Ministerstvo financí
ČESKÉ REPUBLIKY

REPORT ON FINANCIAL MARKET DEVELOPMENTS IN 2014

June 2015

CONTENTS

The data presented in this report were obtained from the specified sources between April and May 2015.

SUMMARY OF DEVELOPMENTS IN 2014

Macroeconomic Situation and External Development

Year-on-year, the Czech Republic's real GDP increased by 2.0%. For the first time since 1993, the ratio of the current account of the balance of payments to GDP reached a positive value in 2014, specifically 0.6%. During the entire year, the year-on-year inflation rate fluctuated much below the CNB's inflation goal. At the end of the year, it reflected a growth of 0.1%, resulting primarily from the continuing negative value of the production gap and the significant decrease in petroleum prices at the end of the year. Over the course of 2014, the Czech crown weakened by 1.1% in relation to the euro to a rate of 27.7 CZK/EUR and by 14.8% in relation to the dollar to a rate of 22.8 CZK/USD. The exchange rate thus remained above the unilateral exchange rate commitment of 27 CZK/EUR as published by the CNB in 2013.

Funds available in the Financial Market

The total volume of funds increased by 4% during 2014 to attain a value of CZK 4.6 trillion. The greatest growth, in both relative as well as absolute terms, was recorded for the resources that were placed in investment funds. However, deposits with credit institutions continue to be the segment that holds the largest share.

Structure of Household Savings

Total household savings kept in intermediary financial market products increased by 7% year-on-year to reach a value of CZK 2.8 trillion. Once again, there was a noticeable outflow of resources in the case of term deposits (their share of total savings decreased by 1.6 pp), with the funds moving to non-term types of accounts. In addition, there was a decrease in the share of savings held in building savings schemes (1.6 pp) and in life insurance (0.6 pp). Conversely, the share of household savings kept in investment funds and pension funds recorded an increase (by 1.5 pp and 0.6 pp, respectively).

Financial Market Entities

There were only slight changes in the number of the entities in each of the segments, because the basic characteristics of the institutional structure of the Czech financial market have developed naturally. In the credit union sector, the operating licence of WPB Capital was revoked due to long-term unresolved deficiencies. The individual categories of the participating funds started to be consolidated in the pension management company sector. The number of insurance intermediaries continues to increase.

Banking Sector

The total volume of banking sector assets increased by 3.3% to CZK 5.3 trillion. This, however, reflects a decrease of 7.7 pp in relative growth. The reported pre-tax profit totalled CZK 76.4 billion, which reflects a year-on-year growth of 4.3%. Historically, this is the second best result that has ever been achieved. The overall capital ratio of the banking sector increased to 17.8%.

Interest Rates

The CNB kept the base rate (the 2W repo rate) at 0.05% during the entire year and continued to maintain its exchange rate commitment, thus keeping market interest rates at the lowest they have ever been. The APR for new consumer loans decreased by 0.17 pp to 14.86%. In the case of the APR for residential real estate, the decrease was even more significant – by 0.54 pp to 2.94%.

Deposits and Loans

The volume of bank deposits grew by 2.9% and attained a level of CZK 3.4 trillion at the end of the year. There was also an increase in the volume of bank loans, specifically by 4.8% to CZK 2.6 trillion. However, as compared to 2013, the rate of the increase for both indicators was lower (3.8 pp in the case of deposits and 1.7 pp for loans). The indicator reflecting the share of non-performing loans to total client loans increased slightly from 5.9% to 6% over the course of the year. The ratio of client deposits to client loans, which has been stable in the Czech Republic over the long-term, reflected a slight decrease of 3.5 pp to a level of 143%.

Mortgage Market

The unpaid contractual principal for mortgage loans provided to households grew by CZK 50.3 billion and reached CZK 681.4 billion at the end of 2014. As compared to 2013, the year-on-year change decreased by 1.3 pp to 8.0%. Mortgage loan rates, as reported by Hypoindex, decreased during the entire year and reached a level of 2.37% at the end of 2014 (reflecting a change of 0.69 pp as compared to the end of 2013).

Building Savings Banks

In 2014, 481,000 new building savings contracts were signed, reflecting a year-on-year increase that is 3.3 pp higher than in 2013. However, the total number of contracts and the total saved amount decreased. The situation with loans was not better. The total volume of loans provided by building savings banks decreased by 4.5% over the course of 2014 to a level of CZK 249.6 billion, and the volume of new loan contracts signed with building savings banks decreased to CZK 37.3 billion, which is 9.6% less than in 2013.

Credit Unions

In 2014, the CNB revoked the operating licence of the credit union WPB Capital, spořitelní družstvo. This affected the way in which the individual indicators developed, and, as a result, the overall balance sheet for the entire sector decreased year-on-year by 0.43% to CZK 31.3 billion. Specifically, the volume of accepted deposits decreased by 0.3% and the volume of provided loans dropped by a very significant 8.0%. The share of non-performing loans in the total number of receivables increased by 18.6% year-on-year and is approximately four times higher than in the banking sector. In spite of the indicators, the number of credit union members increased by 6.7% during the year to 57,179.

Regulated Markets

The main PX index recorded a decrease of 4.3% and fluctuated at between 850 to 1080 points. The decline in trading activity continued in 2014 reflecting a year-on-year decrease of 8.4% to CZK 166.4 billion, particularly in the largest segment of shares.

Securities Dealers and Asset Management

The trading volume in the securities dealer sector increased by 28.6 % year-on-year to CZK 93.1 trillion. This significant increase is due to the activities of non-bank securities dealers, who, over the course of 2014, closed trading deals involving the assets they manage for their clients at a level that was CZK 11.9 trillion higher than in 2013. In addition, bank securities dealers closed trading deals on their own account at a level that was CZK 11.3 trillion higher than in 2013. As result, the dominant position of bank securities dealers weakened and their share of trading deals within the entire sector was only 64.3%, reflecting a year-on-year decrease of approximately 4.5 pp. The volume of managed assets increased by 13.1 % in 2014 to CZK 1,102.7 billion.

Investment Funds

In 2014, the volume invested in collective investment funds grew by 21.9 % (CZK 59 billion) and, at the end of the year, CZK 328.9 billion was invested in these funds. The value of the assets in domestic funds increased by CZK 37.5 billion as opposed to only CZK 21.5 billion in the case of foreign funds. Mixed funds saw the greatest influx of new resources and their assets increased by CZK 52.2 billion, reflecting a relative growth of 101.4%. These were followed by bond funds, which recorded an increase of CZK 20.2 billion, reflecting a relative growth of 22.9%. The volume of the assets managed in qualified investment funds increased by CZK 3.4 billion in 2014 to CZK 72.2 billion, which corresponds to 22% of the total volume of assets in public funds.

Insurance Companies

The development in the insurance sector continued to stagnate. Total gross premiums written reached a level of CZK 157.8 billion, which is comparable to the level in 2010. The slight year-on-year increase (0.8%) was achieved thanks to the non-life insurance segment, which grew by 1.9%. Conversely, there was a 0.4% decline in the life insurance segment.

Pension Savings

Due to the planned termination of Pension Pillar 2, the number of participants in retirement savings schemes increased by only 1,250 to a total of 83,200 individuals. The volume invested by the participants in the retirement funds reached a level of CZK 1.7 billion at the end of 2014.

Supplementary Pension Insurance and Supplementary Pension Savings

At the end of 2014, the participant assets in both the participating as well as the transformed funds in Pillar 3 totalled CZK 317 billion, reflecting an increase of 12.4%. The number of participants in Pillar 3 once again decreased, specifically by 160,000 to 4.8 million individuals. The average monthly contribution made by participants in the transformed funds increased slightly to CZK 574. Conversely, in the case of the participating funds, the average contribution decreased by 3.6% to CZK 722. The share of contracts that include an employer contribution grew slightly in 2014 to 19.1% The total direct state support disbursed to participants in Pension Pillar 3 totalled CZK 6.85 billion.

The Government Sector

In the government sector, the financial results for 2014 report a deficit equal to 2.0% of GDP. As compared to 2013, this reflects a worsening of 0.8 pp. The resulting balance was affected by, amongst other things, the inclusion of the Deposit Insurance Fund in the government sector, which, in 2014 paid out compensation totalling more than CZK 14 billion to the clients of the credit unions that went into default. The total debt of the general government sector reached a level equal to 42.6% of GDP at the end of 2014. As compared to the previous year, this reflects a significant 2.5 pp decrease in the ratio of indebtedness to GDP. This is partially due to the fact that the available monetary resources of central government institutions were included in the state treasury single account managed by the CNB.

Financial Market Legislation

As far as Czech legislation is concerned, 2014 saw the amendment of the regulations governing the following: the activities of banks, credit unions, and securities dealers; payment services, including cash payments; the activities of insurance intermediaries and independent loss adjusters; and the activities of investment firms and investment funds. The Act on Bonds was also amended. At the European level, the high-priority topics included the legislative proposals associated with the following: defining a framework for the recovery and resolution of credit institutions and investment firms including common rules and approaches for resolution of credit institutions; deposit guarantee schemes; improving the settlement of securities trading transactions and central depositories; and mortgage loans.

1. MACROECONOMIC SITUATION AND EXTERNAL DEVELOPMENTS

1.1. Macroeconomic Situation[1]

In 2014, the Czech economy continued with the recovery that started during the second half of 2013. Real gross domestic product (GDP) increased by 2.0% in 2014. The quarter-on-quarter changes in GDP remained almost the same throughout the entire year. On the other hand, the quarter-on-quarter growth in gross value added (GVA) was significantly higher in the fourth quarter of 2014 when compared to the previous quarter-on-quarter figures as well as in comparison with GDP growth during the last quarter. Both the accelerated growth in GVA and the year-on-year slowdown of GDP growth during this period were affected by the large volume of indirect taxes at the end of 2013, which resulted primarily from the pre-supply of tobacco revenue stamps prior to the planned increase in excise taxes. This effect was not repeated in 2014. The gradual recovery of the economy should continue in 2015 thanks to the improving economic situation in the eurozone, lower petroleum prices, and increased domestic demand. In 2014, the Czech economy grew at a tempo higher than the average in the EU and in the eurozone; however, it lagged behind the performance of the economy in the USA.

Table 1.1: GDP growth rates

Annual (in %)	2009	2010	2011	2012	2013	2014
Czech Republic	-4.8	2.3	2.0	-0.8	-0.7	2.0
EU-28	-4.4	2.1	1.7	-0.5	0.0	1.3
Eurozone (EA12)	-4.5	2.0	1.6	-0.8	-0.4	0.9
USA	-2.8	2.5	1.6	2.3	2.2	2.4

Source: Eurostat

GDP growth in 2014 was supported by all of the components of domestic demand as well as by the rapid 8.8% growth in the export of goods and services. Household final consumption expenditure significantly grew in relation to the improving mood regarding the economy and the increase in real wages based on higher work productivity. Government consumption remained at level comparable with the preceding year. Investments in fixed capital resumed in direct relation to the positive predictions for demand and the higher use of production capacity, thus contributing to the increased use of investment resources from the EU sources.

The strengthening domestic economy also started to be positively reflected in the unemployment rate, which, according to a random labour force survey (LFS) performed in 2014, decreased to an average level of 6.1%. Within the international context, the Czech labour market was in relative good condition. However, further economic growth will soon run into the limitations associated with structural unemployment. According to the random LFS, the employment rate for the 15 to 64 age group grew by 1.3 pp to 69.0% as a result of an increase in the number of employed individuals and a decrease in the size of the population in the productive age group. The level of economic activity with the 15 to 64 age group increased year-on-year by 0.6 pp and reached 73.5 %.

Table 1.2: Macroeconomic indicators of the Czech economy

	Indicator (in %)	2011	2012	2013	2014
CZ	Final consumption expenditure (change, in constant prices):	-0.7	-1.5	0.9	1.9
	Household consumption (change, in constant prices)	0.2	-1.8	0.4	1.7
	Government consumption (change, in constant prices)	-2.9	-1.0	2.3	2.3
	Gross fixed capital formation (change, in constant prices)	1.1	-2.9	-4.4	4.5
	Unemployment rate LFS (average for period)	6.7	7.0	7.0	6.1
	Inflation (CPI, average for period)	1.9	3.3	1.4	0.4
Inflation in Eurozone (HICP, average for period)		2.7	2.5	1.3	0.4
Inflation in USA (HICP, average for period)		3.8	2.1	1.3	1.3

Source: CSO, CNB, MLSA

[1] On the basis of data published as of 31 March 2015.

The average inflation rate as measured by the consumer price index reached a level of 0.4% in 2014, which is the second lowest value in the history of the independent Czech Republic. The unusual decrease in regulated prices, particularly the reduction in electricity prices, contributed towards the very low inflation rate. In addition, the significant drop in petroleum prices at the end of the year and the continuing negative value of the production gap also played a role with regard to the decelerated growth of price levels. The main pro-inflation factor in 2014 was the weakened exchange rate for the Czech crown. The year-on-year inflation rate fluctuated at slightly positive values from the start of the year. Price levels started to gradually increase during the second half of the year, but, in December, the inflation rate dropped by 0.5 pp from its November value to 0.1% due to the positive demand shock resulting from the drastic reduction in petroleum prices. The predictions for a continued low inflation rate led the CNB to make a decision to extend the unilateral exchange rate commitment and maintain a level of at least 27 CZK/EUR until the second half of 2016. The CNB will also not increase the primary interest rates prior to that time and they will remain at their technical minimum of 0.05%, at which they have been since November 2012.

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

2014	Inflation (year-on-year in %)[2]			Key interest rate of central bank (in %)[3]		
	Czech Republic	Eurozone	USA	Czech Republic	Eurozone	USA
January	0.2	0.8	1.6	0.05	0.25	0.00 – 0.25
February	0.2	0.7	1.1	0.05	0.25	0.00 – 0.25
March	0.2	0.5	1.5	0.05	0.25	0.00 – 0.25
April	0.1	0.7	2.0	0.05	0.25	0.00 – 0.25
May	0.4	0.5	2.1	0.05	0.25	0.00 – 0.25
June	0.0	0.5	2.1	0.05	0.25	0.00 – 0.25
July	0.5	0.4	2.0	0.05	0.15	0.00 – 0.25
August	0.6	0.4	1.7	0.05	0.15	0.00 – 0.25
September	0.7	0.3	1.7	0.05	0.15	0.00 – 0.25
October	0.7	0.4	1.7	0.05	0.05	0.00 – 0.25
November	0.6	0.3	1.3	0.05	0.05	0.00 – 0.25
December	0.1	-0.2	0.8	0.05	0.05	0.00 – 0.25

Source: CSO, CNB, Eurostat, ECB, Fed

The disinflationary trend in the eurozone continued throughout 2014 and led to the 0.2% decline in consumer prices in December. In response to the unfavourable development in prices, the ECB decreased interest rates in June 2014 and then once again in August. In both cases, the main refinancing rate was reduced by 0.10 pp, resulting in a final value of 0.05%. A non-standard step was the reduction of the deposit rate to a negative value of -0.20% with the aim of supporting the interbank market. In addition, in mid-October 2014 the ECB launched a programme to buy back asset-backed securities and resumed the purchase of bonds issued by financial institutions. The debt crisis situation in the eurozone started to settle down in 2014. Both Greece and Cyprus returned to the primary state bond market. In May, Portugal joined Ireland and Spain on the list of countries whose bailout programmes have ended. The exchange rate of the euro in relation to the US dollar strengthened slightly during the first quarter of 2014 from 1.36 to 1.38 USD/EUR, however, during the next quarters it significantly decreased to 1.23 USD/EUR in December due to the different directions in American and European monetary policies and unresolved problems in the eurozone, particularly those associated with Greece.

The American economy also saw a decrease in the inflation rate during the second half of 2014 due to the drop in petroleum prices. Although the average inflation rate in 2014 remained at the same 1.3% level as in the preceding year, the year-on-year increase in consumer prices in December was only 0.2%. The Federal Reserve System has assessed that the effect of the drop in commodity prices is only temporary and responded to the continuing recovery of the American economy by starting the previously announced gradual limitation of the asset buyback programme that started in January and which the Fed terminated at its October meeting. Due to the Fed's dual mandate (i.e.an effort to influence both the development in price

[2] In the Czech Republic and the USA, measured according to the year-on-year growth in the CPI; in the eurozone, expressed in terms of the year-on-year increase in the HICP.

[3] As of the first calendar day of the applicable month.

levels as well as activities in the real economy), its decision-making process was also influenced by the improving labour market. During all of 2014 interest rates remained at minimum levels ranging from 0.00 to 0.25%.

