-sluzby-a-vyporadani-obchodu/aktuality/2017/vyhodnoceni-konzultace-ke-smernici-o-pod-30027>, <https://www.mfcr.cz/cs/soukromy-sektor/bankovnictvi-a-platebni-sluzby/platebni-sluzby-a-vyporadani-obchodu/aktuality/2018/konzultace-ke-kapitolam-ia-a-ib-smernice-31586>) or
  - the reviews in the fields of accounting.

<sup>2</sup> <http://www.finance.gov.ie/what-we-do/international-financial-services/>

<sup>3</sup> <http://www.luxembourg.public.lu/en/publications/k/LFF-luxfin-2020-EN-2016/index.html>

<sup>4</sup> <http://www.rokovania.sk/Rokovanie.aspx/BodRokovaniaDetail?idMaterial=23437>

<sup>5</sup> <https://abanksb.bg/downloads/Strategy-Development-Bulgarian-Capital-Market-EN.pdf>

<sup>6</sup> <https://www.bse.hu/About-Us/About-Budapest-Stock-Exchange/BSE-Strategic-Report-2017>

<sup>7</sup> [http://www.fm.gov.lv/en/s/financial\\_market\\_policy/financial\\_sector\\_development\\_plan/](http://www.fm.gov.lv/en/s/financial_market_policy/financial_sector_development_plan/)

<sup>8</sup> <https://www.vlada.cz/scripts/detail.php?id=82538&tmplid=50> (str. 177-198 Rámce strategie konkurenceschopnosti)

<sup>9</sup> [https://ekonomika.idnes.cz/financnici-chteji-udelat-z-ceska-centrum-evropskych-fondu-a-vydelat-112-eko-zahranicni.aspx?c=A130129\\_205431\\_eko-zahranicni\\_brd\\_čj\\_8594/2012 - KVV](https://ekonomika.idnes.cz/financnici-chteji-udelat-z-ceska-centrum-evropskych-fondu-a-vydelat-112-eko-zahranicni.aspx?c=A130129_205431_eko-zahranicni_brd_čj_8594/2012 - KVV)

<sup>10</sup> <https://www.imf.org/en/News/Articles/2017/03/06/PR1773-Vienna-Initiative-New-Working-Group-on-Capital-Markets-Union-for-CESEE-Region>; <http://vienna-initiative.com/full-forum-2018/>

<sup>11</sup> <https://www.afme.eu/en/news/press-releases/20162/deeper-capital-markets-in-cee-countries-could-unlock-200-billion-in-capital/>

<sup>12</sup> [https://www.bet.hu/pfile/file?path=/site/Kepek/KKV-konferencia/01\\_-\\_Niall\\_Bohan\\_European\\_Commission.pdf](https://www.bet.hu/pfile/file?path=/site/Kepek/KKV-konferencia/01_-_Niall_Bohan_European_Commission.pdf)

<sup>13</sup> [https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union\\_cs](https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union_cs)

<sup>14</sup> <http://www.mfcr.cz/cs/soukromy-sektor/kapitalovy-trh/podnikani-na-kapitalovem-trhu/2017/zprava-svetove-banky-o-kapitalovem-trhu-29766>

<sup>15</sup> [https://ec.europa.eu/info/funding-tenders/funding-opportunities/funding-programmes/overview-funding-programmes/structural-reform-support-programme-srsp\\_en](https://ec.europa.eu/info/funding-tenders/funding-opportunities/funding-programmes/overview-funding-programmes/structural-reform-support-programme-srsp_en)

the development of the real economy. Consequently, the growth of the gross domestic product is not reaching its full potential.

### **Vision**

In order that this Strategy brings about a real change in increasing the efficiency of the capital market, it is crucial to establish a clear national vision for the development and functioning of the capital market in the Czech Republic and to make sure that the vision is being thoroughly implemented. In order to succeed, it is vital to evaluate the current state of affairs and to propose a bundle of measures for achieving the set vision.

The vision of this strategy for development of capital market in the Czech Republic is to achieve the EU average of the following indicators:

- The increase of the market capitalization on the BCPP (with regard to new listings and delistings of companies)
- The increase of the liquidity on the BCPP
- The change in financing of Czech enterprises in favour of non-bank financing (especially to increase the volume of corporate bonds issues)
- A change in the structure of household's savings from depositing it to bank accounts in favour of capital market

### **How to achieve the vision**

- Review structure of the the private sector, including infrastructure organization and market operations.
- Identify the reform areas with the greatest potential to improve the functioning of the capital market in the Czech Republic.
- Develop and implement the selected reform measures according to a concrete time-frame (plan of measures)
- Conduct a comprehensive yearly review of the current state of the above mentioned indicators, single measures and the regulatory environment of the capital market in the Czech Republic, especially focussing on the so-called national legislation (i.e. legislation beyond the compulsory implementation of the Laws of the EU).
- Review the current status of the strategy after five years from the approval and update the strategy

# 1. The importance of a capital market to the national economy

A well-developed capital market is an essential mechanism for the efficient functioning of an advanced market economy. It matches household savings with value added enterprises in need of capital. As such, it benefits the country's economy as a whole and all its participants - households, businesses, and financial intermediaries. Furthermore, it makes the economy more resilient to external shocks and allows a faster economic recovery in the event of a financial crisis.

The capital market is a market for long-term financial instruments, which plays a crucial role in the allocation of capital, supporting productivity and healthy economic growth in the country. The basic function of the capital market is allowing for the most efficient distribution of capital from those who own the capital and currently do not intend to spend it (typically household savings for long-term goals) to those who need it (typically businesses and the State budget). A well-functioning capital market benefits the economy as well as all of the participants:

1) Benefits for **households** – The capital market helps to increase the value of household savings. In more developed capital markets, particularly in the US and developed countries of Western Europe, households have a larger choice of product offerings that make it easier to well-diversify investment portfolios and better diversify investment risk. Therefore, the households have more opportunities to achieve a higher appreciation of their savings while they can invest primarily in the national economy (home biased). Developed capital markets are also typically more competitive, making personal investment available at lower fees. Access to savings choices is also important to building an adequate pension. In the wake of an aging population, household investments in the capital market are a necessary complement to the state-funded public pension system, when the current first pillar (pay as you go) is unsustainable in the long term. In sum, citizens of a country with poorly developed capital markets are unable to match the economic performance of Western European households and thus don't have a number of opportunities that are in other developed countries, to accumulate pension funds.

2) Benefits for **companies** - A developed capital market increases the competitive ability and efficiency of enterprises, even at the international level. If the capital market works effectively, enterprises can use it as an alternative to traditional bank financing, which can result in greater freedom of business (not necessarily the different covenants common to bank loans) and a better cash flow (for bonds, unlike loans, they do not pay the principal on a continuous basis but only at maturity, which is usually the case with a new bond issue for debt refinancing), cost savings or allow for investments that the bank refuses to support for some reason.<sup>16</sup> This enables them to innovate their products faster and expand on domestic and foreign markets. Enterprises can also diversify their capital structure to be better prepared for economic fluctuations or refinancing of their debts. The capital market also represents the most important source of external equity financing.

3) Benefits for **financial intermediaries** – These benefits arise from serving investors and enterprises that pay for their services (for the value added). Looking at developed financial economies, such as Malta, Luxembourg or Ireland, it is clear that the growth of the financial intermediation industry is not

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<sup>16</sup> For example, lending by investment funds has proven to be very successful overseas, the so-called “private debt”, which is able to provide financing in less amount of time than the banks, which may be very important in certain situations. Furthermore, the private debt can offer financing terms unavailable in the standardized products of the banks. The so-called debt originating funds are also being investigated within the Framework of the CMU project.

constrained by the size of the economy nor the national territory, especially because capital flows pass easily across boundaries and its cross-border management is quite easy.

Thus, to the extent that a country's capital market infrastructure serves not only the nation's needs but also regional or global finance, the sector itself becomes a value-added segment for the country's economy adding to employment and growth.

4) Benefits for the **State** – Given the above benefits for households and companies, a well-functioning capital market has a direct and positive impact on investment, employment and thus GDP growth. A developed capital market is also important for the country's international reputation and increases foreign investment. Attaining the status of “developed market” according to the MSCI methodology<sup>17</sup> helps attract more foreign portfolio investment and promotes increased foreign direct investment because it provides the exit strategy for those investments. Even state-controlled companies can use the capital market to be financed through debt issuance.

Moreover, capital markets play an irreplaceable role in terms of government funding through government bonds. It is in the interest of the country that the markets for sovereign bonds and other assets are sufficiently liquid at all stages of the business cycle to ensure smooth financing as well as an indication of market expectations regarding the development of interest rates, economic activity and the credibility of the country as the issuer. It is also essential that government bonds with varying maturity are traded on a liquid market, so as to model the so-called yield curve<sup>18</sup> that forms the basis for the valuation of investments and also helps investors and public institutions anticipate economic developments.

At the same time, government bonds are generally accepted collateral to secure repo deals. In May 2018, the rating of the Czech Republic from Moody's was A1 with a positive outlook, from Standard & Poor's it was AA stable, with a positive outlook, from Fitch it was A + with a positive outlook. The rating of the Czech Republic serves, among other things, as a ceiling for the rating of corporate issuers (no issuer can have a higher rating than the country in which it is domiciled, except for covered bonds or structured financial products). Rating agencies appreciate, in particular, sound public finances, low levels of debt, overall economic growth, robust institutional arrangements supported by EU membership and a surplus of government-wide government sector spending. The excellent rating of the Czech Republic also gives Czech companies the opportunity to secure cheaper financing by issuing corporate bonds, compared to the situation where the Czech Republic would not achieve such a high rating.

The capital market also has a crucial role to play in ensuring the diversification of funding sources and augmenting the resilience of the economy to the effects of systemic risk by spreading it across the actors. From this point of view, we can define two extremes - the so-called bank-based economy (i.e. the economy based primarily on financing through bank loans, dominant in continental Europe), and the market-based economy<sup>19</sup> (i.e. the economy based primarily on capital-markets, for instance the US and the UK). The difference lies in the fact that European enterprises (the real economy) are mostly financed by bank loans, while Anglo-American enterprises are more likely to be financed through the capital market. It is impossible to say that one of these modes of financing the real economy is unambiguously better than the other, nonetheless, economies with a strong predominance of the banking sector or capital market face a number of disadvantages that could be eliminated by a gradual transition to a more balanced mix of these two systems, as the advantages of both systems complement

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<sup>17</sup> The MSCI Index is a measurement of stock market performance and gradates between “developed market”, “emerging market”, “frontier market” and “not rated”.

<sup>18</sup> The yield curve is a graphical representation of the yield-to-maturity relationship of the bond group that is homogeneous in terms of risk and liquidity

<sup>19</sup> See, for example, the analysis in the Green Paper on Creating the Union of Capital Markets of February 2015, available here: [http://europa.eu/rapid/press-release\\_IP-15-4433\\_cs.htm](http://europa.eu/rapid/press-release_IP-15-4433_cs.htm)

each other and disadvantages are diluted. Such a mix is generally considered to be more appropriate and consistent with the European Commission's Capital Markets Union project.

The weaknesses of the pure bank-based economy include the total dependence of enterprises on bank financing, where in the event of a severe financial or economic crisis or an excessive risky lending there is a risk of a potential shortage of loans for SMEs and the risk of costly remediation of the banking sector. No alternative to self-financing or bank lending can negatively affect managerial decisions and subsequent business development. According to AIMA<sup>20</sup>, the company's entry into the capital market leads to a significant increase in its turnover, assets and hiring. When companies have no alternative to bank financing, they adapt their business plans in accordance with the wishes of the bank, they curb their growth ambitions, and limit high-yield risky investments. A bank-based economy is also closely linked to the so-called bank-sovereign loop<sup>21</sup> (interdependence between banks and the country). Should the state get into serious financial problems and be forced to write off part of its debt, banks - mainly the domestic ones and the main holders of state debt – are heavily affected. In this scenario, banks face significant losses associated with depreciation of their assets. Subsequently, this can then be reflected in a decline in credit activity and, in the worst case, bankruptcy. In general, according to a study by the Bank for International Settlement (BIS), the market-based model may be more resilient to financial crises than the bank-based model<sup>22</sup>. However, the most appropriate solution is the combination of both models, which limits the disadvantages of the bank-based model, but at the same time, it does not mean a discontinuity of historical experience, tradition or require change in thinking within the society.

All in all, the capital market grants important benefits for all the economic participants. Firstly, it gives investors, the possibility of efficient appreciation of accumulated financial assets. Secondly, it allows the companies to finance more risky projects, have alternative to bank loans, and thus diversify their capital structure. Lastly, a well-developed capital market helps the country develop the economy faster, increase the number of jobs with high added value and lower risks to the state budget in the event of a banking crisis. For these reasons, every government should seek a well-functioning of the capital market in its country.

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<sup>20</sup>[http://www.europeanissuers.eu/lib/newsflash/research\\_paper\\_-\\_release\\_version\\_-\\_march\\_2014.pdf](http://www.europeanissuers.eu/lib/newsflash/research_paper_-_release_version_-_march_2014.pdf)

<sup>21</sup> <https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2016/12/31/Ireland-Lessons-from-Its-Recovery-from-the-Bank-Sovereign-Loop-43361>

<sup>22</sup> Financial Structure and Growth (BIS, 2014)

## 2. The need for development of the capital market in the Czech Republic

Given the benefits that a well-functioning capital market would bring to the Czech Republic, it is important to pay attention to the current state of the capital market in the Czech Republic. The government of the Czech Republic believes that the capital market in the Czech Republic currently fails to sufficiently fulfil its main function i.e. the effective allocation of unutilised financial resources from investors offering capital towards enterprises desiring it. The current phase of the business cycle also plays a role - most companies do not seem to be “pushed” by the need for external capital. Moreover, obtaining a bank loan is relatively easy at this time of high bank liquidity and low interest rates. In addition, the companies’ investments are strongly supported by European Union subsidies.

However, the factors leading to this complacency may change in the near future, because of the increasing interest rates and reduction of the European Union subsidies. The country must be ready to face this development. That is why a clear strategy for the development of the capital market in the Czech Republic has to be introduced. Furthermore, the report of the World Bank estimates that the capital market in the Czech Republic does not provide a sufficient support for the Czech economy's ambition to join the more developed half of the EU member states. In accordance with the government's goal to become a high-income economy, it is therefore necessary to pay closer attention to the development of capital markets.

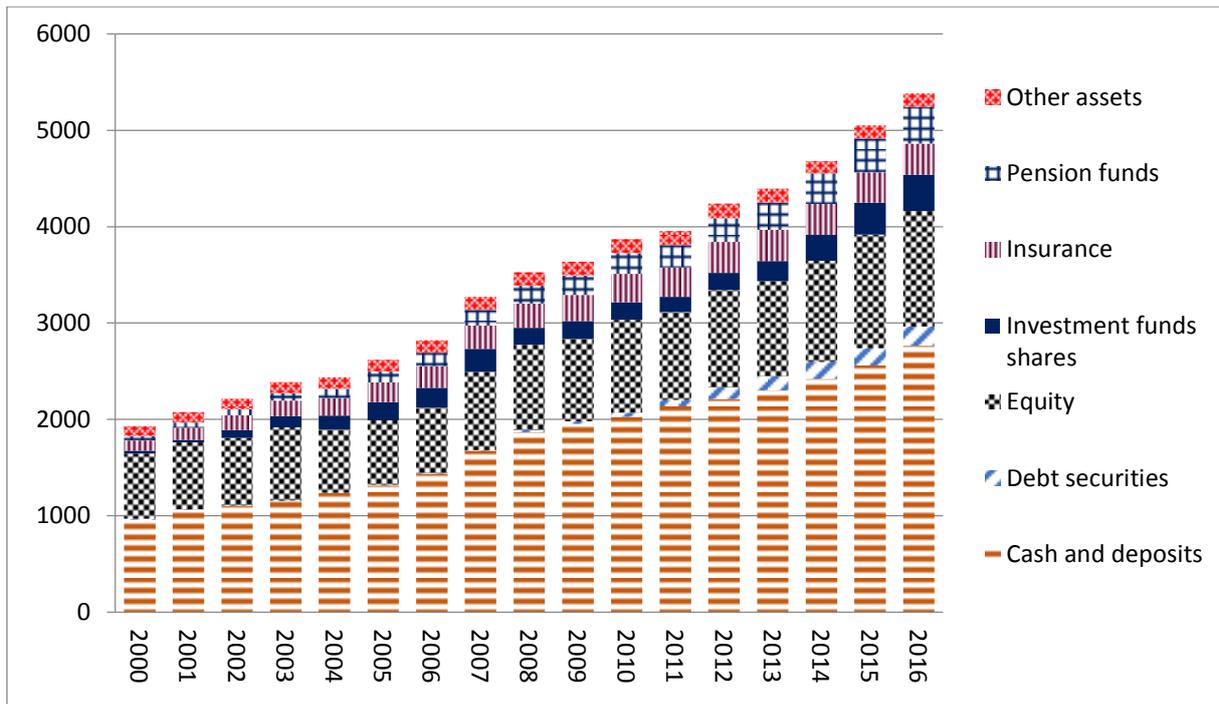
The Czech capital market’ current status appears to be driven by three main structural factors: (1) a conservative distribution of household assets and low retirement savings, (2) a lack of awareness or the interest of companies in obtaining funds through capital market and (3) insufficient offer of investment instruments traded on the BCPP, which is the first logical choice for the Czech investors’ direct investments on the capital market because of its local proximity, the lack of exchange-rate risk and the transmission of information in Czech.

### 2.1 Conservative orientation of Czech portfolios

Czech households are very cautious when allocating their savings. They keep their money primarily in financial products that do not allow them effectively appreciate accumulated retirement funds (i.e. pensions). As a result, despite the high level of savings (among the highest in the EU), the wealth of Czech households lag behind their western neighbours.

The savings rate within the Czech economy is relatively high. With a saving share of 28.7 % of Gross National Income (GNI), it ranks third highest among the European countries. According to World Bank calculations, the Czech economy generates roughly CZK 1,236 trillion in gross savings per annum. However, only a tiny fraction of these savings enters the capital market. This is mainly due to the very conservative investment outlook of Czech households, which has not fundamentally changed over the past 16 years. As seen in Figure 1, the assets of Czech households increased from CZK 2 trillion in 2000 to CZK 5.4 trillion in 2016. By far, the largest portion of household funds is held in cash, bank accounts and time deposits (51 % in 2016). A significant portion of aggregated household assets (namely 18.3 % in 2016) is held in “shares and other ownership interests”. However, stocks listed on the BCPP comprise only 6.2 % of the item, which translates into as little as 1.1 % of the households' assets. Debt securities held by households represent slightly more (3.9 % of total funds) while holdings in Czech investment funds was 7.3 %. Thus, the total portion of household assets placed in exchange-traded shares, debt securities and investment funds (i.e., traditional capital market products) was 12.3 % As we will discuss later, these numbers are relatively low compared to other EU countries. What is more, nowadays, these kinds of assets are held primarily by upper income households within the population. Therefore, we can conclude that these assets are not yet sufficiently represented among the assets of medium-income households, much less lower income.

**Figure 1 Assets of Czech households (CZK billion)**



Source: Eurostat

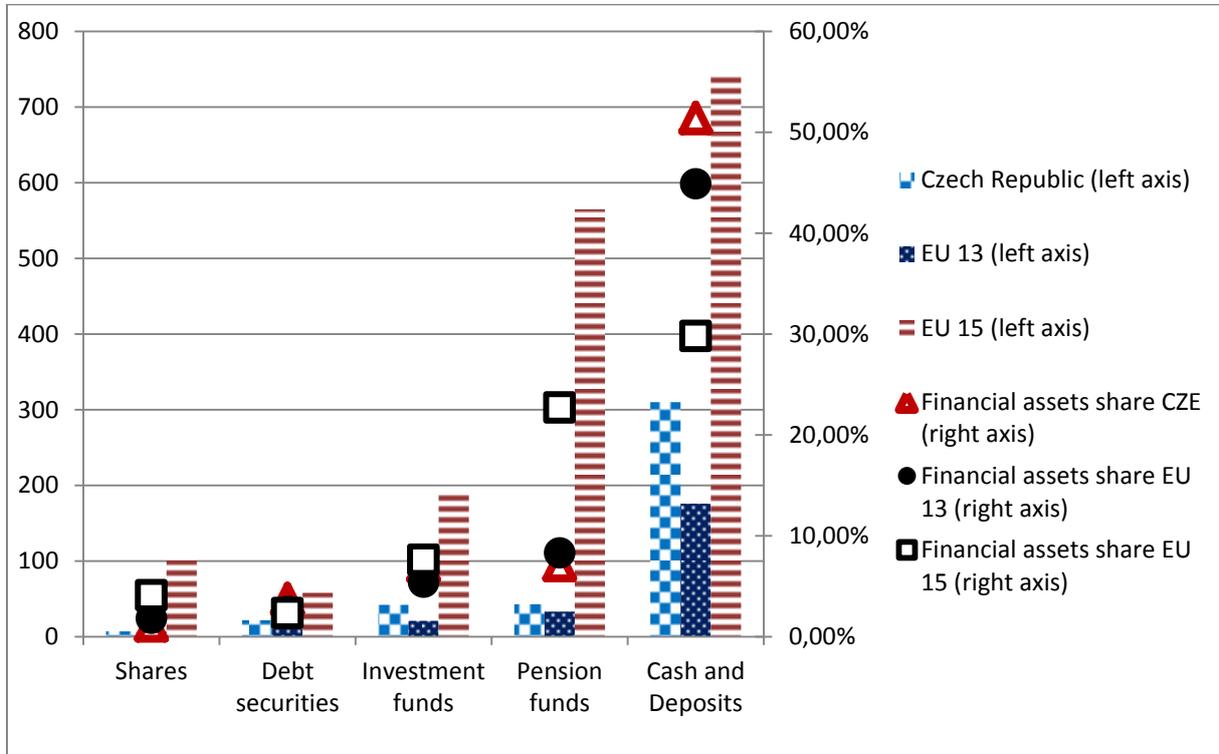
These savings and investment patterns (while investing on the capital market) have a direct impact on the average Czech citizen’s ability to build wealth. This also translates into (hinders) the nation’s ability to converge towards the economic level of Western countries, particularly the more developed EU member states, which is a stated goal of the government.<sup>23</sup> Currently, the average Czech owns financial assets that amount to approximately CZK 600,000, while the average European can boast assets of more than CZK 2 million).

Figure 2 shows (as discussed above) that a typical Czech keeps more than half of their assets in cash and deposits, while a typical European from the EU-13 (the 13 countries which have joined the EU since 2004, the so-called “Eastern EU member states”) allocates about 44.9 % of their assets in this manner, and a typical European from the EU-15 (the 15 countries which have joined the EU before its enlargement in 2004) allocates even about 30 % of their assets in this manner. Within the European comparison, the Czech Republic ranks fifth highest in the proportion of savings invested this way. Whereas in terms of holding riskier assets, The Czech Republic places near the bottom (lowest) of the hypothetical ranking. Thus, there is a large gap in investing in the longer-term assets that can deliver higher returns. For example, stock-listed shares account for only 1.1 % of the wealth of an average Czech (approximately CZK 7 thousand), whereas the average European from the EU-15 accumulates CZK 101 thousand (4.1 % of its financial assets) and even the average European from the EU-13 accumulates a slightly-higher percentage (1.8 % of its financial assets). In absolute terms, the average Czech and the average European are roughly comparable. With regards to the share of assets in bonds and investment funds, a typical Czech, in comparison with typical European from EU-13 or EU-15, doesn’t perform badly. The average Czech citizen keeps 1.4 % more than the average European from the EU-15, who keeps 2.3 % of their assets in bonds. The average European from the EU-13 keeps 2.5 % of its financial assets in bonds. On the other hand, the average European from the EU-15 keeps a slightly higher percentage in investment funds with a share of 7.6 %, while the average Czech keeps

<sup>23</sup> Measuring convergence is somewhat problematic because the current structure of Czech family portfolios does not correspond to the portfolios typical for the Western world. To provide a better comparison, we have modelled the distribution of assets by averaging it for a “typical citizen” of these countries. The following discussion speaks in those terms.