Table 1.4: External financial relations

Annual (CZK bn)	2010	2011	2012	2013	2014
Balance of goods	40.4	75.5	123.8	167.0	238.9
Balance of goods (%, current prices)	1.0	1.9	3.1	4.1	5.6
Current account	-141.8	-84.8	-63.3	-21.8	26.1
Current account to GDP (%, current prices)	-3.6	-2.1	-1.6	-0.5	0.6
Capital account	37.6	12.7	53.0	82.4	32.2
Financial account	122.3	74.8	-11.7	-68.3	-48.0

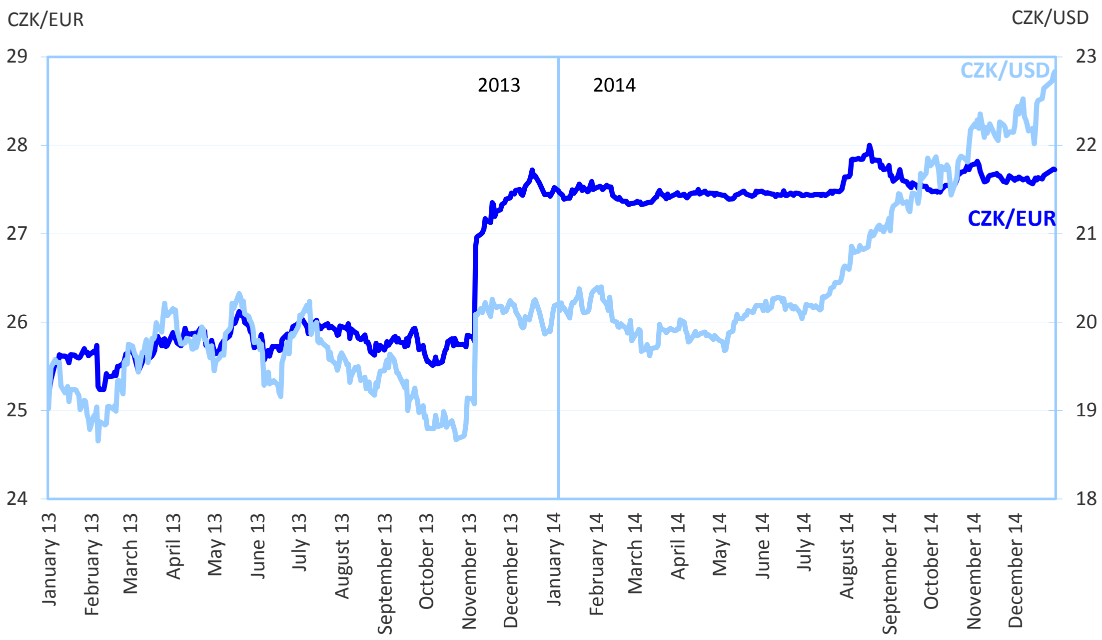
Source: CNB – ARAD, CSO

For the first time since 1993, the external balance, as expressed by ratio of the balance of payments current account to GDP, reached a positive value in 2014, specifically 0.6%. The improvement in the current account balance was due to the significant increase in the goods balance surplus, resulting from the recovery of the European economy and the increased competitive strength of domestic exporters supported by the weakened crown. Conversely, the services balance surplus has been decreasing over the long-term. In 2014, it reached a level of CZK 56 billion, reflecting a year-on-year decrease of CZK 14 billion. The primary income balance, which, in addition to the trade balance, is decisive for the final balance of the current account, worsened as a result of the deficit that increased by CZK 10 billion to CZK 259 billion. There was a greater outflow of investment income, primarily in the case of direct investment. On the other hand, there was an increase in the surplus for the the compensation paid to employees and other primary income. The development in the current account balance corresponds to the degree of development of the Czech economy and does not lead to the risk of macroeconomic imbalances. The financial account recorded a net outflow of CZK 48 billion in financial resources. Direct foreign investment recorded a net inflow of CZK 134 billion, which includes CZK 70 billion of reinvested profit. The financial derivative balance also ended with a slight surplus. There was an outflow of financial resources from the portfolio investments (CZK 90 billion) and also from other investments (CZK 24 billion). Reserve assets increased by CZK 73 billion.

1.2. Foreign Exchange Market

The Czech crown continued to develop according to the continuing currency exchange commitment of the CNB, which was defined on 7 November 2013 and may possibly lead to direct and indirect currency interventions with the aim of preventing the Czech crown from strengthening to a level that exceeds 27 CZK/EUR. For the entire year, the currency exchange rate fluctuated in a range between 27.3 and 27.9 CZK/EUR and no significant changes were recorded. The year-on-year change in the exchange rate at the end of 2014 was 1.1%. Although volatility did increase during the second half of 2012, the exchange rate remained within the range specified above.

Graph 1.1: CZK exchange rates relative to major currencies



Source: CNB

The exchange rate of the Czech crown in relation to the American dollar recorded significant growth, that is to say that the Czech crown significantly weakened against the US currency (a year-on-year change of 14.8% to 22.8 CZK/USD). This was caused by, amongst other things, the completion of the next phase of the quantitative easing programme of the the Fed in the autumn and because of the different performance levels of the both economies. While the gross domestic product of the American economy has been in the positive numbers since 2010, the recovery of economic activities in the EU and the Czech Republic did not start until 2014 (in connection with the improving economic situation in the eurozone, as depicted in Table 1.1). At the same time, the Czech crown is closely correlated with the euro and thus both currencies were affected by the anticipated change in the ECB's monetary policy during the second half of the year. This change did not come about until the start of 2015 when the ECB launched its quantitative easing programme, however the currencies reacted to the expected change in advance in connection with, amongst other things, the end of the quantitative easing in the USA. A weaker euro, much like the weaker crown, should help to increase the competitiveness of European companies in comparison to other states (primarily the USA, Japan, and China). At the same time, once again comparable to the case of the Czech crown, a weaker euro should help to dampen deflation in the eurozone, which was partially supported by the decrease in petroleum prices starting in July 2014.

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

Exchange rate as at the end of	2010	2011	2012	2013	2014	Year-on-year change (%)
CZK/EUR	25.1	25.8	25.1	27.4	27.7	1.1
CZK/USD	18.8	19.9	19.1	19.9	22.8	14.8
CZK/100 HUF	9.0	8.2	8.6	9.2	8.8	-4.8
CZK/PLN	6.3	5.8	6.2	6.6	6.5	-1.7

Source: CNB, CSO

The year-on-year change in the exchange rate of the Czech crown to other currencies in the region was not as dramatic as the weakening of the crown in relation to the US dollar. The development of the exchange rate of the crown to the Polish zloty (PLN) and the Hungarian forint (HUF) was not very volatile. From the perspective of the year-on-year change in the exchange rate, at the end of the year the crown had strengthened in relation to the zloty by 1.7% to 6.5 CZK/PLN and, in relation to the forint, even by 4.8% to 8.8 CZK/100 HUF. From the perspective of the year-on-year change in the average exchange rate, the Czech crown weakened by 2.0% in relation to the forint and by 6.3% in relation to the zloty.

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

Average exchange rate	2010	2011	2012	2013	2014	Year-on-year change (%)
CZK/EUR	25.3	24.6	25.1	26.0	27.5	6.0
CZK/USD	19.1	17.7	19.6	19.6	20.7	6.0
CZK/100HUF	9.2	8.8	8.7	8.7	8.9	2.0
CZK/PLN	6.3	6.0	6.0	6.2	6.6	6.3

Source: CNB, CSO

Given the statement published by the CNB Bank Board on 26 March 2015, according to which the CNB will not discontinue the use of the exchange rate as a tool for easing monetary policy prior to the second half of 2016, there are no significant changes expected for the CZK/EUR currency pair. Conversely, the exchange rate of the Czech crown in relation to the US dollar does have potential for further growth if the effects of economic growth in the USA and the quantitative easing in the eurozone continue, which could significantly affect the exchange rates of the Czech crown in relation to the world's other currencies.

2. FUNDS AVAILABLE IN THE FINANCIAL MARKET

The volume of funds available in the financial market[4] has been increasing over the long-term, however, since 2012, the growth has not been as dynamic. Since 2008, the annual increases of over 10% that occurred between 2004 and 2007 have been replaced by growth at approximately one-half of that rate (4 to 6%). Over the course of 2014, the volume of funds increased by CZK 178.4 billion (4.0%) to a level of approximately CZK 4.6 trillion.

Table 2.1: Funds available in the financial market

As at 31 Dec (CZK bn)	2009	2010	2011	2012	2013	2014	Year-on-year change	
							Abs.	(%)
Deposits in credit institutions [5]	2,473.6	2,563.5	2,690.0	2,883.9	2,995.8	3,041.6	45.8	1.5
of which: building savings schemes	415.2	430.1	433.4	435.0	429.1	413.6	-15.5	-3.6
Investments funds	259.2	283.9	271.8	296.9	338.7	401.1	62.4	18.4
Pension funds	200.6	216.1	232.1	246.6	282.3	318.6	36.3	12.9
Placement of insurance technical reserves	381.4	373.7	381.2	403.1	424.1	431.3	7.1	1.7
Currency in circulation	353.6	357.5	377.9	388.9	405.4	432.2	26.7	6.6
Total	3,668.4	3,794.7	3,953.0	4,219.4	4,446.3	4,624.7	178.4	4.0

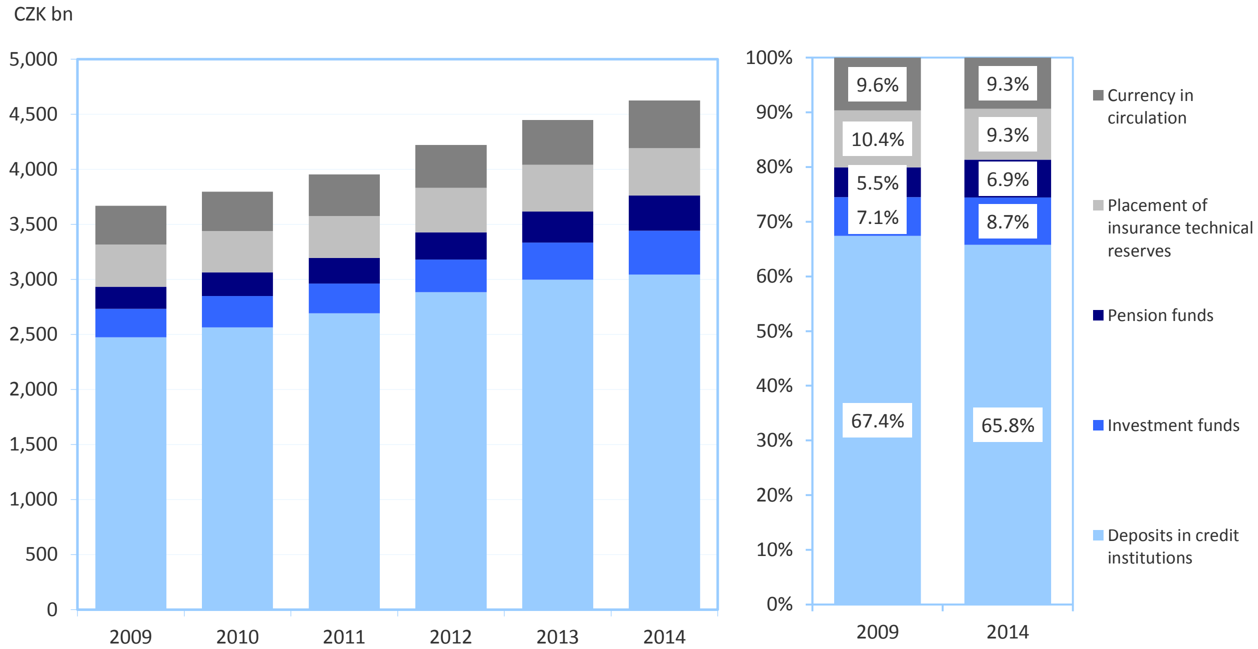
Source: AKAT, CNB – ARAD, MoF

As compared to previous years, in 2014 the highest absolute growth was not recorded in the most significant category – deposits in credit institutions – but rather in the volume of resources placed in investment funds (both collective as well as qualified investment funds). This is associated with the fact that, in the current environment of very low interest rates, investment funds were able to offer financial market participants higher rates of return. The very low interest rates are most likely also the reason for the 2.3 pp relative increase in the amount of currency in circulation as compared to the situation in 2013. As was the case in the preceding year, there was also a significant percentage increase in the volume of funds placed in the pension funds under Pension Pillars 2 and 3. The other categories also achieved growth, with the exception of the building savings subcategory, which saw a decline, as was also the case in 2013.

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

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

Graph 2.1: Funds available in the financial market



Source: AKAT, APS CR, CNB – ARAD, MoF

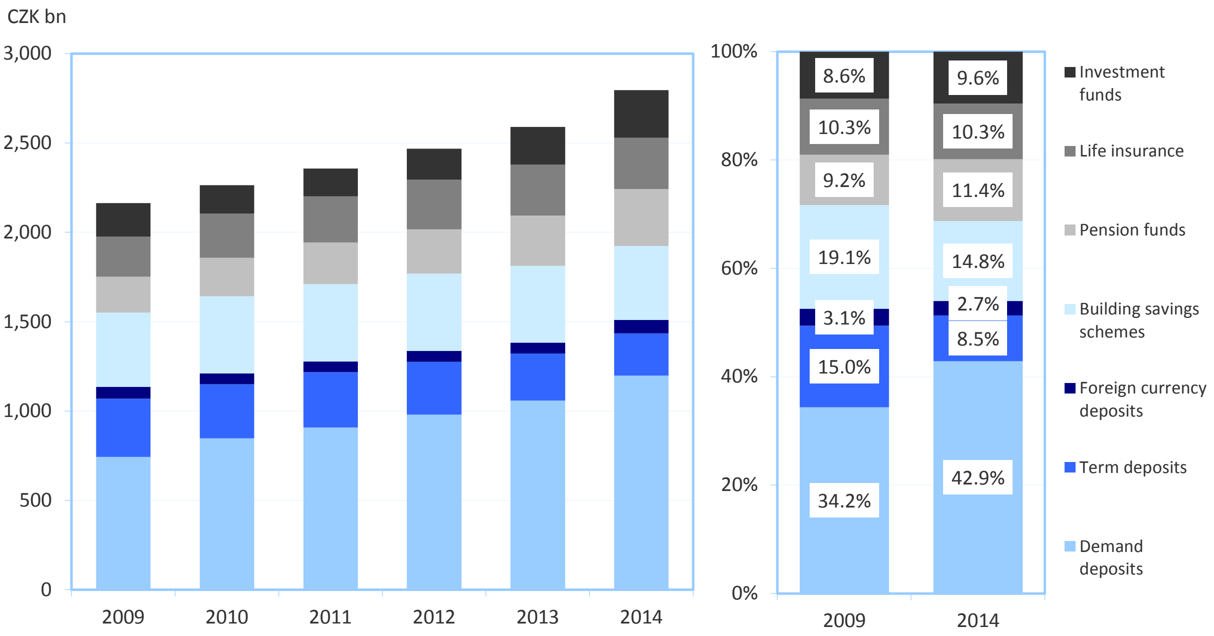
Note: The right side of the graph shows the differences in structure between 2009 and 2014

Based on the development in the volume of funds in the individual categories between 2009 and 2014, it is possible to identify the tendencies described below. As can be seen on the right side of Graph 2.1, there has been an increase in the share of resources allocated in pension funds (from 5.5% to 6.9%) and in investment funds (from 7.1% to 8.7%). Conversely, there was a decrease in the volume of deposits in credit institutions. However, the steepest decline occurred during 2014, as in the preceding years the volume remained at a stable level of approximately 68%. During the monitored period, the share of the remaining two categories – placement of insurance technical reserves and currency in circulation – fluctuated at about 10% and 9.5%, respectively.

3. STRUCTURE OF HOUSEHOLDS SAVINGS

The total volume of household savings kept in products offered on the intermediary financial market[6] has been gradually increasing over the past several years. The year 2014 was not an exception, and the household savings increased by 7% (the greatest increase since 2009) to attain a total volume of CZK 2.8 trillion.

Graph 3.1: Structure of household savings



Source: APS CR, CNB – ARAD, MoF

Note: The right side of the graph shows the differences in structure between 2009 and 2014.

There were not any significant changes in the structure of household savings over the course of the year (less than 3 pp). Once again, there was a sizable outflow of resources from term deposits accounts (-1.6 pp), as funds are being moved to non-term deposit products. As can be seen in Graph 3.1, this shift has been happening over the long-term, primarily due to the fact that interest rates are at a historical low and households now prefer demand deposit accounts (included within the non-term deposit category) as opposed to the term deposit accounts that enjoyed popularity in the past. The second category that has been losing in importance over the long-term consists of the savings kept in building savings accounts. There was a year-on-year decline of 1.6 pp in this category, and, during the entire monitored period of 2009 to 2014, there has been a drop of 4.3 pp. The reason for this is the decreased attractiveness of building savings schemes, from the perspective of their use as savings product as well as with regard to their use as a loan product. (More detailed information is provided in Chapter 5.8). As compared to 2013, there was slight increase in the share of deposits kept in foreign currencies, which may be related to the CNB decision to extend the commitment to maintain the exchange rate at above 27 CZK/EUR. Although the proportion of banking institution products in relation to the overall structure has decreased by 2.6 pp since 2009, households continue to keep the majority of their savings – approximately 69% – in these products.