7% of their financial assets, which is more than 1.6 % in comparison to the average European from the EU-13)<sup>24</sup>

**Figure 2 Comparison of the assets of average Czech, European from EU-13 and European EU-15**

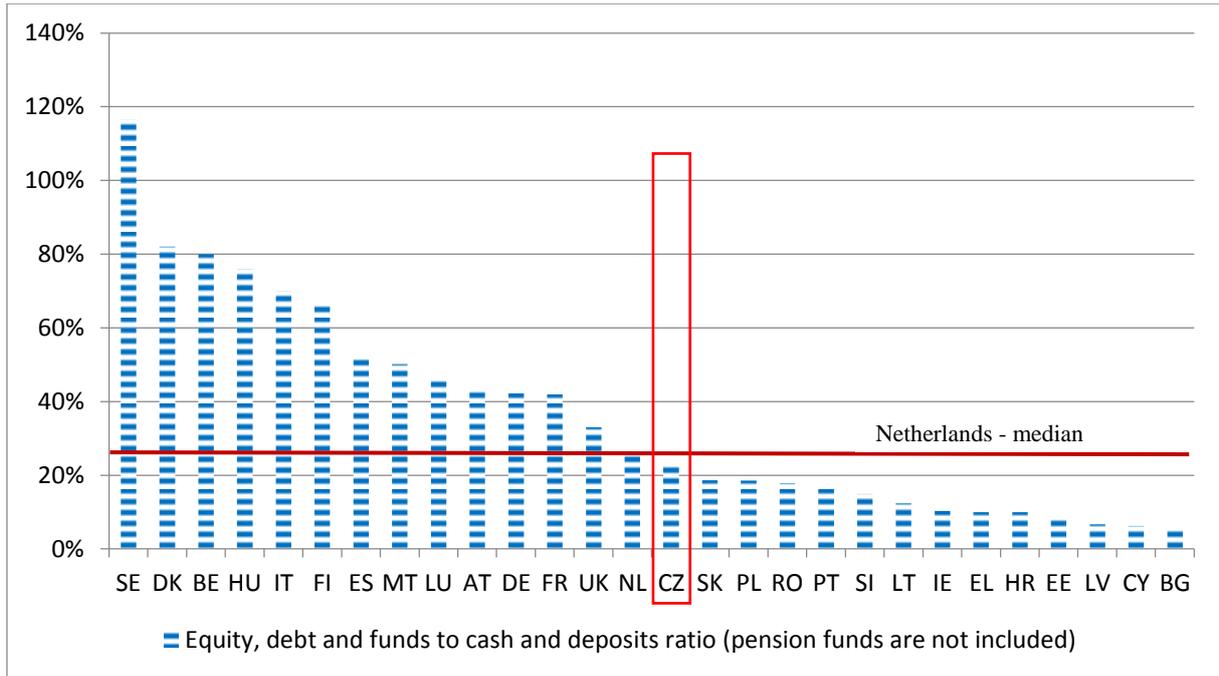


Source: Analysis of the MF using Eurostat data<sup>25</sup>

<sup>24</sup> The overall placement of savings into investment funds continues to be conservative. According to the report of the World Bank, only 19 % of total fund assets are allocated to equity funds, while a significantly larger volume is in mixed (40 %) and bond funds (35 %).

<sup>25</sup> The model takes into account the number of people aged 15 and over; in case of younger people, we assume a negligible amount of financial assets. The model doesn't include pensions, ownership interests, and standardised guarantees. Therefore the right axis doesn't reach 100 %.

**Figure 3 Equity, debt and funds to deposits ratio**



Source: MF and Eurostat

As for retirement planning, the average Czech saves thirteen times less than the average European from the EU-15 in pension products - on average CZK 43 thousand compared to CZK 565 thousand respectively. Even if life insurance is included into this category, we would only reach 12% of households' assets compared to the European average of 38% of households' assets. In absolute terms, the average Czech saves more in retirement planning as compared with the average European from the EU-13 (who saves CZK 33 thousand), but in percentage the average Czech saves 1.2% less.

These figures only confirm the conclusions of the study of the Czech capital market conducted by the World Bank, which found that, on the basis of their model, the current investment decisions of the households could provide Czech citizens with a pension equal to 15.8% of their pre-retirement income in the third pillar of the pension system. This is one of the symptoms of the serious problem, as well as an essential argument for further development of the Czech capital market and the need of higher participation of Czech households in domestic and foreign investments.

Although these problems are of a longer-term nature and require attention, the development of the volume of assets managed in the brokerage market, which confirms the growing interest in investment funds, can be considered positive. The value of assets managed by AKAT<sup>26</sup> members increased from CZK 715.8 billion in 2007 to CZK 1.1496 trillion in 2015. In 2015, there were CZK 203.5 billion in the domestic mutual funds. Assets in Qualified Investors' Funds amounted to CZK 68.5 billion at the end of September 2015 and the total of CZK 385.3 billion in public funds (about a half of these resources are foreign-sourced). This National Strategy is put together, in order for us to provide the strongest possible legislation support to the recent positive developments and thus to contribute to the economic convergence of the Czech Republic to the average of the EU countries.

## 2.2 Limited awareness by enterprises of the advantage of capital market financing techniques

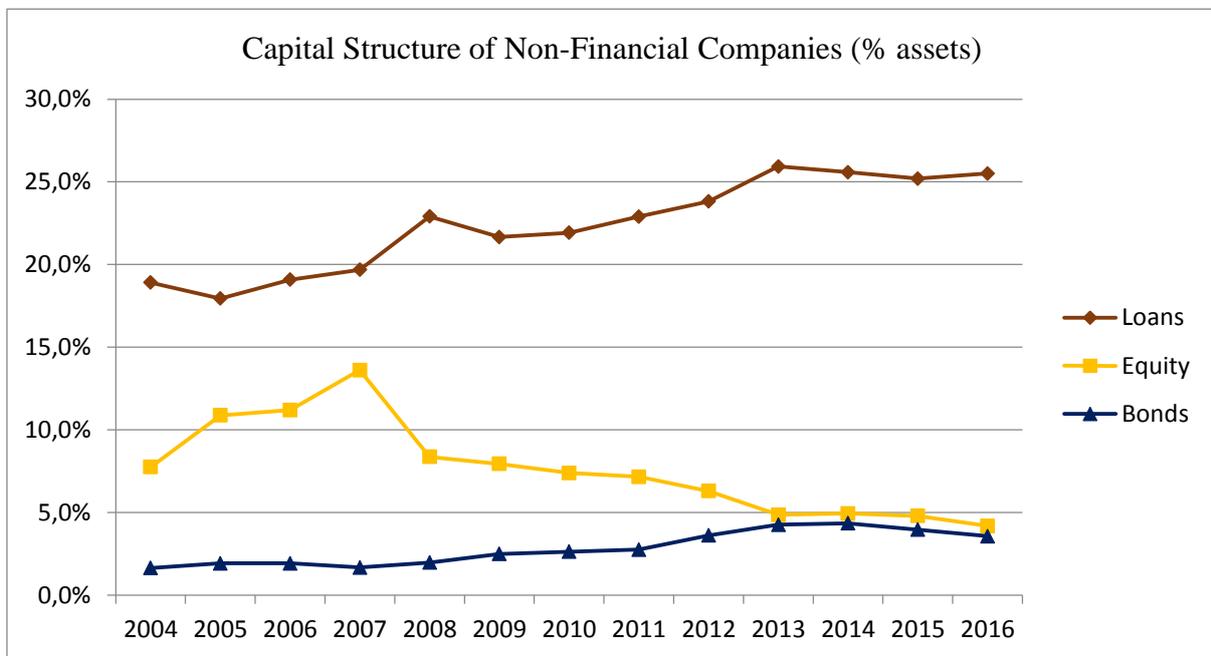
Exchange-traded stocks and bonds do not yet play a sufficient role in the financing of companies. SMEs are especially dependent on funding through retained profits and bank loans. Capital market funding opportunities need to be made more attractive. The companies' level of awareness of the

<sup>26</sup> It is estimated that AKAT represents about 95 % of the capital market.

possibilities and benefits of the diversification of financial resources should be systematically increased.

The Czech Republic's financial system is bank-centred; banks hold 74% of the financial system's assets. Thus, the Czech Republic is clearly one of the “bank-based” economies, presenting the disadvantages described in the previous chapter. The consequences can be particularly traced to the main sources of funding of Czech businesses which today is highly dependent on (1) bank financing, (2) the enterprises own resources and (3) subsidies from the European Union. The financing of Czech non-financial corporations is derived from loans (25.5%), receivables from other companies (28%), unquoted shares (28%) and other equity participation (11%). It should also be noted that the major portions of the last two categories consist of the shares of the founding members, that is, the funding obtained internally. The Czech capital market plays a much less significant role. As can be seen in Figure 4 below, debt securities are only used to finance 3.6 % of the company's operations. Equities quoted on the stock exchange account for only 4.2 % of companies’ capital, with this figure down significantly over the last ten years (while reaching 13.6 % at its peak in 2007).

**Figure 4 Capital structure of Czech non-financial companies**

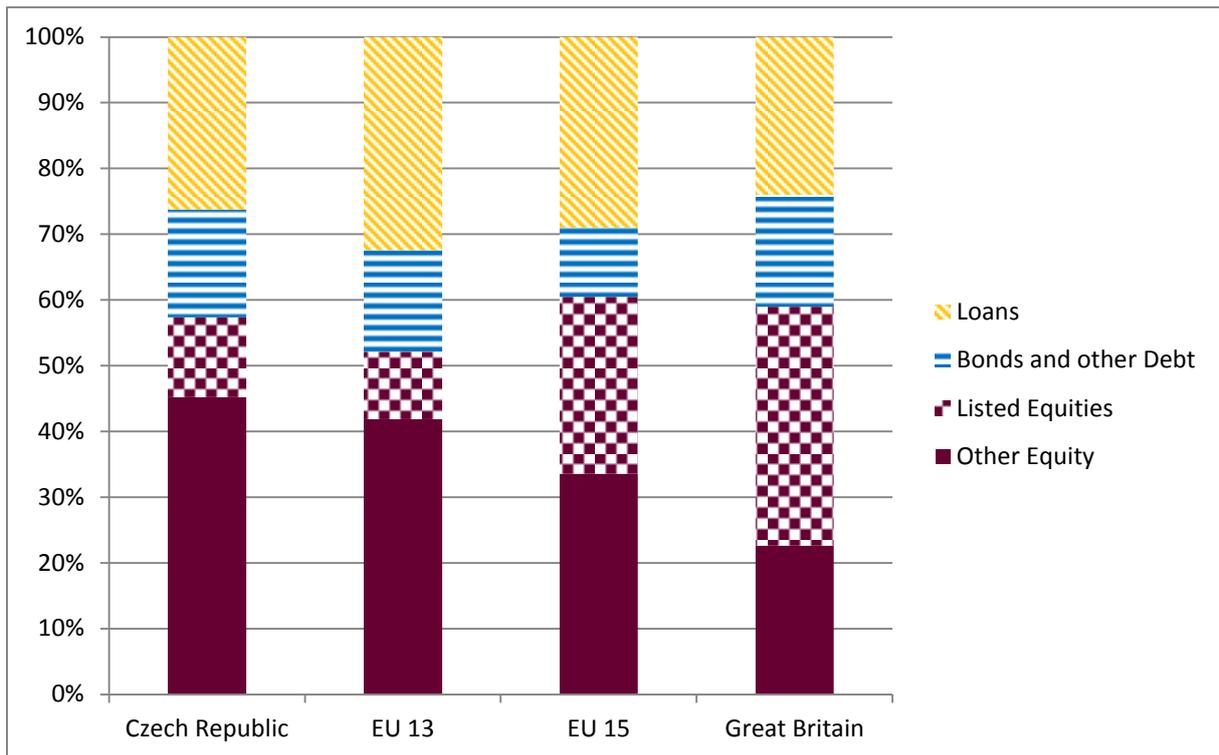


Source: CNB

The insufficient diversification of the sources of the Czech enterprises’ becomes even more evident in international comparison. Figure 5 shows the capital structure for Czech companies in comparison with very similar data for EU-13, EU-15 and the United Kingdom. The result illustrates the marked difference between the Czech Republic and EU-13, EU-15 and the Great Britain, where the share of corporate financing through listed shares and bonds in the Czech Republic is more than one half compared to EU-15 and one third compared to the UK. Compared to EU-13, however, the Czech Republic is doing better, although the gap is not so significant (3 %).

Most of the equity contribution derives from enterprises owners’ own funds and reinvested profits. Most of the debt financing is obtained from the banks. Together this points to the lack of interest in the issuance of shares and bonds by Czech companies, which may result from insufficient information about this type of financing.

**Figure 5 Capital structure in comparison with EU-13, EU-15 and the United Kingdom**



Source: MF and Eurostat

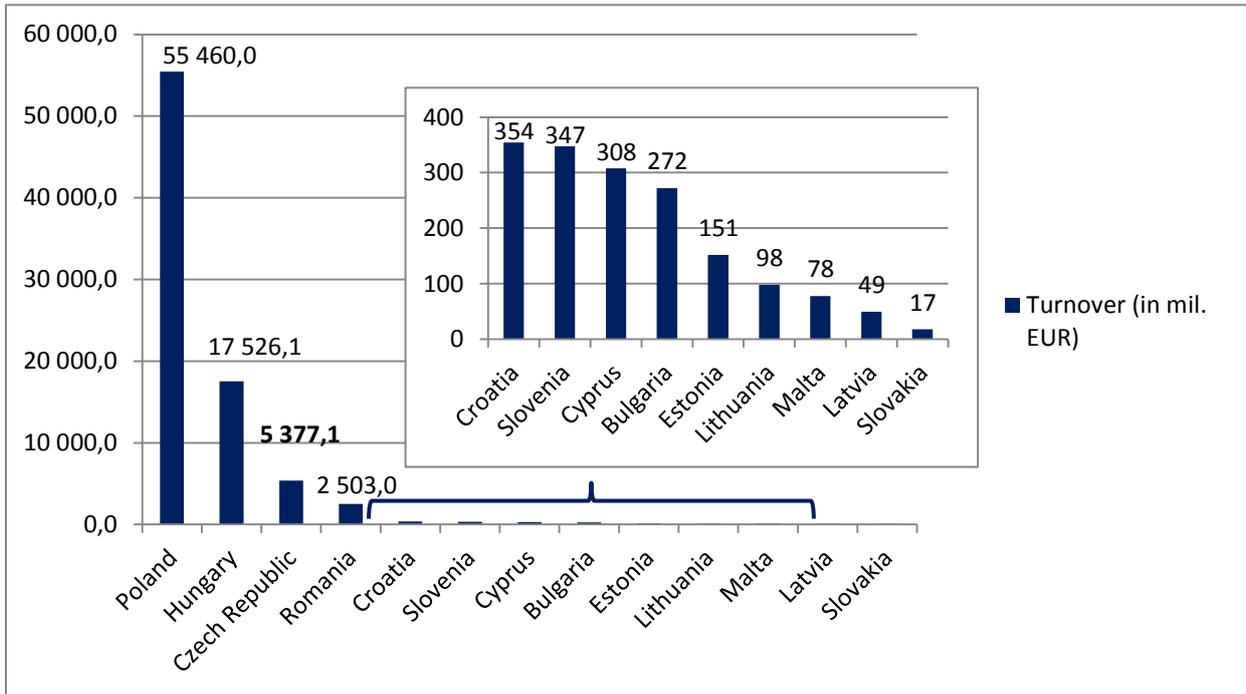
The high dependence on bank loans and internal financing appears particularly acute for SMEs. Economic analysis by the European Commission and research conducted by the Czech Chamber of Commerce shows that there is little awareness among small and medium-sized enterprises about the alternative sources of financing and the possibility of external financing in general. In addition, according to discussions between the World Bank and the Czech capital market participants, the challenging and non-systemically changing regulatory requirements that make the market entry more expensive are a serious problem for the companies considering issues of stocks or bonds.

### 2.3 Low participation in the organized exchanges

Even though the Czech capital market may seem smaller and less liquid in the international comparison, among the EU-13 entrants it ranks best in terms of market capitalization to GDP per capita and third in trading volume. However, a decline in liquidity in recent years may be jeopardizing the interest of investors and issuers in market entry and therefore the financing of companies. For this reason, it is necessary to consider steps to make trading on the Czech capital market more attractive.

Compared to the stock exchanges of other EU-13 markets, the BCPP ranks among the best. As outlined in the World Bank report, it is the largest in terms of market capitalization to GDP per capita. Further as can be seen in Chart 6 BCPP trading volume, which reached EUR 5 377.1 million in 2017, places it third after Poland (EUR 55 460 million) and the Hungarian Stock Exchange (EUR 17 256 million), but it is still significantly lower in comparison to them. The remaining stock exchanges of the EU-13 do not, even in total, reach the volume of trades that are realized on the BCPP.

**Figure 6 Comparison of turnovers at stock exchanges of EU 13 states in 2017**



Source: MF analysis based on data from the annual stock exchange reports

Another factor pointing to a certain quality of the BCPP is, for example, the successful listing of the Moneta Money Bank to the BCPP. Moneta Money Bank has been operating since 2016. Its shares have since become the most profitable in the market and have brought the necessary excitement to the stock market. The management of the BCPP is also trying to initiate stock exchange activity, for example through the new START project, which focuses on small and medium-sized enterprises. During May 2018, the number of securities traded on the BCPP rose from 25 to 57 and the market capitalization rose from USD 62.7 billion to USD 939.2 billion.<sup>27</sup>

On the other hand, the conservative investment outlook of Czech households and the low awareness by Czech enterprises of the benefits of capital market financing also translate through to the current health of the BCPP. With regard to its equity segment, the BCPP faces, in comparison with world averages, low issuances, low market capitalization, low trading volume and a sectoral composition that does not reflect the structure of the Czech economy. The most prominent indicator of the aforementioned problems is the expression of the stock market capitalization in terms of GDP. Compared with the world average, and especially with countries with developed capital markets, the Czech Republic is lagging behind. Interestingly, the difference in market capitalization between developed countries such as the USA, France, Germany and developing countries such as Poland and the Czech Republic is very diametrical. The low volume of issues and low market capitalization of the BCPP, in the comparison with world average, may hinder interest on the part of the foreign investors in the Czech economy. Our market may be small for them and/or possess insufficient liquidity, making it difficult to place a diversified portfolio of assets. Another problem associated with the small market capitalization is the lack of liquidity, which has been gradually reduced over the years.

The problems of the BCPP are not negligible in the context of the Czech Republic's capital market. Such problems can strongly discourage domestic and, above all, foreign investors from investing in the Czech economy. The development of the BCPP, in particular the stimulation of potential initial public offerings, is essential to the inclusion of the Czech Republic in the MSCI list of developed

<sup>27</sup> This was primarily due to the unsponsored listing (ie listing without the issuer's consent) of large companies such as Nestle, Shell, Deutsche Telekom, Unilever, Heineken, Volkswagen, Nokia, Volvo, Deutsche Bank and others.

countries. This is crucial for the increase of foreign investors' interest in the Czech economy and inflows of foreign capital into Czech companies.

The country's bond market is more encouraging. The value of bonds issued by non-financial corporations increased from CZK 75.47 billion at the end of 2007 to CZK 340.37 billion at the end of 2014, and thus is a positive trend<sup>28</sup>. The main issuer on the bond market is the government. At the end of 2015 CZK, the government bond amounted to 1.612 trillion, and thus provides an even deeper pool of debt instruments.<sup>29</sup>

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<sup>28</sup> Here we consider the total volume of bonds in the Czech Republic. In 2013, there was a fundamental change in which most of the bonds were moved from the stock exchange to the OTC market.

<sup>29</sup> 59.89 % of value was held by financial institutions, 18.3% by non-residents and 13.99 % were issued for abroad. Other investors held a much smaller share of the government bonds - households held 3.91 % (CZK 63.1 billion), government institutions 2.69 %, non-financial corporations 1.05 % and non-profit institutions 0.16 %.

## 3. Basic principles of the regulatory approach

The effort for developing the capital market in the Czech Republic should primarily be based on the basic principles of regulation described below, namely the stability and predictability of the regulatory environment and the “bottom-up” approach. This will support the long-term natural organic growth of the capital market in the Czech Republic, based on legitimate economic needs and using the added value of an improved (i.e. enhanced and extended) regime. Developing a capital market based solely on external support (by subsidies or other preferential treatment) is, by its nature, difficult to sustain.

### 3.1 Promoting stability and predictability of the regulatory environment

One of the basic prerequisites for the sustainable growth of the capital market in the Czech Republic is a stable and predictable regulatory environment. The desirable environment for the development of the capital market is a comprehensible legal order that keeps developing on the basis of a dialogue with the private sector, which enables foreseeable business planning, innovation and expansion. No change is often better than an unprompted change, albeit well-intentioned, because an unprompted and seemingly uncontroversial change leads to the need to make further changes, which may negatively affect the stability of the legal environment. The stability and predictability of the regulatory environment is also important in the area of taxation, as investments are long-term and tax changes are sensitively perceived.

Since 2008, Capital market regulation has been the subject of far-reaching changes resulting from the EU law<sup>30</sup> in response to the financial and economic crisis, which has led to increased legal uncertainty and the need to adapt to new requirements. The Czech government and this Strategy have only limited influence on the development of EU law (although the principles on which this Strategy is based can be applied even during negotiating new European regulation). It is therefore necessary to focus on the so-called gold-plating in broader sense<sup>31</sup>, which does not draw from the requirements of EU law.

While the instability of regulatory environment has negative impact on professional market participants (licensed entities) it also negatively affects investors and issuers. Investors fear unpredictable and unfavourable developments of the investment environment (so-called political and regulatory risk), and require a higher risk premium for issuers, which raises the price of the issuers' funding through the capital market for the issuers. Investments on the capital market are of a long-term nature and investors may not be able to exit without losing part of the value of the investment (lower liquidity), therefore stability and predictability are important for them. The mere impression that the “rules of the game” can change quickly and easily increases the cost of capital and thus hinders the development of the capital market (if financing through the capital market is expensive, issuers will continue to prefer traditional bank financing). Financing via the capital market may be more advantageous under certain conditions than credit financing. However, if the uncertainty of the regulatory environment is put in the way of natural capital market development, businesses may tend to use proven bank loans and internal reinvestment methods, which by their nature are more restrictive and thus have an adverse impact on the further expansion of these businesses, creating jobs with higher added value damaging the performance of the Czech economy as a whole.

In view of the above, the Government of the Czech Republic recognizes that the stability and predictability of the regulatory environment is crucial for the development of the capital market. This

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<sup>30</sup> Although new regulation impede the development of the Czech capital market, it should be noted that the EU's common legal framework sets the same rules for all EU members, so it can not be claimed that the changing legal regime leads to a competitive disadvantage for the Czech Republic compared to other EU Member States. But this statement does not have to be applied to countries outside the European Union, whose regulation may not be so strict.

<sup>31</sup> World Bank recommendation: Remove unnecessary regulatory burdens and costs incurred at national level

does not avoid *a priori* the possibility of making necessary adjustments, however, when adopting regulatory changes affecting the capital market, the following basic principles should be respected as far as possible:

- (1) Forthcoming changes should be consulted with the (regulated) entities concerned in a consistent and transparent manner, prepared in cooperation with these bodies; their comments should be adequately taken into account, and any non-consideration of the comments should be explained.
- (2) Changes should be described and reasons therefor should be given and, where appropriate, explained on request so that they can be better absorbed by regulated entities.
- (3) Changes that respond to market failure should be proportionate and targeted so as to regulate only the minimum necessary (proportionality principle). Changes not responding to market failure should be minimized unless explicitly required by regulated entities. The abolition of existing regulation should not be avoided *a priori*.
- (4) Changes should not be hasty; in particular they should not be adopted at a later stage in the legislative process, through an accelerated legislative process or without providing adequate time for adaptation to the new rules.