The most notable change in household savings may be seen in the case of investment funds, where there was a year-on-year increase of CZK 27 billion. Although there has been a significant shift in savings to collective investment instruments since 2011, the share of household savings kept in investment funds in relation to the overall savings structure has still not reached the level at which it was prior to the crisis in 2007 (12.6%).

The share of savings placed by households in the pension funds under Pension Pillars 2 and 3 increased by 0.6 pp in 2014. Looking at the six-year timeframe, it is possible to see a noticeable growth trend within this particular segment and its share has increased from 9.2% to 11.4%. This is due to the increase in the number

[6] Includes household savings that are placed in the financial market through the financial products offered by credit institutions, insurance companies, pension companies, and investment firms. The direct investments made by households in securities, commodities, and real estate are not monitored.

of participants at the end of 2012 and the higher contributions they made in 2013 as a result of the changes in the conditions for receiving the state contribution in Pension Pillar 3.

The last segment – life insurance – decreased in significance by 0.6 pp, although the absolute volume of savings increased slightly. The growth in volume was, however, relatively lower than for other products. If we compare the figures from 2009 and 2014, then the share of household savings managed by insurance companies has not changed. During this period, the share ranged from 10 to 11%.

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

4. INSTITUTIONAL ASPECTS OF THE FINANCIAL MARKET

4.1. Financial Market Entities

From the institutional perspective, there were no significant changes in the financial market in 2014. Particularly in the largest sectors – banks and insurance companies – the number of active entities has remained stable over the long-term. The banking and insurance sectors have a long history in the Czech Republic, which forms the basis for both the fairly extensive experience that exists as well as the detailed knowledge of the needs of Czech clients. As a result of natural historical development, a fairly significant level of competitiveness has been in introduced in these sectors, which makes the effective entry of new subjects more difficult into the market segments already divided amongst the existing entities. In general, the slight year-on-year increases are usually the result of the establishment of new foreign branches, which places a smaller administrative burden on foreign entities who want to provide loan and insurance services. Another option for entering the domestic market fairly quickly is to purchase a banking licence, usually together with the appropriate physical environment form an already established entity within the context of an acquisition or a merger.

The following overview shows the development in the number of entities in the financial market over the past five years.

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

As at 31 Dec	2010	2011	2012	2013	2014
Credit institutions					
Banks	41	44	43	44	45
of which: foreign banks branches	19	21	20	21	22
of which: building savings banks	5	5	5	5	5
Credit unions	14	14	13	12	11
Capital market					
Securities dealers and branches of foreign securities dealers	53	58	61	64	58
Investment funds having legal personality	47	58	77	88	84
Investment companies	23	21	21	24	26
Mutual funds	150	157	165	176	191
Qualified investment funds	33	40	48	56	53
Collective investment funds	117	117	117	120	138
of which: standard	37	37	40	41	50
of which: special	80	80	77	79	88
Investment intermediaries	9,051	10,070	8,810	7,670	7,554
Tied agents[7]	11,251	14,730	20,045	25,821	26,056
Pension funds / companies	10	9	9	10	9
Insurance					
Insurance companies	53	54	53	52	53
of which: branches of foreign insurance companies	17	18	18	18	20
Reinsurance companies	1	1	1	1	1
Insurance intermediaries	115,713	137,486	147,971	156,217	163,204

Source: CNB

There were only minor changes in the number of banks and insurance companies. As of 1 April 2014, a banking licence was granted to the foreign-based Sumitomo Mitsui Banking Corporation Europe Limited to operate its new Prague Branch. The same month saw the entry of two new branches of foreign-based companies to the domestic insurance market, specifically a branch of the Slovak NOVIS Poisťovňa a. s., and the Czech branch of the German D. A. S. Rechtsschutz AG, and one entity – DIRECT Pojišťovna a. s. – terminated its activities. All of the newly established branches obtained operating licences on the basis of a notification

[7] Excluding tied agents of pension companies.

process. At the end of 2014 and the start of 2015, there were articles in the media reporting that certain banks from Asia (Vietnam and China) are interested in establishing branches in the Czech Republic.

In the credit union sector, one entity was required to involuntarily terminate its operations. On 24 June 2014, the CNB revoked the operating licence of the WPB Capital Credit Union and lodged a petition with the court to appoint a liquidator. Subsequently, on 14 October 2014, the Deposit Insurance Fund (DIF) started to disburse compensation to the credit union's clients. This particular credit union started experiencing problems in the spring of 2014, when, on the basis of preliminary measures, the CNB forbade it to accept new deposits and provide new loans, thus restricting the credit union's activities, and then consequently initiated administrative proceedings against the financial institution. The CNB revoked the credit union's licence in an effort to prevent WPB Capital from acting in an illegal and unlawful manner. Based on the notification issued by the central bank, the credit union allegedly artificially increased the volume of capital obtained through credit, provided loans totalling tens of millions of crowns to companies established for expedient purposes, and participated in the acquisition of unpermitted securities.

In the sector of the pension companies that manage the funds under Pension Pillars 2 and 3, the sale of AEGON Penzijní společnosti, a.s. was completed in January 2014 and the company consequently became Conseq důchodová penzijní společnost, a.s. In August 2014, Raiffeisen penzijní společnost a.s. terminated its activities. Its approximately 13,000 clients in Pension Pillars 2 and 3, which represented the smallest client base in the sector, were transferred to the funds managed by Česká pojišťovna, a.s., which, as a result, further strengthened its dominant market position.

As far as the capital market is concerned, the number of entities in the majority of the fund categories continued to increase. This provides evidence that the recent lack of confidence on the part of investors as a result of the financial market crisis has been overcome. Investors are consistently asking for more diverse portfolios of products, which, combined with the liberalisation of the legislative framework as compared to last year, is reflected in the number of entities that are adding these products to their offer. The slight decline in qualified investment funds may have been at least partially caused by the complexity of some of the stricter rules, including the impact of taxes, on this particular category of funds.

The development in the number of investment intermediaries is following the same trend as in preceding years. The number of on-own-account investment intermediaries has decreased (a decline of 1.5%), as compared to the number of tied agents, which has increased (by 0.9%). This opposite direction in the growth of the number of entities providing investment intermediation services is the result of legislative changes. According to the amended Act on Capital Market Undertakings, Level 2 investment intermediaries have become tied agents for whom a separate register is maintained. Since the aforementioned amendment took effect, the number of tied agents has been increasing at the expense of the number of investment intermediaries.

In the field of financial intermediation, the general problem remains regarding those who actively perform their profession as intermediaries and those who perform their profession only randomly or who have terminated their activities entirely but have not asked to be deleted from the register. This discrepancy is most obvious in the insurance intermediary sector, where the CNB's records include over 163,000 registered entities, however, expert market estimates estimate that less than a 100,000 individuals actively perform intermediary activities.

The number of entities taking advantage of the EU's freedom of movement policy and performing activities on the basis of a notification submitted under the single licence system is also gradually increasing. As these entities do not have a reporting obligation towards the CNB, the exact scope of their activities cannot be determined. However, based on some individual findings, it is possible to infer that their offer of products and services is usually not aimed at the broad retail client base and is generally very specialised for only a specific market segment. Although the extent of their activities is limited in a certain way, these entities are considered to be an integral component of the financial market in the Czech Republic, which helps to increase its competitiveness and contributes towards a wider and more comprehensive product offer.

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

As at 31 Dec	2010	2011	2012	2013	2014
Credit institutions	284	302	329	340	357
Insurance companies	658	696	730	743	789
Funds	1,347	1,239	1,173	1,165	1,269
Investment companies	48	46	45	47	48

Source: CNB

4.2. Guarantee Schemes

There are two guarantee schemes that are an integral part of the financial market in the Czech Republic. They serve to protect both savers/investors as well as financial institutions, and subsequently also provide protection for the entire market against the negative consequences that are associated with the insolvency of any of the involved entities. At the EU level, a decision was made regarding the next level of the harmonisation of the guarantee systems for credit institutions. As a result, intensive preparations were launched for transposing the new Deposit Guarantee Scheme Directive into Czech legislation. The main objectives are to strengthen the confidence of depositors regarding the health of domestic credit institutions, to improve the integration of the EU's internal market for credit institution activities from the perspective of the freedom of establishment and the free movement of financial services, and to increase the harmonisation of deposit guarantee schemes and facilitate their closer cooperation.

The Deposit Insurance Fund (DIF) plays a preventive role with regard to credit institutions (it decreases the risk of the panic withdrawal of deposits from credit institutions by the public should any problems arise) and provides a recovery function for depositors. If the CNB announces that a credit institution participating in the DIF is unable to meet its obligations, the DIF will pay out to all individuals and legal entities 100% of their deposit balance, including interest, up to a maximum of EUR 100,000 The disbursement of funds must start within twenty working days of the date the announcement is published. The annual contribution of banks and credit unions to the DIF is equal to 0.04% of the average volume of their insured deposits (including interest) for the relevant quarter. In the case of building savings banks, their contribution is one half of that specified above as the probability of their insolvency is lower. Due to the higher level of risk associated with credit unions, starting in January 2015 their contribution has been increased to 0.08% of the average volume of their insured deposits (an amendment to Act No 87/1995 Coll. on credit unions).

In 2014, the Deposit Insurance Fund disbursed over CZK 14 billion to compensate the clients of two failed credit unions (WPB Capital and Metropolitní spořitelní družstvo) for their deposits. Although the majority of the claims of the clients of both of these credit unions had already been satisfied, at the start of 2015 there were still over three thousand outstanding claims totalling approximately CZK 8 million. In spite of the high volume of compensated claims in 2014, at the start of 2015 the DIF had approximately CZK 18 billion at its disposal and this amount will gradually grow thanks to the regular quarterly contributions that are made. In 2014 the DIF collected contributions from thirty-five credit institutions.

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

As with the DIF, the main source of STGF assets consists of the contributions made by the involved players, i.e. securities dealers and investment companies that manage client assets. As, unlike in the situation of the DIF, the covered client assets remain in the hands of the securities dealer only for a relatively short period of time but repeatedly (as compared to the bank deposits covered by the DIF), the amount of the annual contribution is calculated as 2% of the amount of fees and commissions for the investment services provided during the past year. The volume of contributions collected in 2014 totalled CZK 146.8 million, which reflects a year-on-year increase of 11.8%.

4.3. Financial Arbitrator

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

- a payment service provider and a payment service user regarding the provision of payment services;
- an electronic money issuer and an electronic money holder regarding the issuance and redemption of electronic money;
- a creditor or intermediary and an consumer with regard to offering, providing, or brokering a consumer loan;
- an entity managing or administering a collective investment fund or offering investments in a collective investment fund (or a comparable foreign investment fund) and a consumer with regard to managing or administering the collective investment fund or offering investments in a collective investment fund (or comparable foreign investment fund);
- an insurance company or insurance intermediary and a potential insurance client, insurance policyholder, insured individual, authorised individual, or beneficiary with regard to offering, providing, or intermediating life insurance; and
- a foreign exchange operator and a potential client or actual foreign exchange client for whom a foreign exchange transaction has been performed.

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

As far as the volume of disputes initiated and discussed and the number of enquiries accepted, the Financial Arbitrator initiated 662 new proceedings in 2014. During the monitored period, the FA addressed 1,055 individual disputes and a collective batch of 93,000 applications submitted regarding fee disputes (the proceedings for some of the individual disputes and the collective disputes were initiated during the previous period), of which 661 of the individual disputes and all of the collective disputes were heard. There was thus once again a significant increase in the number of accepted applications when compared to the previous period. There were more than 2,500 enquiries made by the public that were accepted and processed.

4.4. Economic Results of Financial Institutions

The financial results improved in all but one of the financial market sectors (refer to Table 4.3). Specifically, the profit generation decreased only in the insurance sector. This decline was influenced primarily due to the worse results for the technical reserve account in the non-life insurance segment (a drop of approximately 50%). The results for the technical reserve account in the life insurance segment also declined (by 15.1%). The improved profit generation in the other financial market sectors establishes good conditions for positive future development, including an improvement in the reserve funds and the ability to use them for recovering any unexpected losses.

Table 4.3: Profit/loss of financial institutions before tax

As at 31 Dec (CZK bn)	2010	2011	2012	2013	2014	Year-on-year change (%)
Banking financial institutions	65.9	63.4	76.7	73.3	76.5	4.4
Non-banking financial institutions	48.5	24.6	40.2	63.3	79.7	25.9
Financial leasing companies	4.9	8.6	7.8	4.6	5.5	19.6
Pension funds/companies	4.6	4.6	4.8	4.4	5.0	13.6
Insurance companies	28.4	12	15.7	13.8	9.8	-29.0

Source: CSO

The employment level in the financial sector is stagnating overall and in the most important sectors there has even been a slight decline. The 5.5% increase in the number of employees in the segment of non-bank financial institutions partially compensates for the decline in this indicator (refer to Table 4.4). The highest relative decrease in the number of employees was reported in the pension company sector, which is connected with the reduction in the extraordinary one-time increase in employment associated with the initiation of pension reforms. The average monthly wages of financial institution employees increased by 3.6% to almost CZK 48,000.

Given the low flexibility of the labour market and the prudent approach taken by the personnel managers of financial institutions, an increase in employment in the financial sector cannot be expected in the short-term timeframe, even though the real economy is starting to show aspects of recovery.

Table 4.4: Average headcount of financial institutions [8]

K 31.12.	2010	2011	2012	2013	2014	Year-on-year change (%)
Banking financial institutions	38,189	39,124	39,923	39,375	39,105	-0.7
Non-banking financial institutions	14,311	13,855	14,251	14,598	15,397	5.5
Financial leasing companies	2,630	2,586	2,457	2,277	2,152	-5.5
Pension funds/companies	452	470	529	629	547	-13.0
Insurance companies	14,359	14,260	14,464	14,213	13,995	-1.5
Total	69,941	70,295	71,624	71,370	71,196	-0.2

Source: CSO

[8] Average recalculated full-time equivalent for recorded employees.

5. CREDIT INSTITUTIONS AND OTHER PROVIDERS OF ASSET FINANCING

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

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

5.1. Stability of the Banking Sector

Looking back at 2014, it is possible to say that the banking sector in the Czech Republic continued to reflect stable development comparable to the previous years. The long-term factors contributing to the sector's overall stability during the global financial crisis during the post-2008 period and during the period of instability in the eurozone have remained in effect. In particular, these factors include the high level of the sector’s capital adequacy as a whole, a high level of liquidity, a long-term low dependence on funding from the interbank market, a significant share of retail loans secured by real estate lien rights, and a relative low share of client loans provided in foreign currencies.

The capital adequacy indicator of the Czech banking sector as a whole continued to increase in 2014. It has long been significantly above the regulatory requirements.[9] At the end of 2014, the overall capital ratio reached a level of 17.8%, reflecting a year-on-year increase of 0.7 pp. During the past six years, the banking sector has reported a slight year-on-year decline in the overall capital ratio only at the end of 2011 (by 0.3 pp). However, over the longer timeframe it is possible to see that it has been significantly and consistently increasing. If we compare the value of this indicator in 2014 with the situation prior to the global financial crisis (at the end of 2007), we can see an increase of more than 6.0 pp, which reflects an increase of more than 50% as compared to the 11.6% capital adequacy reported at that time. As a result of this development, the banking sector in the Czech Republic as a whole has significantly increased the size of the cushion of capital that can be used to cover any unexpected losses in the future. In general, however, it applies that an increase in the capital ratio, i.e. in capital adequacy, may be the result of not only a greater volume of capital, but also due to a decrease in risk weights. As a result, their definition is important.