### 3.2 Bottom-up approach

The EU's major financial centres have a well-established bottom-up approach to regulate their capital markets. According to this approach, the regulator creates legal standards primarily on the basis of proposals presented by the market and accepts its own proposals only if they have been thoroughly presented and discussed with market participants. The same principle is based on the current European Commission's effort to create a so-called “union of capital markets”. At the same time, however, the need to protect investors must always be respected in order not to disturb their confidence in a just and properly functioning capital market. An important part of this approach is also the promotion of the use of market standards, i.e. the form of self-regulation, co-regulation.

The bottom-up approach has already been used in the Czech Republic to analyse the current state of capital market regulation in the Czech Republic, and market representatives have been significantly involved in the preparation of this concept and have provided a number of suggestive proposals on how to develop the capital market in the Czech Republic.

#### **Examples of “bottom-up” approach in practice**

Some of the proposals submitted by the participants in the capital market during the preparation of this Strategy have already been implemented. For example, (1) a reduction in the minimum investment in qualified investors' funds to CZK 1 million on the condition of performing the suitability test, (2) the refining of the sub-fund's legal regulations in order to better separate their assets and make the regulation work better in practice, (3) reducing the capital requirement for the SICAV to CZK 1, (4) mitigating the “pension” fund limits for investment in investment funds (so called ETFs), and (5) abolishing investment limits for qualified investors. Market representatives also significantly contributed to the new adjustment of mortgage bonds (covered bonds) in the amendment of the Bond Act, which is currently under discussion in the Chamber of Deputies. A number of positively perceived changes in the development of the capital market in the Czech Republic have also been brought by the Act on Investment Companies and Investment Funds, which, for example, modified the new legal form of a stock company with variable capital (so called SICAV) and allowed the creation of sub-funds.

## 4. Suggestions for specific measures

### 4.1 Measures to support households (investors)

Given the current, rather short-term, investment horizon of Czech households portfolios, and the need to provide the Czech citizens with long-term (yielding) investment choices, it is proposed to implement the following measures. These measures are primarily aimed at supporting the long-term investment of Czech households (investors), but other entities may also indirectly benefit from such measures; and the concerted action of other entities may eventually be necessary (including entities that are not directly governed by the government of the Czech Republic). The aim of these measures is in particular to provide more investment choices and remove the barriers, which do not allow the full development potential of long-term investment (investment horizon longer than one year<sup>32</sup>). The terms given in the tables for individual measures mean the planned submission by the government, whether as a legislative proposal, or as an informative document on the implementation of the measure.

#### 1) Long-Term Investments Account<sup>33</sup>

*Individual savings accounts* (or individual retirement account) are, in particular, widely used in “Western” world. Although the individual savings account might be referred to differently<sup>34</sup>, for the purposes of the Czech Republic, it is proposed to use the “Long-Term Investments Account” term to distinguish it from existing products (e.g. personal pension account under the Supplementary Pension Savings Act or savings account or asset account maintained by banks). In 2018, the European Commission also expressed the interest to be concerned with this topic within the frame of the Capital Market Union.

The individual savings account is an investment account designed to create savings for retirement that is not taxed throughout its existence and is not taxed when withdrawn, if it is not an early withdrawal<sup>35</sup>. This account structure is not tied to a specific financial product so it can be used for savings deposits, investments in investment funds, investments in pension funds, or life insurance with an investment component. The main parameter set for this product should be the so-called “60 + 60 rule”, as it is already specified in the tax legislation, stating that the account cannot be cancelled or the money withdrawn (without any impact on tax or social and health insurance) before reaching the age of 60 and the account has to be opened for least 60 months (*i.e.*, if it is set up after reaching the age of 55, a possibility of cancellation shifts forward in time).

It is recognized that the state already supports saving for retirement, especially via (1) pension funds, *e.g.*, participation funds and transformed funds such as by providing tax support, including support for employers' contributions and state contributions and through (2) life insurance such as by providing tax support, including employer's contributions. Nonetheless, there are other ways of “saving” for retirement, for example through the investment fund (*e.g.* life cycle funds) or direct investments in shares or debts. Theoretically speaking, this measure may not have a major impact on the state budget,

<sup>32</sup> It is generally recommended that an investment horizon in the capital market shall be at least 5 years; however, the investment horizon of retirement saving tends to be longer (in some cases more than 30 years).

<sup>33</sup>The recommendations of the World Bank are: Consider an Individual Savings Account regime, with tax incentives for contributions and account holder control over investment decisions.

<sup>34</sup> These include, for example, Individual Savings Account since 1999, previously referred to as Personal Equity Plan and a tax-exempt special savings account since 1986, in the UK, 401k or Individual Retirement Account in USA since 1978, Registered Retirement Savings Plan in Canada since 1957, KiwiSaver in New Zealand since 2007 and long-term investment savings in Slovakia since 2016

<sup>35</sup> However, there may be different combinations of these accounts, for example, in the US there are 4 types of these accounts: (a) (Traditional) 401k, (b) Roth 401k, (c) Traditional IRA and (d) Roth IRA. The “traditional” forms tax the output but not the input, while the Roth form’s input is already taxed (typically at the income tax rate) and therefore the output is not taxed.

especially if there is a single limit for all the “pension products” for a given taxpayer (and even if this limit is increased, it would not be possible for all citizens of the Czech Republic to fully benefit from it). This measure should not lead to a transfer of funds from one “savings” scheme to another (e.g. from pension funds to mutual funds), even though such an impact cannot a priori be ruled out. However, the introduction of this measure should primarily offer citizens of the Czech Republic more opportunities for the retirement savings and motivate them to save more (if an individual limit is raised). This is also linked to the European Commission's effort to introduce the so-called Pan-European Pension Product (PEPP), whose primary purpose is to facilitate retirement savings with regard to intra-EU mobility of persons.

PLAN	CONCERNED ENTITIES	TERM
Propose the introduction Long-Term Investments Account and submit the draft amendment(s) of the concerned laws to the government, in particular the Tax Code or the Capital Market Business Act	MF, Ministry of Labour and Social Affairs (hereinafter referred to as “MPSV”), AKAT, APS CR, the Czech Insurance Association (hereinafter referred to as “CAP”), the Czech Banking Association (hereinafter referred to as “CBA”), Czech-Moravian Confederation of Trade Unions	Q4 2019

### 2) Make the investments in the investment funds more attractive upon the investor’s initiative<sup>36</sup>

In the Czech Republic, most of securities issued by investment funds are distributed through intermediaries whose commissions are paid from an “entrance fee”, which usually amounts to 3% of the invested amount.. A reduction of the distribution fees in case of the investor’s investment initiative would benefit the investors themselves, as well as the capital market as a whole. Therefore, it would be appropriate to launch discussions in order to potentially lower costs of regulation while buying investments on the investor’s own initiative.

PLAN	CONCERNED ENTITIES	TERM
Initiate discussions on the possibility of lowering the costs while buying the securities issued by investment funds upon the investor’s initiative and, if necessary, propose appropriate changes to the regulation concerning such marketing without advisory.	MF	Q4 2019

### 3) Education of retail investors and investment consultants about capital market<sup>37</sup>

Financial literacy is defined as a set of knowledge, skills and attitudes necessary to achieve financial prosperity through responsible financial decision-making. The financial literacy of retail investors (consumers) is addressed by the National Strategy for Financial Education of 2010 (currently under

<sup>36</sup> The recommendations of the World Bank are: 1) Review the regulatory requirements surrounding direct marketing of funds’ securities to encourage investor access to collective investments. 2) Review the securities distribution system and build effective supervisory actions with a view towards better comparing costs to the investor to performance returns and sanction abusive behaviors.

<sup>37</sup> The recommendations of the World Bank is: Launch a program promoting financial literacy, possibly including educational video series on capital markets for investors.

review<sup>38</sup>). As part of this review, the role of capital markets could be highlighted for households with finances in surplus, particularly in relation to topics such as long-term investment or “savings”, especially “retirement savings”.

In relation to investment consultants (investment intermediaries), a change in regulation (with a transition period of 2 years) became effective at the beginning of 2018, which requires the mandatory composition of the uniform exam, the preparation of which was intensively contributed by both the MF and the CNB. Extensive market engagement is expected to prepare for this exam. In 2018, the MF, in cooperation with the European Commission, prepared an analysis of the most appropriate “communication strategy” in relation to the training of investment consultants on the capital market (but also in relation to the potential issuers and the professional investors).

PLAN	CONCERNED ENTITIES	TERM
When revising National Strategy on Financial Education take into account two topics. the capital market and long-term investments for households with finances in surplus	MF	Q4 2019
Engage actively in the activities that relate to examination of investment consultants so the examination can serve its purpose, ie to be effective	MF, EFPA Czech Republic, University of Finance and Administration (hereinafter referred to as “VSEF”), AKAT, ČBA, Czech Association of Financial Intermediaries and Financial Advisers (hereinafter referred to as “CASF”), Masaryk University, Kahn Academy, accredited institutions (for example VECTOR Certifikace)	Q4 2019

#### 4) Creation of the web centre (signpost) for consolidated information on securities and their issuers<sup>39</sup>

The information on securities in the Czech Republic is provided on a non-consolidated basis on the websites of various institutions (the BCPP, the Central Securities Depository (hereinafter referred to as “CDCP”), the CNB, the MF, the Commercial Register, news servers and other sites operated by private entities), which may be confusing for investors. Therefore, it would be appropriate to create a web centre (signpost) for consolidated securities information, which will contain clear information about where such information can best be found:

- 1) reports on actual market prices of securities,
- 2) reports on daily trading volumes of securities,
- 3) a prospectus relating to public offering or other available description of securities,
- 4) financial statements, annual reports and other information from issuers of securities,
- 5) relevant legislation, including available translations into the language customary in the capital markets.

Such a Web Centre should especially refer to the information, regarding all securities offered and traded in the Czech Republic that has to be compulsorily made public. This Web Centre should

<sup>38</sup> <https://www.mfcr.cz/cs/o-ministerstvu/verejne-diskuze/2018/navrh-revidovane-narodni-strategie-finan-31870>

<sup>39</sup> The recommendation of the World Bank is: Create a web-based “Securities Information Center”.

provide information in both Czech and English (with contact for queries) to provide a trusted source of information for foreign investors as well.

PLAN	CONCERNED ENTITIES	TERM
Create a web centre (signpost) for consolidated information on securities and their issuers	MF	Q4 2020

#### 5) Analysis of the availability of currency hedging<sup>40</sup>

Given that financial instruments on the foreign capital market are denominated in a currency other than CZK, Czech investors are exposed to a significant currency risk. The same applies to foreign investors when investing in Czech capital markets. Availability of hedging for Czech and foreign investors is necessary to the reduction of these risks and increasing the interest in cross-border investment. For small investors, there are enough mutual funds that hedge the currency risk at fund level. The availability of the currency hedging (EUR/CZK) seems sufficient at the moment.

PLAN	CONCERNED ENTITIES	TERM
Identify and remove obstacles of availability of currency hedging for investors	MF	Continuously

#### 6) Improving the flow of information from issuers to investors<sup>41</sup>

The World Bank points to a possible information gap between the issuers, central depository and the holders securities of these issuers with regard to announcements relating to corporate actions. As part of the transposition (entry into force June 2019) of the so-called “Shareholder Rights Directive”<sup>42</sup>, this issue has been sufficiently resolved, but the amount and type of information transmitted should be further analysed, for example, whether the new legislation requires issuers to send all relevant information to the CSD, and whether are these information properly submitted to the end-investors

PLAN	CONCERNED ENTITIES	TERM
Further analyse, whether the new legislation, in force since June 2019, requires issuers to send all relevant information to the CSD and whether this information is properly passed on to the end-investors and possibly propose further measures	MF, Ministry of Justice (hereinafter referred to as “MSp”)	Q4 2021

#### 4.2 Measures to support companies (issuers)

Exchange-traded stocks and bonds do not yet play a sufficient role in the financing of companies. SMEs are especially dependent on funding through retained profits and bank loans. Several activity lines are proposed in order to make the capital market funding opportunities for Czech enterprises more attractive (for example to increasing the Czech companies' level of awareness of the possibilities and benefits of the diversification of financial resources), thereby increasing efficiency not only in the financing of companies but also in the economic level of the state as a whole.

<sup>40</sup> The recommendation of the World Bank is: Explore ways to make the EUR/CZK hedging mechanisms more efficient.

<sup>41</sup>The recommendations of the World Bank: Require reporting companies, under law, to notify the CSD of all corporate events so that it may pass on this information to securities holders.

<sup>42</sup> Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement

## 7) Education of CFOs of SMEs on the possibilities of financing through the capital market<sup>43</sup>

Research conducted in January 2018 by the Chamber of Commerce of the Czech Republic and the Association of Small and Medium-Sized Enterprises and Tradesmen of the Czech Republic suggest that the low awareness of the capital market and the possibilities of its use is also problem in relation to managers, financial directors and potential issuers. They usually use bank loans when capital is needed, even if the issue of bonds or equity financing appears to be more advantageous in economic terms. In many instances they are unaware of these ways of financing. The finance directors should therefore be sufficiently educated in order to finance their debt and/or equity via the capital market in appropriate situations. The most effective methods of education for specific target groups should be determined on the basis of an analysis of the appropriate “Communication Strategy” in the field of the capital market and to be able to use current trends, such as green or sustainable financing. Such methods of education may for example take form of videos, handbooks, websites, workshops, conferences etc. As such, an involvement of market participants is presumed (in this respect, there has already been communication with, for example, Czech Chamber of Commerce, CzechInvest or BCPP).

PLAN	CONCERNED ENTITIES	TERM
Analyse the best communication strategy with the small and medium-sized enterprises a further realize proposed measures	MF (3501), European Commission (SRSP), Ministry of Industry and Trade (hereinafter referred to as “MPO”), Ministry of Environment (hereinafter referred to as “MoE”), CzechInvest, University of Economics (hereinafter referred to as “VSE”)	Q4 2019

## 8) Improving the conditions for the functioning of the so-called business angels in the Czech Republic<sup>44</sup>

The Ministry of Finance published a World Bank’s report on business angels in the Czech Republic<sup>45</sup> in October 2018. The term "business angel" does not have a Czech equivalent, but it is possible to see terms like, for example, "angel investor", "angel of business", "business angel" or just "angel", but it is best to stick to the internationally understood term the business angel. Business angel is a person, often wealthy, and usually experienced in business, who invests part of his personal assets directly (not through funds) into newly established companies with growth potential. In addition to capital, they "invest" their managerial experience, skills and contacts as well. Experienced business angels also know they may have to wait for return on their investments. They can therefore be a good source of "smart and patient" capital. Business angels can invest individually or as part of a syndicate to provide more effective access to information and a more rational investment of capital. In the syndicate, one business angel usually plays the lead role. Business angels play an important role in the economy. In many countries, they are the second largest source of external funding in newly founded businesses

<sup>43</sup> The recommendations of the World Bank: 1) Organize a specialized, targeted issuer outreach program for SMEs, to include workshops for potential SME issuers with supplementary handbook on capital markets; 2) Redouble efforts on outreach to potential issuers, including management education, targeted videos, workshops for potential issuers and supplementary handbook on capital markets.

<sup>44</sup> The recommendations of the World Bank is: Review the EC’s June 2017 report on tax incentives to support SME development, to determine which concepts might be incorporated into the Czech Republic’s capital market development strategy going forward.

<sup>45</sup> <https://www.mfcr.cz/cs/soukromy-sektor/kapitalovy-trh/podnikani-na-kapitalovem-trhu/2018/ministerstvo-financi-zverejnuje-zpravu-s-33352>

after the family and friends. They play an increasingly important role in providing venture capital, contributing to economic growth and technological progress. It is therefore in the interest of the Czech economy to seek for a highest possible quality environment for these investors. Part of this report was a set of recommendations that would be appropriate to implement.

PLAN	CONCERNED ENTITIES	TERM
Commission time-series data on angel investment activity to be updated annually (similar to existing venture capital market data).	MF, MPO	Q4 2019
Conduct a taxpayer base analysis to establish realistic expectations / targets for the number of individuals in Czech Republic who have the potential to be a business angel and repeat annually.	MF, MPO	Q4 2019
Commission a demand side survey targeting start-up founders/entrepreneurs on an annual basis.	MF, MPO	Q4 2019
Create a Czech National Angel Association (and become a member of BAE).	MF, MPO	Q4 2020
Introduce a self-certification system for business angels in the Czech Republic.	MF, MPO	Q4 2021

### 9) Analysis of the possibilities of the development of investment crowdfunding in the Czech Republic

Since May 2016, an investment crowdfunding platform Fundlift has been operating in Czech Republic. This platform has successfully funded 35 projects (90 % success of financing) as of May 2018, with a total value of CZK 183 million (with the average project size at CZK 5.2 million). The European Commission published a legislative proposal in March 2018, which also deals with investment crowdfunding. Although at present it seems that the successful operation of investment crowdfunding has not not confronted with major obstacle in the Czech Republic, it is advisable to continue to address this topic and, if necessary, to propose appropriate measures for the further operation and development of investment-crowdfunding platforms in the Czech Republic. At the same time, due care must be taken to ensure adequate protection for investors in cases where they are offered securities without prospectus (typically up to EUR 1 million) so as not to undermine their confidence in the functioning of the Czech capital market.

PLAN	CONCERNED ENTITIES	TERM
Analyse the possibilities of the development of investment crowdfunding in the Czech Republic and if applicable, propose other measures	MF, MPO	continuously

### 10) Analysis of the possibility of creating a simpler form of the joint stock company

Starting companies may face difficulties in trying to obtain funding through the capital market. A limited liability company now has some restrictions (such as the impossibility of publicly offering common certificates or the impossibility of issuing convertible bonds) that actually allow them only to finance through bonds. At the same time, the legal form of a joint-stock company may not be suitable for start-up entrepreneurs, especially in view of the relatively high capital requirement (CZK 2 million). Therefore, the possibility of having a simpler form of joint-stock company that will allow start-up companies to obtain financing via the capital market and otherwise than through business

angels or venture capital funds should be explored. A simpler form of joint stock company to support start-ups has existed in Slovakia since 2017 (the so-called Simple Company for Shares)<sup>46</sup>, a proposal for a simpler form of the joint-stock company (the so-called Simple Joint Stock Company) has been proposed by the Polish Ministry of Technology and Entrepreneurship.<sup>47</sup> The main advantages of Polish proposal include fast electronic registration (within 24 hours), basic capital of at least 1 Polish zloty, more flexible rules for organizational structures of this company and simplified rules for liquidation. Recently, successfully funded projects through the investment crowdfunding described above show that this type of financing could be of interest to Czech businesses. It is important to note that for a successful bond issue, a longer life of the company (now at least 3 years) and a stable cash flow generation would be required, therefore it may be more appropriate for start-ups to finance through equity and quasi-equity (including subordinated debt).

PLAN	CONCERNED ENTITIES	TERM
Consider introducing simpler form of joint-stock company and propose other needed legislative changes	MF, MSp, MPO	Q4 2020

### 11) Standardisation of provision of information by the issuers in English<sup>48</sup>

In order to attract foreign investors to the Czech capital market, the necessary prerequisite is making issuers to publish periodic reports and news even in English. This is already happening in many cases today, but examples of best practice that can serve as a model for other issuers should be supported. The disclosure of information in English should become a market standard, in particular by listed companies. Evaluating compliance with this standard could be part of the Corporate Governance Scoreboard (see below). Corporate Social Responsibility (CSR) should be monitored as part of this evaluation.

PLAN	CONCERNED ENTITIES	TERM
Promote publication of documents in English by issuers of securities, in particular in relation to listed issuers	MF	continuously

### 12) Internationalization of financial reporting<sup>49</sup>

Currently, companies with shares listed in a regulated market are required to use International Financial Reporting Standards (IFRS), which is administratively and financially demanding. It would be appropriate to analyse the possibility of using IFRS standards even for income tax base purposes. At the same time, consideration should also be given to the possibility of bringing Czech accounting regulation closer to IFRS that are internationally comprehensible and recognized by foreign investors.

PLAN	CONCERNED ENTITIES	TERM
Revise Czech accounting regulation with respect to IFRS and analyse the possibility to allow the use of IFRS for tax purposes	MF	Q4 2021

<sup>46</sup> [https://www.slovensko.sk/sk/zivotne-situacie/zivotna-situacia/\\_jednoducha-spolocnost-na-akcie/](https://www.slovensko.sk/sk/zivotne-situacie/zivotna-situacia/_jednoducha-spolocnost-na-akcie/)

<sup>47</sup> <http://en.cridolegal.pl/simplified-joint-stock-comapny-for-startups> ;

<https://www.mpit.gov.pl/strony/aktualnosci/prosta-spolka-akcyjna-mpit-rusza-z-konsultacjami/>

<sup>48</sup>The recommendation of the World Bank is: Require large and medium sized issuer information to be provided in English.

<sup>49</sup> The recommendations of the World Bank are: 1) Perfect and finalize the translation tables for using IFRS to generate the required tax reports; 2) Continue and complete the current pilot program for testing the translation tables for large enterprises; 3) Require investment firms and fund managers to report using IFRS; and 4) Reassess the application and need for investment funds and pension funds to use IFRS.

### 13) Introduction and the implementation of the “corporate governance scorecard”<sup>50</sup>

Corporate governance scorecards allow measurement and comparison of voluntary compliance with corporate governance reference benchmarks, which may be for example standards by the Organisation for Economic Co-operation and Development. The corporate governance scorecard allows comparing progress over several periods and comparing individual companies within one or more countries. The international comparison of implementation is published by the International Finance Corporation (IFC), member of the World Bank Group<sup>51</sup>.

The purpose of introducing such scorecards is, among other things, to help regulators monitor compliance with best practice standards, to help companies make informed decisions, to analyse weaknesses of the companies in their governance, and help market associations evaluate management practices of their members, and help them to improve the current situation if needed

PLAN	CONCERNED ENTITIES	TERM
Support the introduction and subsequent usage of corporate governance scorecards	MF, MSp, BCPP	Q4 2020

### 14) Support of the money market development<sup>52</sup>

The effort to develop the capital market in the Czech Republic should also focus on the money market, where the short-term debt, for example, receivables of individual companies, is traded. It is one of the most important liquidity management tools. The Ministry of Finance's internal analyses shows that most of the businesses deal with short-term liquidity problems through banking products such as Overdraft Loans. One instrument that can be used in the money market is factoring. In 2017, the volume of the largest factoring companies was CZK 113 billion. However, non-bank entities formed only about 2 % of the factoring. A better developed money market could help reduce the costs of short-term assets and would lead to cheaper and more efficient liquidity management of the companies.

PLAN	CONCERNED ENTITIES	TERM
Analyse possibilities of the money market development and, if appropriate, propose other measures	MF, CNB	Q4 2019

### 4.3 Measures to support the professional market participants (market infrastructure)

The market infrastructure, represented by the professional participants of the capital market, forms the backbone of the entire capital market system without which it cannot function. Strong market infrastructure represents jobs with high value-added, which helps the economic growth in the state and the transformation of the national economy towards the structure of Western economies. The following measures should help to develop it.

<sup>50</sup>The recommendation of the World Bank is: Consider the creation of a “Corporate Governance Scorecard” and award winners in publicized events, in order to raise awareness of corporate governance and positively incentive any reputational exposure of new listed issuers.

<sup>51</sup>[https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+cg/resources/toolkits+and+manuals/corporate+governance+scorecards](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/toolkits+and+manuals/corporate+governance+scorecards)

[https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+cg/resources/toolkits+and+manuals/toolkit2\\_codes\\_of\\_best\\_practice](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/toolkits+and+manuals/toolkit2_codes_of_best_practice)

<sup>52</sup> The recommendations of the World Bank are: 1) Encourage Securitization of Invoice Pools by Third Party Agents as Arrangers; 2) Permit Investment Funds to invest in Factored Receivables; 3) Develop reverse factoring as a financial instrument; and. 4) Allow SME Receivables to be listed.