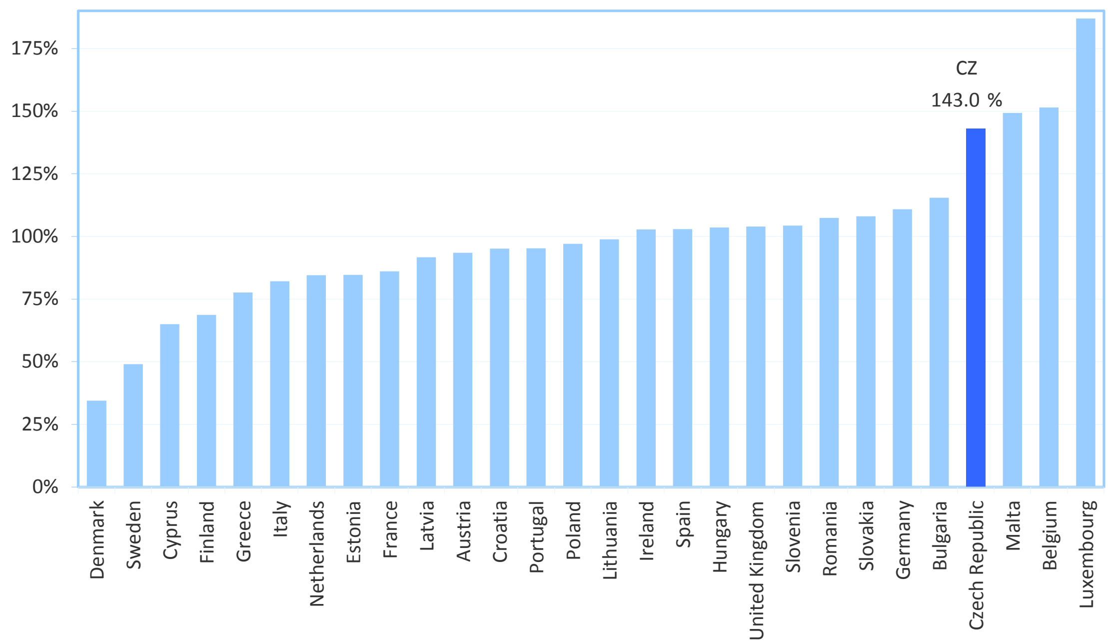
The resilience of this sector to any possible negative shocks has been repeatedly confirmed by the stress tests regularly performed by the CNB. According to the results published on 10 December 2014 (based on the data as of the end of the third quarter of 2014), the sector’s capital adequacy would remain above the 8% regulatory minimum even in case of materialization of a more theoretical and less likely, so called negative scenario "Europe in Deflation", which presumes a significant drop in the economic activity in the Czech Republic and abroad. If this negative, rather theoretical development were to occur, the capital adequacy of the banking sector would decrease to below 14% and a total of eleven banks would not have a sufficient level of capital adequacy. In order to bring the capital adequacy of all the banks registered in the Czech Republic (i.e. not including the branches of foreign banks) back up to the regulatory minimum of 8%, the banks would have to increase their regulatory capital by approximately CZK 15 billion (about 0.4% of GDP) at the end

[9] The minimal regulatory requirement has traditionally been at a level of 8%. This was, however, updated to reflect the current version of the Capital Requirements Regulation and Directive, and additional capital requirements were introduced. In particular, this concerns the capital conservation buffer of 2.5%, which has been in effect since July 2014 and applies to the entire sector. In addition, in November 2014, the CNB implemented an additional reserve in the case of the largest banks to cover systemic risk (i.e. a systemic risk buffer) of up to 3%. It is possible that more capital requirements will gradually be introduced in the form of countercyclical capital reserves of up to 2.5%, or even more in certain exceptional cases. It is also important to mention the possible implementation of capital reserves for critical system institutions that may gradually be introduced starting in 2016. The capital adequacy indicator value that must be met by a specific institution may therefore be higher.

of the testing period. According to the CNB, taking into account the size of the sector, this is not a volume that would significantly threaten the overall stability of the entire sector.

The sector's relatively lower dependence on funding from the interbank market also contributes towards the stability of its financing and its overall high level of liquidity. Banks in the Czech Republic have been obtaining the majority of their funding through client deposits for a long time. As a general rule, it applies that, during periods of acute liquidity problems, difficulties first appear in the interbank market where financial institutions lend to each other. , On the other hand, client deposits are usually a more reliable and stable source of funding, if there is a liquidity crisis and if the public continues to have confidence in the deposit guarantee system. The monitored ratio of deposits to loans (refer to Graph 5.1) has remained fairly stable in the Czech Republic over the long term and, at the end of 2014, achieved a level of 143.0 % (reflecting a year-on-year decrease of 3.5 pp).[10] This ratio provides evidence that, in the Czech Republic, the volume of deposits banks receive from their clients is significantly higher than the loans they provide to them. From this perspective, the Czech banking sector is one of the most resilient to this risk in the entire European Union. Conversely, the least positive values for this indicator are reported by, for example, Denmark and Sweden, where, in the past, there was a rapid increase in the volume of loans without a corresponding increase in client deposits. In comparison, the countries where this indicator reported more growth in its value in 2014 include Ireland (by 9.8 pp), Latvia (by 10.2 pp), and Lithuania (by 16.3 pp). This is a continuation of the trend where an increase in the funding of loans through deposits is being reported more by those countries where the banking sector had to undergo some sort of recovery or transformation process in response to the global financial crisis during the post-2008 period. There has been a cumulative increase of this ratio indicator during the period from the end of 2008 to the end of 2014 in countries such as Portugal (by 22.7 pp), Slovenia (39.6 pp), and Spain (16.1 pp).

Graph 5.1: Client bank deposits to loans ratio in 2014 in selected EU member states



Source: ECB, MoF calculations

In general, however, it is difficult to find a universal interpretation and a clear-cut explanation of the development in the deposits to loans indicator across countries. This is because its value may grow not only due to the positive development in the volume of deposits as the result of the generally healthy process

[10] The international comparison uses the data published by the ECB specifying the volume of loans and deposits for monetary financial institutions (excluding the ESCB – European System of Central Banks) for the category of all non-financial institutions (including central governments). The figure for the Czech Republic is generally different from that published by the CNB in its analyses. One of the reasons for this difference is because the volume of deposits and loans used for calculating the ratio indicator does not include all deposits and loans. As a result, the value tends to be lower and, in 2014, the ratio of client deposits to client loans calculated using the data in the CNB's ARAD system exceeded 120%.

of restructuring the sources of banks' financing. It may also increase due to a decrease in the volume of loans provided because of uncertainty in the financial markets or the real economy. In those latter cases, an increase in the value of this ratio may be an unfavourable sign. Another issue associated with the interpretation of this indicator is the necessity to set it within the broader context of the product structure of the specific national financial market. If, for example, the majority of retirement savings in a country are managed within the non-bank segment of the financial market, this could result into a decrease in the volume of bank deposits. Although these funds could ultimately be included in the banks' balance sheets (and thus in the aforementioned indicator), they would only be partially reflected in, for example, the deposits made by retirement savings asset managers (e.g. pension funds and life insurance companies). In addition, from the perspective of the stability of the banks' financing, these sources cannot be equated with the more diversified retail deposits. This is because institutional deposits tend to be made by a lower number of subjects and may thus generally be more volatile.

However, the majority of the factors mentioned above, which could weaken the relevance of the indicator, do not apply in the case of the Czech Republic to a significant degree. The high value of this indicator in the Czech Republic did not result from an involuntary bank credit deleveraging due to an uncertainty in the financial markets or due to problems faced by banks. To the contrary, the banking sector is able to use as a source of financing a significant volume of the deposits made by households who place the majority of their savings in banks (see Chapter 3).

Finally, it should be noted that the deposits to loans ratio evaluates the banking sector as a whole, which does not rule out the fact that some banks report a significantly lower value of the coverage of loans by primary deposits and are more vulnerable from this particular perspective. At the same time it applies that the total deposits to total loans ratio can not be evaluated on its own. It must be interpreted within the context of the fact that over the past several years there has been a significant increase in the share of deposits kept in non-term products.[11] The financing of bank assets thus became more dependent on using financing sources which tended to have a shorter maturity.

5.2. Banking Sector Assets

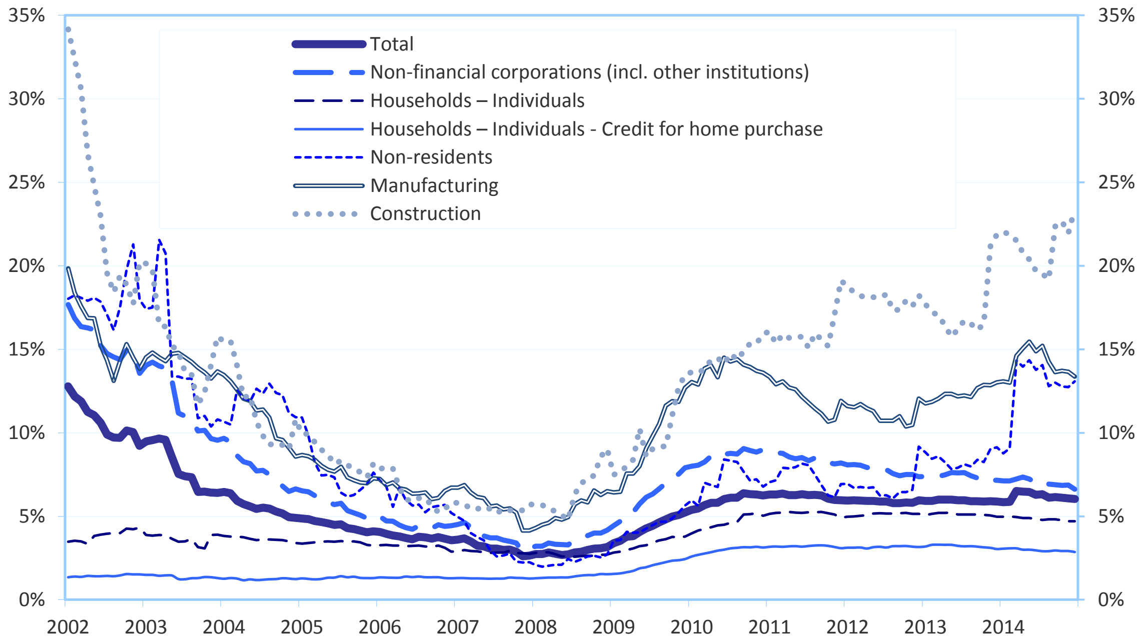
At the end of 2014 the total asset volume reported by the banking sector, including building savings banks, totalled CZK 5.3 trillion.[12] In comparison to 2013, the growth dynamics were slower and the balance sheet total increased by only 3.3% (as opposed to the almost 11% in the previous year). This slowdown in growth was also reflected in the smaller increase in the volume of receivables due from clients (up by 4.8% as compared to 6.5% in 2013). This may be an indication that there once again may be a slight decline in loan activity due to, for example, an increasing ability of some client segments to use internal sources of financing or an increased preference for other sources of external financing, such as the issuance of bonds.

The quality of the banking sector assets as a whole, monitored on the basis of the share of non-performing loans, has essentially not changed since the end of 2010. The values for this indicator, reported at the end of the year, were at a level of approximately 6.0% during the entire period. Some differences (such as in the quality of the loan portfolio and the provisioning) can be observed across the individual segments of banks according to their size by asset volume. Graph 5.2 shows the quality of the loan portfolios, which is in this regard the most important factor due to the focus of the domestic banking sector on the provision of loans.

[11] More detailed information is provided in Chapter 3 – Structure of Household Savings, and Chapter 5.5 – Deposits and Loans.

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

Graph 5.2: Share of non-performing loans



Source: CNB - ARAD, MoF calculations

At the end of 2014 the share of non-performing customer loans to total customer loans (granted to residents and non-residents) reflected a slight year-on-year increase of 0.15 pp to 6.0%. However, at the same time it applies that there was a visible improvement in the two most important borrower segments – non-financial corporations and households (individuals). The share of non-performing loans provided to non-financial corporations once again showed a year-on-year decrease of 0.5 pp to 6.6% and thus reached its lowest value since 2009. In the case of households (individuals), the share of non-performing loans decreased by 0.3 pp to 4.7%. Of this figure, the share of non-performing mortgage loans for home purchase provided to households (individuals) for housing decreased by 0.2 pp to 2.9%. Conversely, there was significant year-on-year increase in the share of non-performing loans in the case of non-residents, where the ratio increased from 9.1% to 13.1%.

However, the share of non-performing loans in 2014 was still at twice the level it was in comparison to the relatively short timeframe of 2007 and 2008, when the value of this indicator was below 3% in some months. Nevertheless, currently, the indicator is at much lower values than in 2002, when the banking sector faced significant problems and this indicator generally greatly exceeded a level of 10%.

The way in which the structure of the specific categories of non-performing loans is developing cannot be considered to be favourable. The share of the specific category of "loss loans" in relation to the total volume of loans provided increased by 3.6 pp year-on-year to a level of 5.6%.

The data for the specific segments may, in some cases, better illustrate the specific tendencies. For this reason, the graph includes two segments from the sector of non-financial corporations. In 2014 it is once again possible to observe a deterioration in the quality of the loans provided to the manufacturing industry (by 0.35 pp to 13.4%) as well as to the construction industry (by 1.51 pp to 23.4%). However, it is not possible to draw definitive conclusions based on this development for two reasons. Firstly, the loans provided to these segments are only a portion of the loans provided to non-financial corporations (in the case of the manufacturing industry, the volume of provided loans is CZK 241 billion and in the case of construction, it is CZK 48 billion), and, additionally, this is in a situation when the share of non-performing loans provided to non-financial corporations had an overall tendency to decline in 2014. In addition, the changes in the quality of the loans provided may not necessarily represent an accurate picture of the overall development in a particular sector, as it primarily reflects only that portion of the companies within the given economic sector which accepted a larger volume of loans in the past, as opposed to reflecting the overall situation in the sector as a whole.

From the perspective of problems that may potentially arise in connection with the developments in exchange rates, it is essential to monitor loans denominated in foreign currencies. As in the previous years, their share of total loans did not significantly change in 2014 and remained relatively low (more information is provided in the text below). This long-term situation continues to have positive implications with regard to the resilience of debtors against shocks resulting from exchange rate fluctuations, and, consequently on the functioning of the real economy and the stability of the financial sector.

Thanks to the low share of foreign currency loans, changes in the domestic currency do not directly affect the size of loan payments, as most of these payments do not have to be recalculated into the domestic currency in which borrowers (particularly households) usually generate the income used to repay these loans. Even if the domestic currency depreciates, the loan payments for loans denominated in the domestic currency do not increase nor is the ability of borrowers to repay impaired, and there is, therefore, no decrease in the quality of bank assets. Over the past several years, the share of foreign currency loans provided to non-financial companies has been fluctuating at the level of about 20%. At the end of 2014, it was 22.8%, reflecting an increase of 0.6 pp. However, it frequently applies that the relevant cash flow for repaying these loans is offset by export revenues in foreign currencies, thus significantly decreasing the level of currency risk. The ratio of foreign currency loans to total loans across all sectors was 18.6% (a year-on-year increase of 0.4 pp). This value is however increased by the high share of foreign currency loans held by non-financial companies (as noticed above), financial institutions (26.7%), and non-residents (76.2%). Another factor that may have contributed to the increase in non-performing loans over the past two years (as a result of currency exchange rates) is the recalculation effect associated with the central bank’s commitment to weaken the domestic currency. Household debt in foreign currencies has, however, been over the long-term less than 0.2% and is therefore essentially negligible. For this reason, the situation in the Czech banking sector is different than in a number of other Central and Eastern European countries (Poland, for example), where there is not only a high share of foreign currency loans overall, but also specifically in the household segment.

5.3. Economic Results of the Banking Sector

The banking sector's pre-tax profit in 2014 achieved a level of CZK 76.4 billion (refer to Table 5.1). This represents an increase of 4.3% and the banking sector thus came close to reaching the highest level that was previously achieved during the monitored period in 2012. One of the factors contributing to the favourable development in profitability was the growth in interest revenue, which increased year-on-year by 4.6%. Banks benefited of both a decrease in interest expenses (by 1.6%) as well as an increase in interest income (2.7%).

Conversely, net income from fees and commissions declined slightly (by 2.6%) to CZK 36.1 billion. However, given the relative size of this entry in comparison to net interest expense, the change in this income category did not have any major effect on the development of overall profit. Administrative expenses, which increased year-on-year by almost 7.0% to CZK 70.4 billion, also had a negative impact on profit. On the other hand, the way in which the other entries developed (specified in the table as 'Other costs', equal to the balance of the entries subtracted from profit) had a positive effect, as there was a year-on-year decrease of CZK 3.7 billion.