## 15) Greater involvement of pension funds in the functioning of the capital market in the Czech Republic<sup>53</sup>

Despite the fact that some changes have been made, the allowed investments for pension funds (transformed and participant funds) are still limited in the Czech Republic. In western countries (for example, the UK), pension funds are traditionally significant clients of private equity funds<sup>54</sup>, which enables them to achieve attractive appreciation within a longer time horizon. In the Czech Republic the abilities of the pension funds are limited de facto by strict regulation of fees (especially transformed and participant management fee). Therefore, the new type of “fund for alternative investments” should be considered with no regulation on fees to allow for more long-term investments in particular, private equity funds.

Another limitation for the classic development of the capital market in the Czech Republic is the guarantee of non-negative returns on transformed funds, which effectively prevents them from investing in more volatile assets (typically shares or corporate bonds) that can generate interesting returns over the longer term. Pension funds play probably the most important role for capital markets abroad, whether it is Poland, the Netherlands or Norway, because they are so-called long-term investors who manage a huge amount of invested funds. Therefore, opportunities should be explored to “relax” retirement savings of Czech citizens so that all - citizens of the Czech Republic could potentially benefit potentially higher yields of their long-term savings, pension funds with greater opportunities for valorisation of managed assets and the real economy with greater availability of options financing through the capital market. There must be no violation of the fundamental “prudent investor” principle governing pension funds worldwide, regardless of national regulation. From this point of view, pension funds are very conservative investors who put some of the most demanding requirements on their investments (for example, invest only in so-called benchmark issues<sup>55</sup> of covered bonds), but this prudence fulfils in regard of their obligations towards their “investors”, not because their investments are limited by regulation.

The current regulation of pension funds in the Czech Republic allows these funds to invest only in very safe low-cost assets, which are usually only government bonds; in fact, citizens' saving in the pension funds does not contribute to the financing of the real economy and the economic growth of the Czech Republic. As a result of the analyses made, it appears that it is almost unrealistic to change the guarantee of non-negative returns for transformed funds, other options should be analysed as to how the funds invested in these funds for several decades can be released with the consent of the participants in these funds. One of the options offered is, for example, to allow simultaneous savings in both transformed and participation funds (state support would only be provided in relation to one of these products) or consider other options to motivate participants to transfer funds to their participating funds.

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<sup>53</sup> The recommendations of the World Bank are: 1) Expand the range of investable securities, to include private equity, private placements and infrastructure bonds; 2) Better exploit asset pooling methods for fund management and accounting; 3) Provide targeted incentives to migrate the Transformed Fund assets into higher growth Participant Funds and/or ISAs; 4) Modify the minimum return guarantee provision to eliminate the year by year measurement; and 5) Additional: Design broader, low cost options for annuities and phased withdrawal products.

<sup>54</sup> A private equity fund is a fixed-term fund (typically 10 years) and invests money from institutional investors (usually pension funds and life insurance companies) into companies that are not quoted on the stock market (because they do not reach the required size -- market capitalization). The fund manager (General Partner, GP) invests part of his money together with the money earned from passive investors (limited partners, LPs) in order to be involved in the success of the investment. The management fee consists of the fund's management charges 2 % per annum and 20 % of the profit.

<sup>55</sup> Issuances above EUR 500 million that meet requirements of the directive CRD (2013/36/EU) and its implementing regulation LCR (2015/61).

At the same time, it should be noted that currently the average monthly deposit is just over CZK 600, which will not allow existing participants to sufficiently finance their income from the first pillar of the pension system if their income in the first pillar is to decrease in the future (70 % of its current real value). Therefore, other options should be considered to motivate participants to higher monthly deposits, for example through additional state support for deposits over 1 000 CZK per month or (this is also related to the individual savings account topic described above). Possible higher government expenditures could be compensated, for example, by limiting state support only to a certain age of the participant (e.g. until the retirement age).

PLAN	CONCERNED ENTITIES	TERM
Propose the introduction of a new subscription fund with higher management fees that will be able to invest in alternative assets (e.g. in private equity funds)	MF	Q4 2019
Revise the state aid system in relation to pension funds so that participants are motivated to increase monthly deposits and transfer funds saved from the transformed funds into participating funds and at the same time consider limiting the granting of state aid to the age of the participant	MF	Q4 2019

#### 16) Making the sub-funds more attractive

Currently, sub-funds (investment compartments) can only be created by SICAV (joint stock company with variable capital). There is no reason not to allow this for other legal forms, especially if they demand to do so. Basically, it is just about proposing acceptable legislative solutions; common in the other EU member states. In the case of sub-funds, it is possible to combine the investment of one particular investor in several different sub-funds of a single investment fund, typically due to the diversification of the investor's portfolio. However, over time, the requirements for the distribution of investor's exposure in each sub-fund change, e.g. due to a change in the investment preferences. In the event of such changes (i.e., a transfer between investment compartments of one SICAV), it is desirable that no undue taxation arises at the investor level, as the investor does not generate profit, the securities are barely redistributed inside the SICAV. Similarly, this reasoning applies to securities of different classes.

PLAN	CONCERNED ENTITIES	TERM
Allow the creation of sub-funds also for other legal forms than SICAV	MF	Q4 2019
Allow the so-called "time test" to be maintained for the transition between sub-funds of one SICAV	MF	Q4 2020

#### 17) Support the XML format usage when requesting information from financial institutions (in particular in relation to distrainers)

The relevant solution, to minimise costs, would be obligatory use of XML format, when requesting information from financial institutions, because this format allows automatic processing, which leads to a significant reduction in the costs borne currently by the financial institutions. This issue goes beyond the capital market, but it also concerns the development of the capital market, because the more Czech citizens will invest in the capital market (whether directly or through investment funds), the more questions will be raised by executors (notaries and others) to professional capital market participants where the debtor who is being executed may "hide" funds.

PLAN	CONCERNED ENTITIES	TERM
Support the XML format usage while tracing the financial assets.	MF, MSp, General Financial Directorate, Chamber of Distainers,	Q4 2019

### 18) Analysis on the possibility of the modernisation of the register of dematerialised securities<sup>56</sup>

The possible introduction of the so-called “multi-level register of dematerialised securities” has been under discussion among market participants for a long time. A multi-level register is a globally accepted standard that brings simplicity, flexibility, and legal certainty. It thus greatly increases the attractiveness of the market for foreign investors, directly supporting shareholder greater engagement.

Increasingly, the issue of dematerialisation of securities on a distributed ledger technology (DLT) is also being discussed. Using a distributed ledger technology can help to replace some securities (i.e. instruments) with an electronic record to facilitate the initial coin offering of the issuer. This system of securities holding and its setting requires a rigorous discussion and analysis given the constraints that the current system has, compared to the efficiency, effectiveness and consistency of the new technical solution. In 2018, as part of the transposition of the so-called Shareholder Rights Directive<sup>57</sup>, there was a discussion with the market participants on the multi-level registration of dematerialised securities. At present no reasons have been found for changes in the existing financial instruments register. It is therefore appropriate to do another evaluation after a certain amount of time.

PLAN	CONCERNED ENTITIES	TERM
Consider revision of the register of dematerialised securities, including multi-tier register and DLT technology, in discussion with other stakeholders and propose further measures	MF, MSp, MPO	Q4 2020

### 19) Support for the trading of corporate bonds on the capital market<sup>58</sup>

Corporate bonds<sup>59</sup> represent an important part of the capital market. They provide a suitable alternative to credit financing for companies (both are debt financing, however, in some situations, bond financing may be more advantageous, especially as bonds are not repaid on a regular basis, repayment of principal can be refinanced by new bond issues; the issuance conditions are primarily the issuer, including possible covenants). On the other hand, corporate bonds represent an interesting investment

<sup>56</sup> The recommendation of the World Bank is: In order to make the market more attractive to foreign investors, amend the CMA and Civil Code to recognize the ‘chain of nominees’ concept.

<sup>57</sup> Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

<sup>58</sup> The recommendation of the World Bank is: Allow short term government debt securities as collateral for member operations on the PSE.

<sup>59</sup> A specific category, besides government bonds and corporate bonds, consists of covered bonds, which are traditionally called “mortgage bonds” in the Czech Republic. These are bonds the issuer of which is a bank and which are usually covered by receivables from mortgage loans (or public debt claims). The European Commission proposed in March 2018 the harmonization of the basic elements of the covered bonds legislation in the EU. Because covered bonds are primarily used to finance banks (and mediated mortgage loans), they can not be considered as typical corporate bonds that serve to finance the real economy (businesses). Similarly, corporate bonds should not be considered as other bonds issued by banks (and therefore, bonds issued by banks are often reported in statistics separately from corporate bonds). Nevertheless, it can be stated that bonds issued by banks have common features rather with corporate bonds than government bonds. Another specific category is municipal bonds (bonds issued by municipalities and regions), which in turn show the common features of bonds rather than corporate bonds, but in fact they are not the same.

opportunity that provides higher yields than government bonds (or bank deposits) and at the same time they are so-called *fixed-income instruments* are not as volatile as they are not dependent on the success of their issuer's business, because these instruments have higher seniority than shares or subordinated debt. Moreover, if they are secured by assets (such as real estate), they can represent a higher quality asset and given the traditional functioning of the security agent in the Czech Republic, this does not pose a problem even in the event of a claim for pledges (in the near future, even more standardized with regard to similar treatment abroad).

Although investing in bonds can be “buy and hold” (holding of the bond until maturity), a well-functioning secondary market helps to properly evaluate the bonds promoting liquidity, which further extends the range of interested investors and the amount of funds invested. At the same time, the ability to sell bonds easily in a liquid secondary market increases the likelihood that these bonds can serve as collateral (for example, in repo operations). In Poland, for example, the bond market (Catalyst) is relatively successful in addition to the more familiar NewConnect stock market. From this point of view, the possibilities of developing the secondary market for corporate bonds should be explored and obstacles to such development should be removed.

PLAN	CONCERNED ENTITIES	TERM
Consider possibilities to support the trading of corporate bonds	MF, CNB, CDCP, BCPP, AKAT, CBA	Q4 2019

#### 20) Development and publication of instructions on the initial due diligence guidelines for foreign investment funds<sup>60</sup>

It would be appropriate to develop and publish due diligence materials in English. The materials should include an analysis of the compliance with all applicable international laws (such as the analysis of compliance with the regulation 17f-7 of the American Investment Company Act 1940), as well as an analysis of compliance with all relevant international standards. Similar material could be found, for example, on Wiener Börse AG's website, which is a sister company of the BCPP.

PLAN	CONCERNED ENTITIES	TERM
Develop and publish guidance on initial due diligence for foreign investment funds, for example, according to the pattern of the Vienna Stock Exchange	MF, BCPP	Q4 2020

#### 4.4 Measures to support the Czech Republic (the State)

Although all previous measures contribute indirectly to the economic development of the Czech Republic, the following measures concern the immediate support of the state activities.

#### 21) Analysis of other options of the development of the government securities market<sup>61</sup>

The prices for government securities form the basis for the determination of the prices of all other fixed income securities (most notably corporate bonds). The government securities market is a reliable benchmark for maturities of parallel corporate bonds and increases the efficiency of that market. It is necessary to evaluate the effect of the government securities on the relationship between prolonging maturity and yield on investments. Furthermore, the possibility of trading government securities on the BCPP should be analysed.

<sup>60</sup> The recommendation of the World Bank is: Prepare a due diligence package on the PSE/CSD and post it to the web.

<sup>61</sup> The recommendations of the World Bank are: 1) Consult with the market traders to obtain their views on the yield curve; and 2) Consult with the MoF Debt Management Department to explore tenor consolidation.