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

Item (in billion CZK or %)	2009	2010	2011	2012	2013	2014	Year-on-year change
Total profit or loss before tax from continuing operations	168.4	157.4	162.1	167.2	168.2	168.0	-0.1%
Net interest income	103.3	105.3	109.9	107.9	105.5	110.4	4.6%
Interest income	174.4	167.0	172.3	170.4	154.8	159.0	2.7%
Interest expenses	71.2	61.7	62.4	62.5	49.3	48.5	-1.6%
Net fee and commission income	36.4	38.5	39.1	37.3	37.1	36.1	-2.6%
Fee and commission income	46.8	48.4	50.0	49.2	49.9	49.0	-1.8%
Fee and commission expenses	10.3	9.9	10.9	11.9	12.8	12.9	0.7%
Administration costs	60.5	62.4	66.0	66.6	65.8	70.4	6.9%
Other costs	8.5	15.8	19.5	1.9	3.4	-0.3	-108.9%
Total profit or loss before tax from continuing operations	**70.8**	**65.6**	**63.4**	**76.7**	**73.3**	**76.4**	**4.3%**
Total profit or loss before tax from continuing operations	2.8	2.7	2.8	2.9	2.9	3.1	7.4%
Ratio of net interest income and net fee and commission income	61.3%	66.9%	67.8%	64.6%	62.7%	65.7%	4.8%
Ratio of net interest income and financial & operating income and expenses	21.6%	24.5%	24.1%	22.3%	22.0%	21.5%	-2.4%

Source: CNB - ARAD, MoF calculations

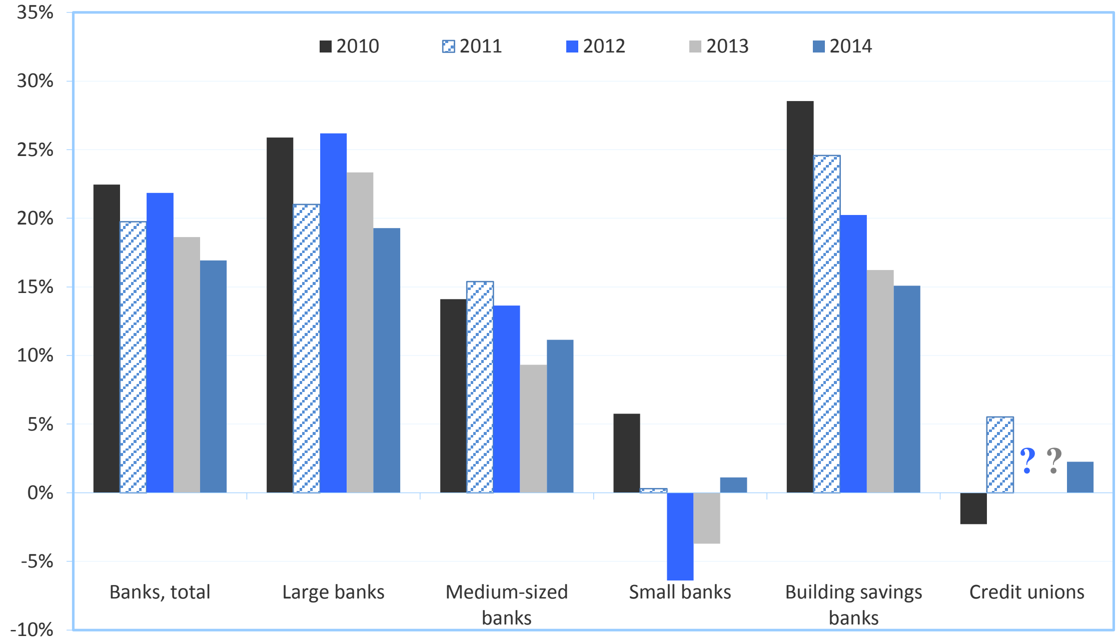
The development in the net interest margin reversed its previously declining trend and reported an increase of 4.7% to CZK 110.4 billion. Banks were able to successfully increase interest income (by 2.7%) whilst, at the same time, limiting interest expenses (by 1.6%). Conversely, the reduction in the monetary policy rates in 2013 and the gradual trickling down of this development to the interest associated with banking assets and liabilities is reflected in the tendency of both interest expense as well as interest income to decline.

As compared to net interest income, the net income from fees and commissions decreased year-on-year by 2.6% to CZK 36.1 billion. This was caused by a 1.8% decrease in (gross) fee and commission income, in conjunction with a slight 0.7% increase in the costs associated with attaining this income.

The ratio indicators provided at the bottom of Table 5.1 better illustrate the relative importance of some of the entries that help to generate profit in the sector. For the first time during the monitored period, in 2014 net interest income attained a level that was more than three times the income from fees and commissions. The key importance of net interest income may also be illustrated in relation to the indicator reflecting the profit from financial and operating activities, which attained a level of 65.7% (an increase of 4.8%, or 3 pp). In comparison, the contribution made by the net income from fees and commissions to the profit from financial and operating activities reached a level of only 21.5%.

As a whole, the banking sector reported a profitability level of 16.9% with regard to Tier 1 capital (a decrease of 1.7 pp). This is the continuation of a long-term decline. As recently as in 2009, this value was almost 10 pp higher. Some of the possible reasons for this downward trend include the rather long-term effects of increase of Tier 1 capital and a decrease in the net interest margin. In relation to assets, this margin reached a level of 2%, but, at the end of 2011, it was 2.5%. As shown in Graph 5.3, the individual groups within the credit institution sector achieved different results. As in the past, the highest profitability was achieved by the large bank sector (19.3%).[13] However, even this sector reported a year-on-year decrease of 4.1 pp. As in the previous years, the profitability of building savings banks continued to decrease, albeit at a slower tempo (by 1.2 pp to 15.1%). In comparison, the profitability of the medium-sized and small bank sectors increased by 1.8 pp to 11.1% and 4.8 pp to 1.1%, respectively. This is the first year since 2012 that the small bank sector reported a positive value, primarily thanks to a decrease in administrative costs. For the sake of comparison, the graph includes the profitability of the credit union sector, which achieved a level of 2.3%.[14]

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



Source: CNB - ARAD

5.4. Interest Rate Development

The development in market interest rates is affected primarily by the CNB's setting of interest rates and the effects of its monetary policies. As recently as in 2012, the central bank was able to cut its key 2W repo rate three times (it gradually went from 0.75% down to 0.05%). In 2013, the CNB could no longer perform a similar reduction in its monetary policy interest rates as they were already very close to the lowest possible level, i.e. at "technical zero".

[13] Since 2012, the CNB's classification of banks according to balance sheet total is as follows: large banks – balance sheet total greater than CZK 250 billion; medium-sized banks – balance sheet total of CZK 50-250 billion; and small banks – balance sheet total of less than CZK 50 billion.

[14] The CNB has not provided the profitability data for credit unions for the 2012 to 2013 timeframe.

In autumn 2013, the CNB decided to declare an exchange rate commitment[15] (which is sometimes simplistically and somewhat inaccurately labelled an intervention), with the aim of weakening the value of domestic currency and maintaining it at a certain level. The central bank's declared effort to maintain the exchange rate of the Czech crown relative to the euro close to the published level may have an indirect effect on the financial markets, including an impact on the anticipated development of the monetary policy interest rates. It is generally expected that the central bank will not increase the currency policy rates during the time that the currency exchange commitment remains in effect. As a result, within the context of the CNB's public declarations, these rates may possibly remain at their historically lowest level in the Czech Republic for a longer period of time. An overview of the CNB rates at the end of each half of the individual years is provided in Table 5.2.

Table 5.2: CNB interest rates

(%)	30 Jun 2012	31 Dec 2012	30 Jun 2013	31 Dec 2013	30 Jun 2014	31 Dec 2014
2W repo	0.50	0.05	0.05	0.05	0.05	0.05
Discount	0.25	0.05	0.05	0.05	0.05	0.05
Lombard	1.50	0.25	0.25	0.25	0.25	0.25

Source: CNB – ARAD

The settings of the monitored CNB rates (refer to Table 5.2) did not change over the course of 2014. Together with the reduction in the primary monetary policy rates to record low levels, there was another adjustment made in 2012 to the spread between the key base rate and the other CNB rates. The discount rate, which, up to that point was 0.25 pp less than the 2W repo rate (and before that even a full percentage point lower), was left at the same level as the repo rate. The range between the Lombard rate and the 2W repo rate was also decreased. Since the end of 2010, the difference between these two rates was 0.2 pp, whereas in the past it was 1 pp.

A number of other key central banks from around the world are implementing a policy of monetary easing. However, it needs to be emphasised that, in comparison with the monetary policy of the CNB, additional instruments, such as asset repurchases, are being used to a greater degree. In 2014, the Bank of England kept its basic interest rate at 0.5%, the Federal Reserve in the USA at an interval from 0.0 to 0.25%, and the Central Bank of Japan at an interval from 0.0 to 0.1%.[16] The ECB, as in the previous period, implemented two 0.1 pp decreases to bring the rate down to a level of 0.05%.

The overview of average client interest rates in the Czech Republic in individual years (refer to Table 5.3) shows a continuing gradual decline of the interest rates. As far as deposits are concerned, the interest paid on the deposits of non-financial businesses continued to be lower than in the case of deposits made by households. The spread between the interest paid in these two segments has been fluctuating at around 0.6 pp for the past three years. Given the downward tendencies for both rates, the situation is coming close to a point where the interest paid to households was almost three times higher than that paid to non-financial businesses (0.84% as compared to 0.29%). There is also an apparent difference in the sensitivity of the interest paid on the deposits in these two client segments. Whilst, over the entire monitored six-year period, the interest rate has decreased by less than one half in the case of households, non-financial businesses have experienced a drop of two thirds.

The average interest rate charged on new loans to households also decreased over the course of the year. In 2014, the interest on home loans decreased by 0.2 pp to 3.9%. The interest paid by households on consumer loans decreased by 0.1 pp to 14.5%. The average interest rate for loans provided to non-financial businesses also reported a decrease, specifically by 0.2 pp to 3.0%. As is the case with deposits, it is possible to see a higher relative change in the loan interest rates in the non-financial businesses segment as compared to the household segment (refer to Table 5.3).

[15] The CNB decided to use this instrument in autumn 2013. According to the CNB's website, "in its most recent statement of 26 March 2015 the Bank Board stated that the CNB would not discontinue the use of the exchange rate until the monetary policy horizon, i.e. before the second half of 2016". The CNB also specifies that, if needed, it "will intervene on the foreign exchange market to weaken the crown so that the exchange rate of the crown against the euro is kept close to CZK 27/EUR" [translations from Czech made by the MoF].

[16] In addition, the Central Bank of Japan recently confirmed its commitment to repurchase government bonds totalling 80 billion Japanese yen, an amount corresponding to approximately one-sixth of the country's GDP.

Table 5.3: Average interest rate

As at 31 Dec (%)		2009	2010	2011	2012	2013	2014
Deposits	households and small entrepreneurs	1.4	1.3	1.2	1.2	1.0	0.8
	non-financial businesses	0.9	0.6	0.5	0.6	0.4	0.3
Loans	to households and small entrepreneurs	7.0	7.0	6.8	6.5	6.0	5.6
	for consumption	13.9	14.4	14.6	14.5	14.6	14.5
	for residential real estate	5.2	5.3	5.1	4.8	4.3	3.9
	to non-financial businesses	4.6	4.1	3.9	3.7	3.2	3.0

Source: CNB – ARAD, MoF calculations

Note: Data refers to bank interest rates on CZK-denominated loans and deposits

In the case of loans provided to households, it is worthwhile to monitor the more comprehensive indicator that includes the other costs associated with the loan (i.e. the annual percentage rate of charge, or APR) in addition to the interest rate (which is used as the basic measurement of the cost of the loan).[17] Looking at the data for the individual months, it is possible to observe a certain seasonality in the previous years, specifically the interest rate has had a tendency to decrease in the December of each individual year and then to increase to a certain level in the January of the following year. This can be partially explained by the fact that there is an increased effort on the part of financial institutions to acquire new clients particularly during the period when there is an increase in the volume of seasonal credit purchases. However, this previous type of development did not repeat itself to the same extent in 2014. In the case of the APR for consumer loans, there was only a slight decrease between November and December (by 0.07 pp), and, in addition, it could have been caused by other factors.

The APR for new consumer loans provided in 2014 tended to decrease only slightly (refer to Table 5.4 and Graph 5.4). In December 2013 it was at 15.03%. After an initial increase in April 2014 (up to 15.34%), the APR gradually decreased and was 14.86% at the end of the year. This reflects a year-on-year decrease of 0.17 pp. The APR for the purchase of residential real estate recorded a more significant decrease (0.54 pp) and was at a record low level of 2.94% at the end of the year. The cost of loans for residential real estate is thus at a historically low level[18] as banks in the mutually competitive market continue to respond to the way the interest rates are set by the central bank and to the developments in the financial market in the real economy.

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

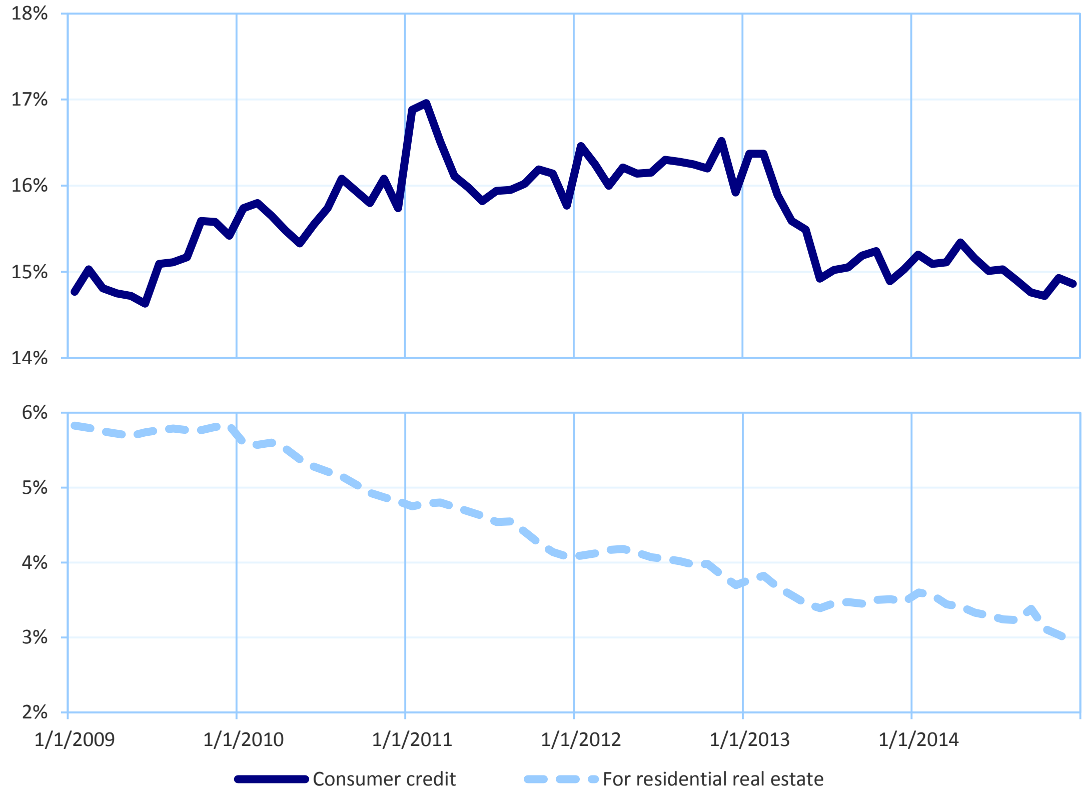
New loans 2014 (%)	January	February	March	April	May	June	July	August	September	October	November	December
Consumer credit	15.2	15.1	15.1	15.3	15.2	15.0	15.0	14.9	14.8	14.7	14.9	14.9
For residential real estate	3.6	3.6	3.4	3.4	3.3	3.3	3.2	3.2	3.4	3.1	3.0	2.9

Source: CNB – ARAD

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

[18] The decline in client interest rates for residential housing (as measured by Hypoindex) continued at the start of the year 2015 and attained a level even lower than the previous historical minimum.

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



Source: CNB – ARAD

5.5. Deposits and Loans

In 2014, the volume of deposits increased by 2.9% to CZK 3.44 trillion and loans increased by 2.8% to CZK 2.64 trillion (refer to Table 5.5). This reflects slightly slower growth dynamics, as in 2013 both of these indicators increased by almost 7%.

Deposits made by households increased significantly faster than in the previous year (by 6.1% as compared to 2.4%). The deposits made by households thus reflected the growth in the volume of resources that could otherwise be allocated in other financial market segments or used for purchasing other assets or for consumption. However, at the same time it also applies that the volume of household savings placed in pension funds and investment funds grew at a faster tempo (by 12.9% and 27.1%, respectively). The deposits of non-financial companies essentially maintained the same growth dynamics as in previous years and increased by 7.9%. The increase in this category of deposits may basically be interpreted in the same way as in the case of the household segment. That is to say, expressed aggregately it may be a sign that companies are increasing the volume of funds that they could otherwise use for investing in the real economy.

From the perspective of absolute change, the volume of deposits recorded the greatest growth in the household segment (by CZK 110.9 billion) followed by non-financial companies (CZK 61.7 billion). Conversely, the largest drop may be seen in the volume of deposits in the government sector (a decrease of CZK 88.8 billion). Households thus further increased the more than 50% share they hold of total deposits (56.0%, or CZK 1.9 trillion of 3.4 trillion). Non-financial companies, with a deposit volume of CZK 838.4 trillion (8.0% of all deposits), remain the second most important depositor. As far as the growth dynamics of deposits are concerned, the fastest growing segments in 2014 were non-residents (an increase of 18.7%) and non-profit institutions (an increase of 17.3%). In comparison, the deposits of both the government sector as well as financial institutions recorded a significant decrease (20.7% and 10.9%, respectively). This is the opposite of the situation in 2013, when, following the non-resident sector, these two sectors increased the volume of their deposits at the fastest rate.

From the perspective of the development in the maturity structure of deposits , the trend from the previous years continued and there was an increase in the deposits kept in non-term accounts (a growth of 13.4%) and a decrease in term account products (by 15.2%). As a result, the share of deposits kept in non-term accounts in relation to all deposits reported a dynamic growth of 6.5 pp to 69.6% across all client segments.[19] As recently as six years ago, this ratio was only at 52.8%. This is a continuation of the long-term trend in the decrease in the share of term-accounts. One of the reasons for this development is the growing popularity of savings accounts, which fall under the category of non-term deposits.

Over the past few years, due to the volume of loans for housing purchase, households are not only the most significant depositors, but also top the list of borrowers. As compared to the previous years, the volume of bank loans provided to households in 2014 grew at a slightly slower rate than the volume of their deposits (4.0% as compared to 6.1%.) and reached a level of CZK 1.2 trillion, which represents 47% of the total volume of bank loans. The volume of loans received by non-financial companies grew at a tempo slower than that of households (by 0.9% to CZK 874.9 billion). In comparison to the situation in 2013, there has been an apparent slowdown of activity and a return to the growth dynamics of 2012. One of the possible causes may be the tendency of companies to fund their growth by internal financing or capital market instruments. The situation may also be influenced by continued restructuring and the tendency to reduce indebtedness in certain sectors that expanded primarily due to the dynamic growth during the pre-2008 period. From the perspective of the dynamics of year-on-year development, financial institutions replaced non-residents as the sector with the fastest growing volume of loans (an increase of 24.4%). However, the non-resident sector once again reported a fairly high growth rate of 12.1%.

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

As at 31 Dec	Bank deposits (CZK bn)				Bank loans (CZK bn)			
	2013	2014	Change	Change (%)	2013	2014	Change	Change (%)
Households	1,812.2	1,923.2	110.9	6.1	1,180.7	1,228.1	47.4	4.0
Non-financial companies (including other institutions)	776.7	838.4	61.7	8.0	867.1	874.9	7.7	0.9
Government institutions	428.1	339.3	-88.8	-20.7	57.5	59.1	1.6	2.7
Financial institutions	164.6	146.7	-17.9	-10.9	119.7	149.0	29.3	24.4
Non-residents	132.1	156.9	24.8	18.7	287.1	322.0	34.9	12.1
Non-profit institutions	26.3	30.8	4.5	17.3	2.1	2.0	-0.1	-2.8
Total	3,340.1	3,435.3	95.2	2.9	2 514.3	2 635.1	120.8	4.8

Source: CNB – ARAD

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

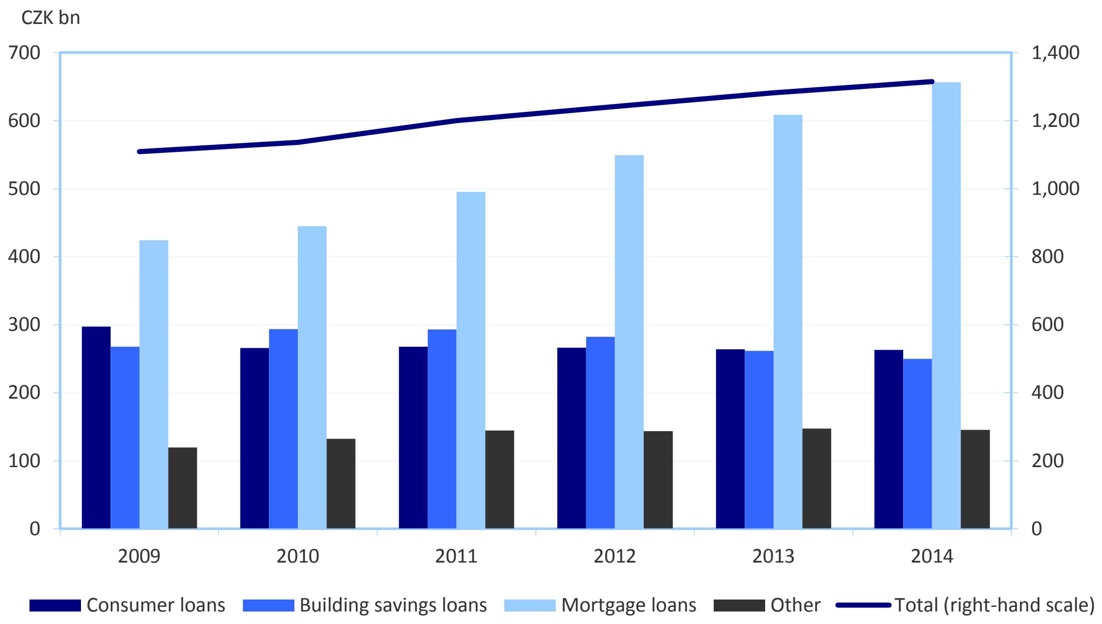
5.6. Household Indebtedness

Households are a key client segment that warrants a broader analysis than just from the perspective of its position in relation to the banking sector. The total household indebtedness with regard to both bank as well as non-bank financial institutions exceeded CZK 1.3 trillion at the end of 2013 (refer to Graph 5.5). This represents an increase of 2.6%, although the dynamics of year-on-year growth once again reflected a decline (by 0.7 pp). Similarly as in previous years, the development of indebtedness in the individual credit segments followed different trends, i.e. had different dynamics. The tempo at which the volume of mortgage loans increased slowed to 7.9%. During the most dynamic of the previous three years, the growth rate in this category fluctuated around a level of 11%.[20] In the case of loans provided through building savings schemes, 2014 was the first year in which the rate of the year-on-year decline slowed down. The decline in 2014 was 4.5%, which is 2.9 pp less than the tempo of the decline in the previous year.

[19] This issue as it relates to households is also addressed in Graph 3.1. However, it should be noted that Graph 3.1 monitors deposits at building savings accounts and in foreign currencies separately.

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

Graph 5.5: Total household indebtedness[21]



Source: CNB - ARAD, MoF calculations

The absolute volume of household debt for housing needs increased by CZK 36.1 billion. As compared to 2013, this reflects a slight decrease in the year-on-year growth rate (by CZK 2.4 billion). However, the development in these two loan categories that make up housing loans, i.e. building savings loans and mortgage loans, was different. The volume of loans obtained through building savings schemes did decrease, specifically by CZK 11.8 billion. However, this decrease was lower than in 2013, when the volume of these loans declined by CZK 20.8 billion. In the case of mortgage loans the rate of the year-on-year increase slowed down as compared to before. In 2014, their volume grew by only CZK 47.9 billion as compared to the more than CZK 59 billion in 2014. Consumer loans continued to decline slightly, reflecting a year-on-year decrease of CZK 1.4 billion. The size of this category has not changed in any significant manner since 2010 and the volume has decreased by CZK 2.8 billion, which corresponds to 1.1% of the initial value. Similarly as in previous year, the share of loans for housing needs in relation to total household indebtedness increased (by 1.0 pp). Therefore, at the end of the monitored period the value of this indicator came close to a level of 69% (CZK 0.9 trillion out of a total CZK 1.3 trillion).

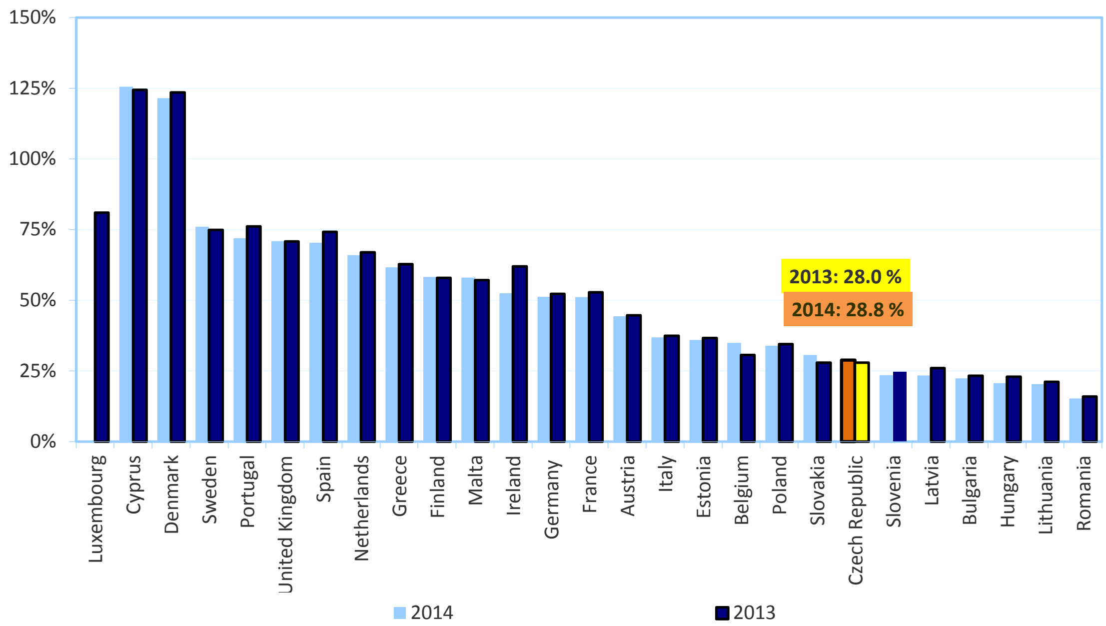
As can be seen in Graph 5.6, the level of household indebtedness (monitored according to the ECB data on the volume of loans provided to households as reported in the balance sheets of monetary financial institutions, but not including the ESCB) in relation to the size of the national economy, which indirectly reflects the amount of household income and thus the ability of households to meet their financial obligations, remains relatively low in the Czech Republic in comparison with the rest of the European Union. Using this method of measurement, there was a slight year-on-year growth of 0.8 pp to 28.8% of GDP.[22] As has been the case in previous years, it therefore applies that the costs associated with the servicing of household liabilities are generally not a factor that might limit private consumption to the same extent as in countries with higher relative levels of indebtedness. As is also apparent from Graph 5.6, the other new EU member states from Central Europe continued to report low levels of indebtedness. The reason may be the relatively recent transition of these countries to a market economy, as a result of which they have not yet had sufficient time to accumulate the relative volume of loans as is common in Western Europe. A marked decrease in

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

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

the relative level of household indebtedness was reported primarily by those economies where there was an increase in indebtedness during the credit boom that preceded the subsequent crisis after 2008, and now this level is gradually being reduced (e.g. Portugal, Spain, and Hungary), and by economies that have managed to reduce the value of their relative debt ratio by increasing the value of the denominator for this indicator, i.e. thanks to the renewed growth of the economy. The latter is typically the situation in the Baltic states, Poland, and Spain, where, just in the past year, the economy has shown above-average GDP growth.

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



Source: ECB, Eurostat, MoF calculations

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

Another specific characteristic of indebtedness is the currency in which the loans are denominated. One of the factors that have helped households in the Czech Republic to maintain their long-term ability to repay debt is the fact that more than 99.8% of the loans are denominated in Czech crowns. The size of the payments expressed in CZK cannot therefore be directly affected by the exchange rate volatility as has been the case in some of the other countries in the Central and Eastern European region. Conversely, countries with a higher level of foreign debt are now facing negative effects in two areas. Primarily, the higher volatility of payments denominated in the domestic currency is reflected in a fluctuating volume of private consumption, thus destabilizing domestic aggregate demand. In addition, if the cushion of consumer spending is not sufficient to cover these fluctuations, the volatility of the exchange rate may subsequently be reflected in a decline in the repayment rate for loans and deterioration in the quality of bank assets. With its low level of foreign debt, the Czech banking sector has a significant advantage in this area (refer to Chapter 5.1).

5.7. Mortgage Market

The dominant segment in the mortgage market consists of individuals (households) with regard to both the number of contracts as well as the volume of the principal of the provided loans.

The development in the mortgage loans provided to households may be analysed from more than one perspective. As can be seen in Table 5.6, the monitored indicators include the number of mortgage loans, the contractual principal, and the unpaid principal of mortgage loans. The number of mortgage loans increased year-on-year by 11.6% to 824,700 contracts. The volume of the unpaid contractual principal of the mortgage loans provided to households grew by 8.0% year-on-year (in absolute terms, by CZK 50.3 billion) to CZK 681.4 billion. The overall volume of contractual principal increased by 12.6% to CZK 1,281.7 billion in 2014. As compared to 2013, however, the year-on-year increase for all of the monitored indicators was lower in 2014. In both relative as well as absolute terms, the year-on-year increase in the number of mortgage loans was lower by 6,700 contracts (-7.3%). The year-on-year growth rate of contractual principal in 2014 was CZK 6 billion lower than in 2013 (-4.0%) and, in the case of unpaid principal, the year-on-year growth was CZK 3.6 million lower (-6.7%).

Table 5.6: Balance of mortgage loans provided to households

As at 31 Dec		2012	2013	2014	Year-on-year change	
					Abs.	(%)
Per year	Number of mortgage loans (000s)	73.6	92.6	85.9	-6.7	-7.3
	Contractual principal (CZK bn)	121.6	149.3	143.4	-6.0	-4.0
	Unpaid principal (CZK bn)	42.0	53.9	50.3	-3.6	-6.7
Total	Number of mortgage loans (000s)	646.2	738.8	824.7	85.9	11.6
	Contractual principal (CZK bn)	989.0	1,138.3	1,281.7	143.4	12.6
	Unpaid principal (CZK bn)	577.2	631.1	681.4	50.3	8.0

Source: MRD

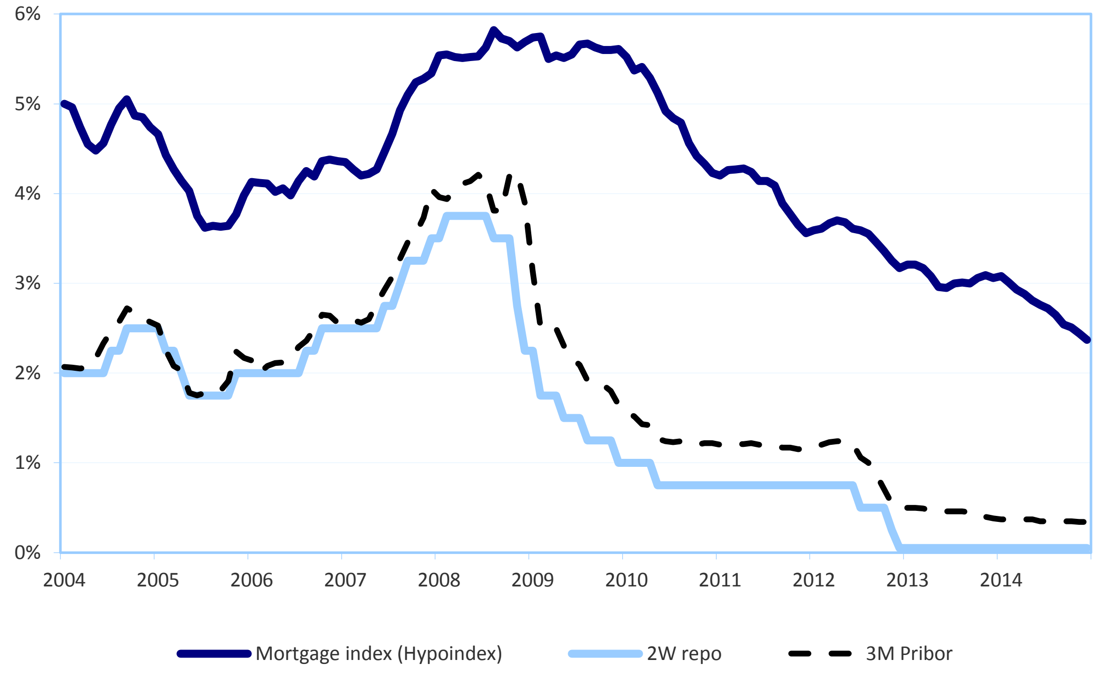
One of the factors that contributed towards the growth in the Czech mortgage market was the continuing declining trend in interest rates as expressed using the Hypoindex[23]. Over the past few years, these rates have been reaching new minimum levels in each year that this indicator has been monitored (since 2003). Whilst in the preceding years, the year-on-year decline increased at a slower rate, between 2013 and 2014 the Hypoindex rate dropped by 0.69 pp to a level of 2.37% at the end of 2014. In comparison, during the previous period the difference in the rates at the end of 2012 and the end of 2013 was only 0.11 pp. Given that the Hypoindex rates decreased gradually over the course of 2014, the arithmetical average of the decrease for the twelve months between the end of 2013 (when the rate was 3.07%) and the end of 2014 (when the rate was 2.73%) is much lower and is only 0.34 pp. In April 2015, i.e. after the end of the period covered by this report, the Hypoindex rate dropped to a new record minimum of 2.11%.

Some of the possible long-term causes of the decline in the Hypoindex rate include the increasing competition amongst lenders, the increasing popularity of variable rate contracts[24] (which are priced lower than fixed rate loans), and of course the cheaper bank sources resulting from the effects of the greatly eased monetary policy. The relationship between the developments in the client, interbank, and monetary policy rates is depicted in Graph 5.7.

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

[24] Based on the data published by the CNB, approximately 52% of the new mortgage loans provided in 2014 are either variable rate mortgage loans or mortgage loans with a fixed rate for a period of less than one year. This represents an increase of 18 pp as compared to 2013. However, this indicator is somewhat distorted as the statistical methodology used by the CNB reports a portion of the loans provided by building savings banks together with standard mortgage loans.

Graph 5.7: Development of selected interest rates



Source: Fincentrum, CNB – ARAD

During the first quarter of 2014, the interval between the Hypoindex rate and the 2W repo rate decreased to a level below 3 pp and continued to drop to a level of approximately 2.3 pp at the end of the year. The last time that the interval between the two rates was this low was in 2008. However, at that time the monetary policy rate was substantially higher (above 3%) and the Hypoindex rate was almost 6%. The maximum interval (4.6 pp) was recorded at the end of 2009. The central bank started to progressively decrease its key interest rates as early as in 2008. However, lenders reacted to this development only gradually with the improving situation in the real economy and in the financial markets.