It is important to open this market to small investors in addition to institutions. They are, in principle, the safest asset for capital market investment, and although they do not serve directly to finance the real economy, trading with them enables the development of market infrastructure.<sup>62</sup>

PLAN	CONCERNED ENTITIES	TERM
Analyse the impact of government bonds on the Czech capital market and also analyse the impact of the Czech capital market on the government bonds.	MF	continuously

## 22) Active involvement in pan-European and global initiatives

The European Commission aims to support SMEs, employment and growth. Within these goals, it creates a range of tools that the Czech Republic could learn to use in order to further develop the Czech capital market. These include, for example, the European Fund for Strategic Investments (so-called Juncker Package) or so-called Innovative Financial Instruments (the partial replacement of EU subsidies by loans, guarantees and investments). The Czech Republic should also endeavour to finance other projects in the field of capital market development through the Structural Reform Support Program of the European Commission, which is primarily intended for the development of the Central and Eastern European region. Some projects undertaken within the framework of the programme have already taken place or are under way. In the context of the capital market, these include: 1) Analysis of the capital market in the Czech Republic and recommendations for its further development, 2) Preparation of the National Strategy for the Development of the Czech capital market, 3) Development of a communication strategy in the field of capital market; and 4) Analysis of Czech business angels and their support. It would also be appropriate, for example, to actively cooperate with the World Bank, the International Monetary Fund (IMF), the European Investment Bank (EIB), the European Investment Fund (EIF), the European Bank for Reconstruction and Development (EBRD) and the International Organization of Securities Commissions (IOSCO). Account should be taken of experience with such cooperation abroad in other countries, in particular the countries of Central and Eastern Europe.

PLAN	CONCERNED ENTITIES	TERM
Enhance active cooperation with international organizations that can help develop the Czech capital market	MF, CNB, MPO, Office of the Government, World Bank, IMF, EIB, EIF, EBRD, IOSCO	continuously

## 23) Active involvement in the law-making process in EU<sup>63</sup>

For the Czech capital market, it is essential to support the active participation of regulators in the negotiation of EU legislation, including the implementing legislation negotiated by the European Securities and Markets Authority (ESMA) or the European Commission committees. This is the only way to ensure that the interests and specificities of the Czech capital market are sufficiently taken into account at EU level. The objective of active participation should be to strive to reduce regulatory burdens (see, for example, the European Commission's REFIT program) resulting from the Union's

<sup>62</sup> In Slovakia, for example, the trading with government bonds was 96 % of the total volume of all trades on the Bratislava Stock Exchange in the year 2017.

<sup>63</sup> The recommendations of the World Bank are: 1) Encourage participation in EU-wide committees impacting capital market regulation, so that the Czech market's needs and specificities are better reflected at EU level; And 2) Consider a system to second staff to ESMA and other European authorities.

(not only) capital market rules and the principle of proportionality, taking into account the size and scope of the activities undertaken by market participants.

PLAN	CONCERNED ENTITIES	TERM
Support greater activity in the law-making process in EU	MF, CNB	continuously

#### 24) Securing internships for state officials and regulators<sup>64</sup>

Promoting the internship of state officials and regulators (i.e. MF and CNB staff) at market participants is very necessary for the development of their competence and erudition and for the understanding of regulated entities and their needs. This is also related to the “bottom-up” approach mentioned above. These internships have already been successful in the past, but it is desirable to allow these internships on a regular basis, at least once every 2 years. In view of the fact that most of the capital market participants are controlled abroad, it would be appropriate to allow these internships also at their foreign mothers, which will allow state officials and regulators to get international comparisons as well.

PLAN	CONCERNED ENTITIES	TERM
Enable internship for people preparing capital market regulation at the capital market participants	MF, CNB, AKAT, CBA	continuously

#### 25) Monitoring the criteria of the status of developed capital market according to MSCI<sup>65</sup>

The MSCI indexes are important guidelines for foreign investors considering whether to enter the capital market in an individual country. Achieving the status of a “developed capital market” means that the investors are more interested in investing in the country than in case of the “emerging capital market” status – the current status of the Czech Republic<sup>66</sup>. The Czech Republic meets the requirements of MSCI in terms of gross domestic product per capita (the current requirement is at least USD 15 595), however, for obtaining the status of a “developed capital market” by the MSCI index there is a need to have at least 5 issues with a market capitalization of USD 3.2 billion, of which at least USD 1.6 billion must be traded on the stock exchange. For P/E = 15 and 22 CZK/USD exchange rate, this criterion can only be met by companies with a net profit of at least CZK 4.7 billion. Such profit was achieved in the Czech Republic in 2017 by very few companies.<sup>67</sup> While, for example, with Škoda Auto an estimated market capitalization would have been USD 21.7 billion and would have traded about 7 % of its shares on the BCPP, Agrofert would have an estimated market capitalization of USD 3.3 billion, and according to MSCI would need to trade at least 49 % of the shares. In addition, MSCI requires liquidity for at least 20 % of the annualized traded value ratio (ATVR) for, for

<sup>64</sup> The recommendation of the World Bank is: Consider a system to second staff to ESMA and other European authorities.

<sup>65</sup> The recommendation of the World Bank is: Seek to elevate the Czech market’s MSCI rating and incorporate the evaluation criteria within the capital market development roadmap as desired outcomes.

<sup>66</sup> Available on the internet: <https://www.msci.com/market-classification> or: <https://www.msci.com/index-methodology>

<sup>67</sup> Such as Škoda Auto (CZK 31.8 billion), Energy and Industrial Holding (CZK 22.5 billion), CEZ (CZK 18.9 billion), Československá obchodní banka (CZK 17.1 billion), Česká spořitelna (CZK 14.6 billion), Komerční banka (CZK 14.4 billion), Unipetrol (CZK 8.7 billion), Czech Property Investments (8.4 bn CZK), UniCredit Bank (CZK 7.6 billion), Hyundai Motor Manufacturing Czech (CZK 6.7 billion), O2 Czech Republic (CZK 5.6 billion) and Agrofert (CZK 4.8 billion). In theory, foreign companies with strong Czech ties, such as PPF (net profit of CZK 16.5 billion), innogy group (formerly RWE) in the Czech Republic (10.5 bn CZK) and Penta Group (CZK 6.2 billion), could be also considered in this regard.

example, Škoda Auto, which represents an annual trade volume of at least USD 4.34 billion (CZK 95.5 billion) and Agrofert at least USD 660 million (CZK 14.5 billion).

It should also be noted that the Czech Republic's shift to a higher category would mean a reclassification with regard to Large Cap (from USD 8.6 to 17.2 billion), Mid Cap (from USD 3.2 to 6.4 billion), and Small Cap (from USD 334 million to 668 million).<sup>68</sup> Nevertheless, it is appropriate for the Czech Republic to continuously monitor and evaluate the situation and, if necessary, to strive for a shift in the criteria for inclusion in the index of developed capital markets under MSCI.

PLAN	CONCERNED ENTITIES	TERM
Monitor the criteria in the Czech Republic in view of the possible future achievement of the status of the “developed capital market” according to the MSCI index	MF	continuously

## 26) Education of the state-controlled companies about the possibilities of financing through the capital market<sup>69</sup>

It is in the interest of the Czech Republic and the Czech capital market to encourage<sup>70</sup> state-controlled companies to satisfy their needs to finance their debt via the capital market (or at least to consider this option), i.e. the issue of bonds, which should be in line with their need to obtain the most efficient financing. This type of financing is already used by Czech Aeroholding, Prague Airport, Czech Railways, Czech Export Bank or CEZ.

PLAN	CONCERNED ENTITIES	TERM
Educate state-controlled companies about funding opportunities through the capital market	MF, other relevant ministries	continuously

## 27) Make available translation of the laws regulating the capital market into English<sup>71</sup>

As it is necessary to cooperate internationally (the capital market is, by its very nature global), the availability of translations of the laws governing the capital market, at least to English, which is considered the usual language in the world of international finance, is necessary. The available translations should be kept up to date. The CNB has been translating and publishing its regulations on its website for a long time and the MF has recently launched translations of selected laws. It would be appropriate to continue in this good practice.

PLAN	CONCERNED ENTITIES	TERM
Ensure the availability of up-to-date versions of the legislation governing the capital market in English	MF, CNB	continuously

<sup>68</sup> Which would mean, for example, (according to the current market capitalization value as of 30 May 2018) for ČEZ (USD 13.4 billion) a move from Large Cap to Mid Cap for O2 Czech Republic (USD 3.9 billion) and VIG (USD 3.6 billion) move from Mid Cap to Small Cap and Kofola (USD 371 million), Fortuna (USD 476 million), CETV (USD 570 million), STOCK (USD 650 million), or Pegas Nonwovens (USD 355 million) elimination from the index. Erste Group (USD 17.8 billion), Komerční banka (USD 7.8 billion), Moneta Money Bank (USD 1.8 billion), Philip Morris (USD 1.3 billion), TMR (USD 213 million) Pražské služby (USD 184 million), Energoaqua (USD 85 million), TOMA (USD 81 million) and NWR (USD 26 million) would not be a moved between categories.

<sup>69</sup> The recommendation of the World Bank is: 1) Encourage SOEs to meet their debt financing needs through the capital market, consistent with their need to obtain the most efficient financing.

<sup>70</sup> This, of course, must not conflict with the requirement of legislation (in particular Act No. 90/2012 on commercial corporations) not to give to the relevant corporate bodies the guidelines on business management.

<sup>71</sup> The recommendation of the World Bank is: Require applicable laws and rules to be translated into English.



## 6. Conclusions

This National Strategy is designed to support the development the capital market in the Czech Republic and thus boost investment, employment and growth for the national economy. The key to the long-term sustainable development is above all the stability and predictability of regulatory environment and close cooperation with market participants when creating new regulation. The implementation of the proposed measures should significantly contribute to capitalizing on the potential of the capital market in the Czech Republic and addressing some of the structural factors that currently limit it. While the specificities of the capital market in the Czech Republic may require a longer period of time to achieve a significant shift, the consistent application of the proposed measures and principles should lead to a significant improvement in the use of the capital market for the development of the real economy in the Czech Republic by the year 2023. In view of the wide variability of the proposed measures and the number of stakeholders, the proposed measures must be coordinated. Consequently, the Strategy was consulted in its preparation with stakeholders, their comments were taken into account in the Strategy, and these entities expressed their support to the Strategy. Taking into account that the regulation and development of the capital market falls under the responsibility of the Ministry of Finance, the Ministry of Finance is entrusted with the coordination of this Strategy, which will regularly inform the government of the Czech Republic about the progress in implementing individual measures and about the development in the monitored indicators. Since the capital market is constantly evolving (not only in the Czech Republic) and faces a number of new trends, this National Strategy should be subjected to regular updates (at least once in five years).

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## The list of abbreviations

AFME	Association for Financial Markets in Europe
AKAT	Czech Capital Market Association
APS CR	Association of Pension Companies of the Czech Republic
BCPP	Prague Stock Exchange
BIS	Bank for International Settlements
CDCP	Central Securities Depository Prague
CMU	Capital Markets Union
CVCA	Czech Private Equity and Venture Capital Association
CAP	Czech Insurance Association
CASF	Czech Association of Financial Intermediaries and Financial Advisers
CBA	Czech Banking Association
CNB	Czech National Bank
CR	Czech Republic
EBRD	European Bank for Reconstruction and Development
EFSI	European Fund for Strategic Investments
EIB	European Investment Bank
EIF	European Investment Fund
ELTIF	European Long Term Investment Funds
ESMA	European Securities and Markets Authority
EU	European Union
DLT	distributed ledger technology
GNI	gross national income
GDP	gross domestic product
HK CR	Czech Chamber of Commerce
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
MF	Ministry of Finance of the Czech Republic
MoE	Ministry of Environment
MPO	Ministry of Industry and Trade of the Czech Republic
MPSV	Ministry of Labour and Social Affairs of the Czech Republic
MSP	Ministry of Justice of the Czech Republic
OECD	Organisation for Economic Co-operation and Development
PEPP	Pan-European Pension Product
SICAV	joint stock company with variable capital
SMEs	small and medium sized enterprises
SRSP	Structural Reform Support Programme
VŠE	University of Economics Prague
VŠFS	University of Finance and Administration Prague