Table 5.7 provides an overview of mortgage loans according to the client categories. The total number of mortgage loan contract grew by almost 88,000, which reflects a slightly slower growth rate as compared to the previous period (6,500 less). Due to the highest number of contracts and the highest rate of annual change in the client category of households, the highest absolute year-on-year increase in the number of contracts was achieved specifically in this category. From the perspective of relative changes, the ranking of the categories remains the same as in the previous monitored period. The number of contracts increased the most in the category of households (by 11.6%), followed by the category of business entities (10.6%). The slowest growth in the number of contracts was recorded by municipalities (7.5%) Whilst in the case of business entities and municipalities there were no significant changes in the tempo of the year-on-year change (only a few tenths of a percentage point), in the category of households the annual growth rate in the number of contracts decreased by 2.7 pp. This may be evidence of the increasing level of saturation in this market segment, as well as a reflection of the more prudent approach taken by potential borrowers during the period in question and the fact that they postpone any possible real estate purchases.

Table 5.7: Mortgage loan balances by client categories [25]

As at 31 Dec		2012	2013	2014	Year-on-year change	
					Abs.	(%)
Individuals	(000s)	646.2	738.8	824.7	85.9	11.6
	Contractual principal (CZK bn)	989.0	1,138.3	1,281.7	143.4	12.6
Business entities	(000s)	16.8	18.6	20.5	2.0	10.6
	Contractual principal (CZK bn)	311.1	337.7	383.0	45.3	13.4
Municipalities	(000s)	0.9	1.0	1.1	0.1	7.5
	Contractual principal (CZK bn)	9.5	10.2	11.1	0.9	8.6
Total	(000s)	664.0	758.4	846.3	87.9	11.6
	Contractual principal (CZK bn)	1,309.6	1,486.1	1,675.7	189.6	12.8
	Unpaid principal (CZK bn)	697.5	752.1	811.7	59.6	7.9

Source: MRD

During the monitored period there was an absolute increase of CZK 189.6 billion in contractual principal, of which CZK 143.4 billion (approximately 75.6% of the total increase) is in the category of households and CZK 45.3 billion is in the business entities category. The more marginal category of municipalities reported an increase of only CZK 0.9 billion. As far as growth dynamics are concerned, the volume of contractual principal increased by 12.8%, which is only slightly less than in 2013, when it grew by 13.5%. In 2014, the category of business entities reported a 5 pp increase in the annual growth rate in the volume of loan principal to reach a level of 13.4%, thus exceeding the growth rate in the category of households, which has long held the position of the fastest growing category prior to this time. The volume of mortgage contractual principal in the category of households, which was increasing by an average of 15% annually starting in 2010, increased by only 12.6% in 2014, reflecting a 2.5 pp decrease in the growth rate. In the categories of municipalities, the rate at which the volume of loan principal increased from 6.9% in 2013 to 8.6% in 2014. The last line of Table 5.7 specifies the volume of unpaid principal, which increased by CZK 59.6 billion (7.9%) in 2014. This is almost the same annual growth rate as in 2013, when it was 7.8%.

Table 5.8: Volume of mortgage loans

As at 31 Dec	2012	2013	2014	Year-on-year change	
				Abs.	(%)
Volume of mortgages to households (CZK bn)	700.5	746.6	796.9	50.3	6.7
Volume of mortgages for residential property (CZK bn)	747.6	789.5	844.3	54.8	6.9
Volume of mortgages for property (CZK bn)	864.3	909.7	965.0	55.3	6.1

Source: CNB – ARAD

The volume of mortgage loans[26] provided to households[27] has increased at almost the same rate of approximately 6.5% over the past three years. The data on unpaid principal from the perspective of the purpose of the loan (residential vs. non-residential real estate) provide another view. The volume

[25] The definitions of the individual categories of client segments are based on the statistics published by the Ministry of Regional Development.

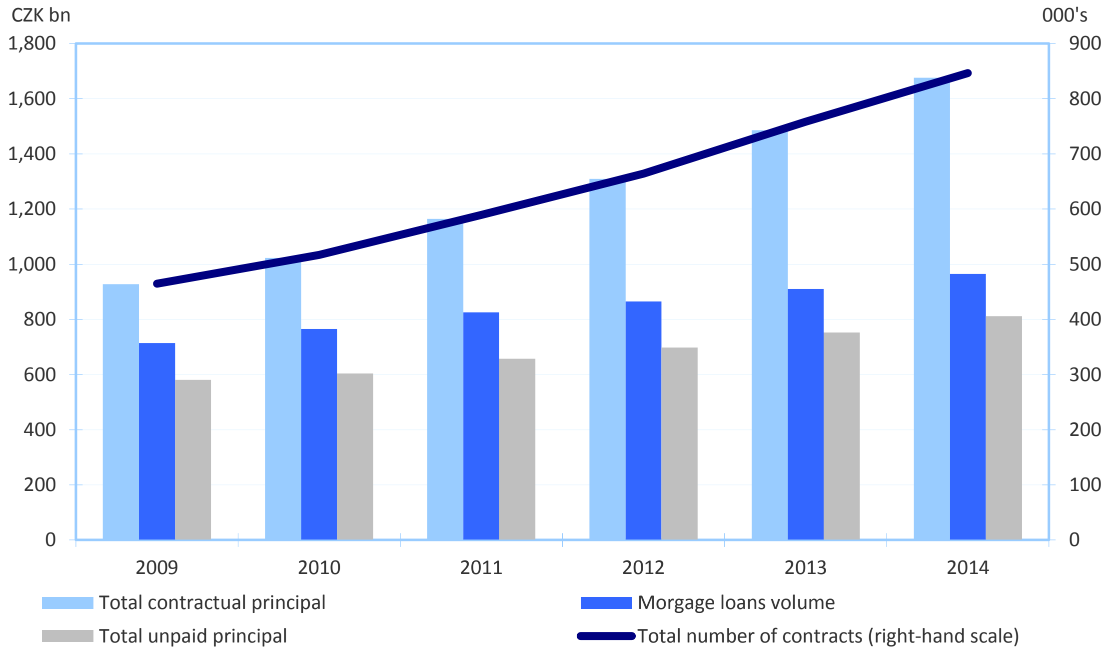
[26] Based on the data published by the CNB, this includes the volume of unpaid (outstanding) principal including refinanced loans. From the perspective of the methodology that is used, it is not possible to, for example, automatically interpret an increase in the indicator as an increase in the loans provided by banks or their willingness to provide loans, as it may also be a reflection of the deteriorating ability of borrowers to repay their debt. In addition, the statistical methods used by the CNB generally report a portion of the loans provided by building savings banks within the category of mortgage loans. The CNB definition of newly provided mortgage loans is understood to include any new agreements between a bank and a client, i.e. financing contracts, which establish an initial interest rate, as well as any subsequently negotiated agreements associated with the existing contract (such as the refinancing of a mortgage loan). The share of refinanced loans within the total number of mortgage loans is continuing to grow. Not all the data required to calculate the exact amount of refinancing is available, however, based on other information, it is possible to estimate that this share is several tens of percentage points. Taking into account the above-specified distortion of the indicator of provided mortgage loans for the given year, the main reporting value of this indicator is primarily the fact that it illustrates the ability of the individual mortgage loan providers to maintain their respective market shares.

[27] The methodology used by the CNB includes the following in the category of households: employees, recipients of property income, pension recipients, and recipients of other financial transfers.

of mortgage loans overall increased in 2014 by 6.1% to CZK 965 billion, which provides evidence of the continuing trend of the faster year-on-year growth, which started in 2013 when this indicator was 5.6%.

The development of the overall mortgage market indicators is depicted in Graph 5.8. The information presented in this graph regarding the total number of contracts, contractual principal, and unpaid principal includes the data for households, business entities, and municipalities (also refer to the data in Table 5.7). The volume of loans represents the mortgage loans provided for residential and non-residential real estate (also refer to the data in Table 5.8).

Graph 5.8: Aggregate mortgage market indicators



Source: MRD, CNB – ARAD

The forecasts for how mortgage loans will develop in the future are made using several long-term factors that do not have a tendency to change in any significant way over the medium-term timeframe. The positive predictions for the future development of the mortgage loan market in relation to households are based on the relatively low level of indebtedness that exists amongst Czech households. Over the shorter timeframe, other factors will have an effect, including the developments in wages and the labour market and, consequently, the rate of economic growth. The rate of economic growth is itself influenced by the demand for loans and the developments in the financial markets. In this respect, the realisation of the deferred demand associated with the still waning uncertainty connected with the earlier financial and debt crisis may also have an effect, albeit to a lesser degree. The expected development in real estate prices is another possible factor that may have an effect. As a result of the increased demand for certain types of housing in specific locations, prices are increasing,[28] however, this tends to have an impact more on the actual type of housing that is chosen. The decreasing interest rates would also continue to have a positive effect on the volume of mortgage loans, and whether this trend continues or is interrupted will play a key role in the future development of the mortgage loan market. The ever-decreasing size of the gap between interest rates for deposits and loans, combined with the decreasing offer of safe investment opportunities often motivates households to take out a mortgage loan rather than resolving their housing situation in some other way. The refinancing of mortgages, which generates a significant proportion of new loans for housing (but not, however, a change in the total amount due), combined with the migration of clients from mortgage loans to loans provided by to building societies, will also continue to introduce a certain level of uncertainty with regard to future development.

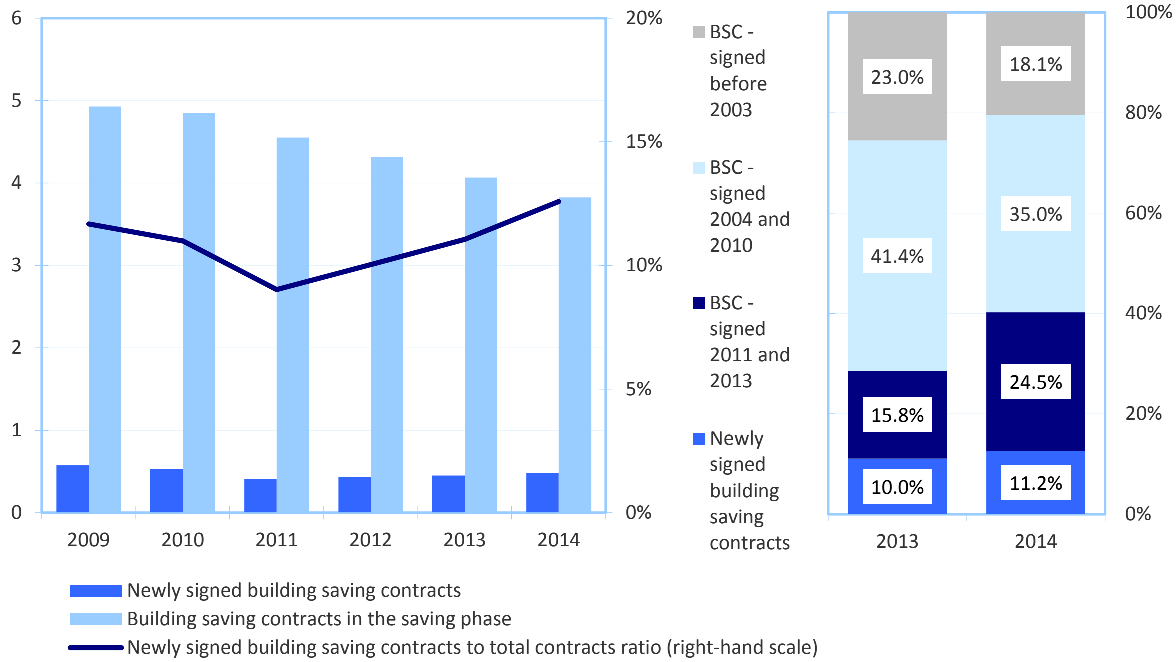
[28] Based on the data published by the Czech Statistical Office, the prices of older flats in the Czech Republic increased by almost 6% in 2014, whereas the prices for new builds grew by only 1.6%.

5.8. Building Savings Banks

For the building savings bank sector, the year 2014 was marked by an increase in new contracts as compared to the previous period. More than 481,000 new contracts were signed for building savings schemes in 2014, which is 32,000 more than was the case in 2013. This reflects a year-on-year increase of 7.1%, which is almost twice the growth rate in 2013. The renewal in the growth of the base of contracts in the savings phase, i.e. the share of new contracts in relation to the total number of building savings contracts, increased to 12.6% in 2014, and this indicator thus achieved the highest value of the entire monitored period (refer to Graph 5.9).

Whilst there was a positive development in the number of new contracts, the total number of contracts in the savings phase continued to decline, following the downward trend that started in 2004. At the end of 2014, the total number of contracts in the savings phase was approximately 3.8 million, reflecting a decrease comparable to that in 2013 (approximately 241,000 fewer contracts, which corresponds to a 5.9% drop). As can also be seen in Graph 5.9, one-fifth of the registered contracts in the savings phase were made prior to 2004 (when the state contribution was CZK 4,500). Another two-fifths of the contracts were made between 2004 and 2010 (with a state contribution of CZK 3,000). Based on this, it is apparent that more than 50% of the contracts are used for the purpose of long-term savings.

Graph 5.9: Number of building savings contracts (BSC)[29]



Source: Building savings banks, MoF calculations

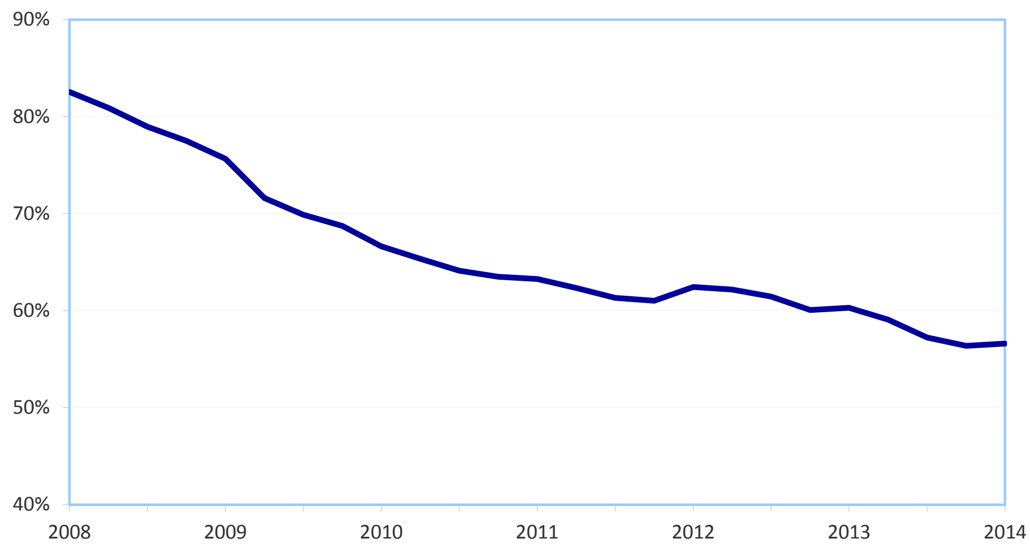
For the second year in a row, there was also a decrease in the total saved amount and it went down to CZK 413.6 billion. The rate of the year-on-year decrease went up from 1.4% in 2013 to 3.6% in 2014. In relation to the total value of the deposits, it is important to monitor the indicator reflecting the deposits after the minimum saving period (refer to Graph 5.10)[30], which was 56.6% at the end of 2014. The deposits after the minimum saving period represent the portion of total deposits for which the participant has met the conditions for the minimum saving period and, as a result, the building savings contract becomes the equivalent of a traditional deposit account with a withdrawal period. This value of indicator has also been consistently decreasing. Historically, the indicator reflecting the deposits after the minimum saving period achieved its highest value (82.6%) at the end of 2008, which marked the completion of the five-year minimum

[29] During the existence of the building savings schemes, the state contribution has been decreased twice. During the first ten years, the state contribution was CZK 4,500. Starting in 2004, this was decreased to CZK 3,000 for all new contracts. The second decrease was in 2011 and it applied to all participants in the building savings schemes. Since that year, the maximum state contribution is CZK 2,000 per participant.

[30] The minimum saving period is the period of time for which the client must increase their savings in order to meet the conditions for receiving the state contribution. Since 2004, it has been six years. Prior to that time, it was five years.

saving period of the increased number of contracts that were made under the more advantageous conditions at the end of 2003.

Graph 5.10: Percentage of deposits after the minimum saving period



Source: Building savings banks, CNB – ARAD, MoF calculations

The reduction in the volume of deposits after the minimum saving period could partially be the result of the lower interest rate paid on deposits, which the building savings banks started to apply in 2013 and, in some cases, continued to use in 2014. This factor, combined with the change in the rules for withdrawing the saved amount on behalf of minors (as a result of the amendments to the Civil Code)[31], has most probably led to the decreased popularity of building savings schemes. The interest rates for mortgage loans, which have been reaching historical minimums, also affected the behaviour of building savings bank clients. Over the course of 2014, the interest rates for alternative savings products were comparable to the rates offered for new building savings accounts. However, if the state contribution amount is taken into consideration, the building savings schemes continue to be the best form of savings plan that offer the ability to obtain a loan for housing needs. In addition, the data that reflects the increasing tempo of the growth in the number of new contracts states that building savings schemes, as a specific product, is maintaining its position in the portfolio of household financial products.

The developments in the financial market and the environment resulting from low interest rates, including mortgage loan rates, has primarily had a negative effect on the use of the buiding savings loans. This particular category of loans continued to decline in 2014, when the total number of loans[32] decreased by 63,000 to 753,000 (refer to Table P2.4 in Appendix 2).

Table 5.9: Main indicators for the building savings bank sector

	2009	2010	2011	2012	2013	2014
Loans in total (CZK bn)	267.5	293.4	293.1	282.2	261.4	249.6
Saved amount (CZK bn)	415.2	430.1	433.4	435.0	429.1	413.6
Loans in total to saved amount ratio (in %)	64.4	68.2	67.6	64.9	60.9	60.4

Source: Building savings banks

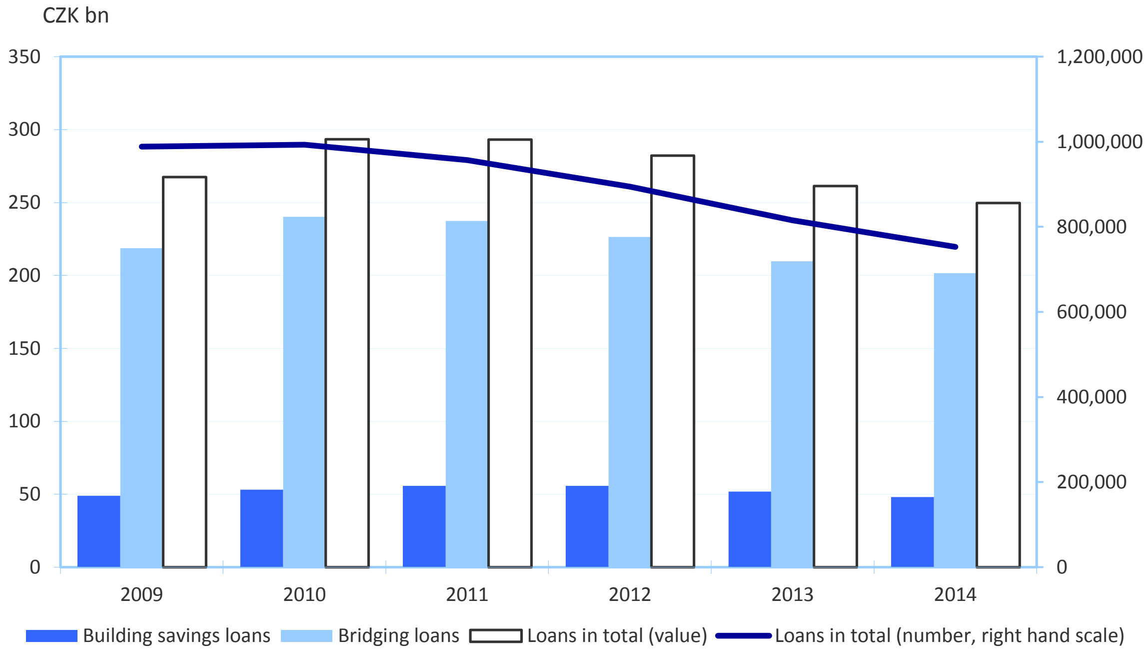
The continuing downward trend in the demand for loans provided by building savings banks is also apparent in the overall volume of these loans, which decreased year-on-year by CZK 11.8 billion (-4.5%) to CZK 249.6 billion. Building savings loans decreased much more dramatically – by 7.2% – as compared to

[31] Since 1 January 2014, at which time the new Civil Code entered into force, in order to terminate the building savings contract of a minor, the consent of the Children's Services Court is required.

[32] Building savings banks provide building savings loans and bridging loans. The term “loans” as it is used here is understood to include both types. If any information relates to only one type of loan, this fact is explicitly stated.

the 3.9% decrease in bridging loans. Their share of total loans has remained at the same level of approximately 20:80 during the entire monitored period (2009-2014). Due to the slower year-on-year decline in the total volume of loans, and the much more significant decrease in the saved amount, the ratio of loans to saved amount started to decline more slowly and reached a level of 60.4% in 2014.

Graph 5.11: Volume of loans granted by building savings banks

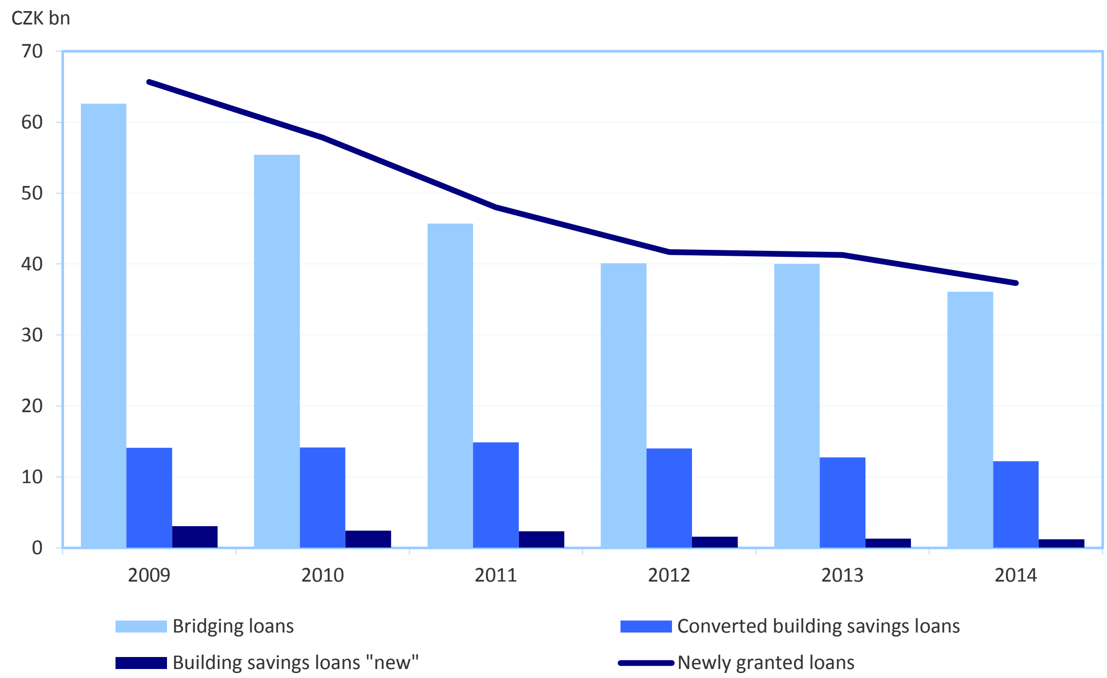


Source: Building savings banks

Whilst the total volume of loans started to decline at a rate that was 2.9 pp. lower, the rate at which the volume of new loans[33] decreased over the course of the year went up by 8.7 pp. After two years of maintaining a relatively stable level of CZK 41.5 billion, the volume of newly granted loans resumed the long-term declining trend and, at the end of 2014, were down to CZK 37.3 billion. However, there was a difference in the development in the two components that are added to together to determine the total number of newly granted loans. The volume of new bridging loans decreased year-on-year by 9.7%, whereas the volume of new building savings loans decreased by only 5.4% during the same period. It is interesting to note that 60% of all new loans in 2014 were granted by one building savings bank.

[33] Newly granted loans are calculated as the sum of newly granted bridging loans (the light blue bar in Graph 5.12) and newly granted building savings loans (the dark blue bar in Graph 5.12). A special category consists of “converted building savings loans” (these are not newly granted loans), which were used by the borrowers as a bridging loan that, after the contractual conditions are met, are converted into standard building savings loans with a new repayment schedule and generally with better interest conditions.

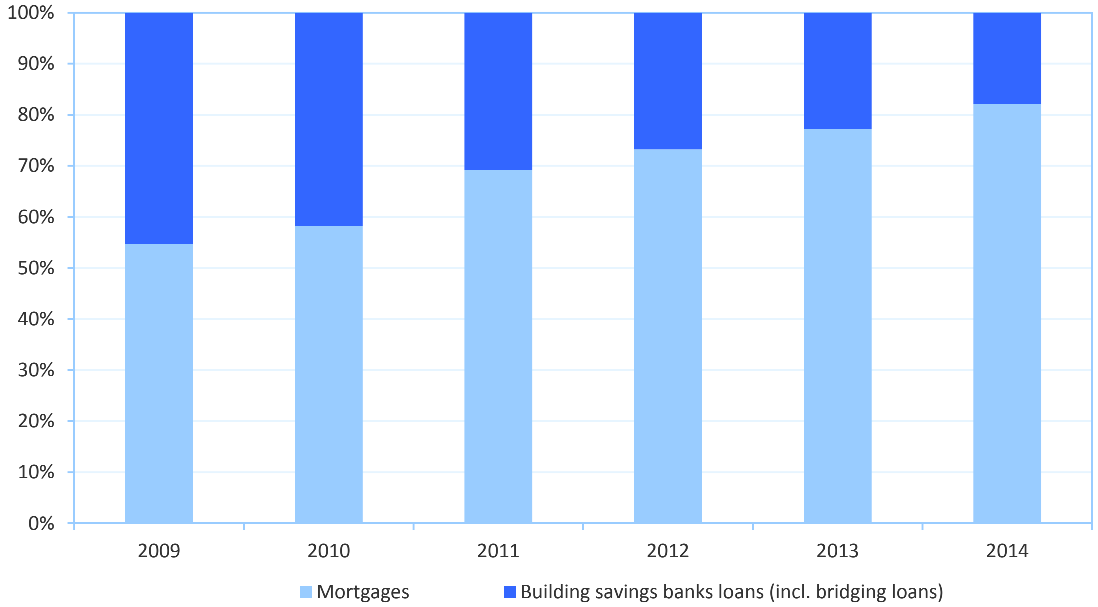
Graph 5.12: New loans in the building savings bank sector



Source: Building savings banks

The rapidly dropping mortgage loan interest rates, which have been pushed down to record low minimums over the past few years, played a role in the decline in the number and volume of loans. Building savings banks loans, due to their stable rates, are not preferred in this highly competitive environment. After what was another very successful year for mortgage banks, the percentage share of new building savings banks loans in relation to the volume of new loans for housing granted to households decreased from 23% to 18% to the advantage of the mortgage banks. As can be seen in Graph 5.13, the volume of new mortgage loans increased year-on-year by 24%, whereas the volume of newly granted building savings loans decreased by 9%.

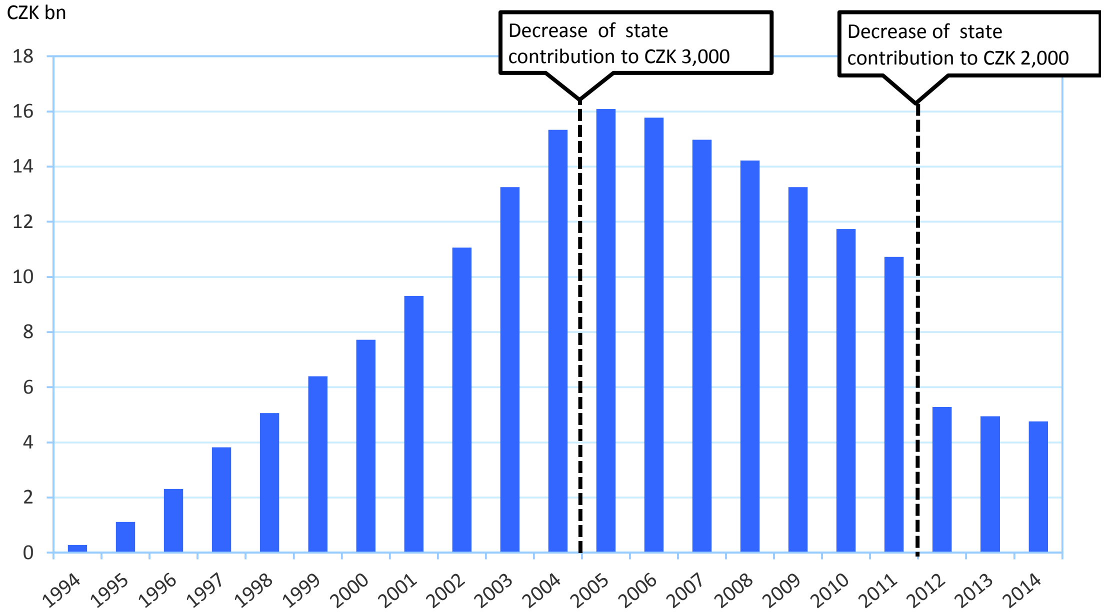
Graph 5.13: Shares of new loans granted by commercial and building savings banks



Source: Building savings banks, CNB – ARAD, MoF calculations

State contributions totalling CZK 4.8 billion were disbursed in 2014 for building savings schemes, which is CZK 239 million (4.8%) less than in 2013. A more significant drop (50.6%) was recorded between the years 2011 and 2012[34], which was a reflection of the decreased amount of the annual state contribution. Overall, between 1994 and 2014 the government has paid out state contributions totalling approximately CZK 187 billion to participants in building savings schemes (refer to Graph 5.14 below).

Graph 5.14: Paid state contribution

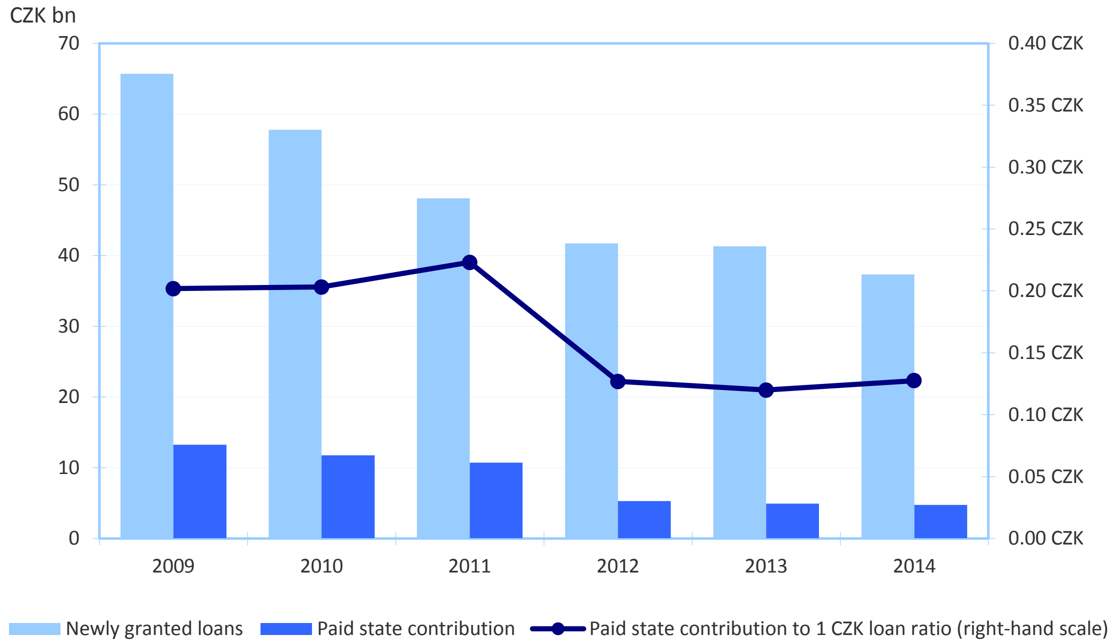


Source: MoF

In its effort to support the financing of housing policy and to target household savings for housing purposes, the state pays out resources from the state budget. The line in Graph 5.15 plots the amount of the state contribution allocated for each 1 CZK of the expenditure (i.e. loan) generated by the building savings bank sector and earmarked specifically to finance housing needs. In 2014 this amount was CZK 0.13, which is about one third lower than it was during the 2009 to 2011 period (when it was approximately CZK 0.21). Given that this value has been fluctuating at a level of about CZK 0.13, it is apparent that the effectiveness of the state contribution has increased as compared to the 2009-2011 period. It is not expected that this particular indicator will deviate away from this current trend in the future to any significant degree.

[34] The state contribution is disbursed retroactively for the preceding year, and thus the effects of the decrease in the state contribution that occurred in 2011 were not reflected until 2012. For this reason, in Graph 5.15 the designated decreases in the state contribution are moved one year forward from their effective date.

Graph 5.15: Paid state contribution to loan ratio



Source: Building savings banks, MoF calculations

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

5.9. Credit Unions

The operating licence of the credit union - WPB Capital, spořitelní družstvo, was revoked in 2014 on the basis of the CNB decision of 24 June 2014.[35] As will be demonstrated in numbers below, the revocation of the operating license was reflected in the sector of credit unions to a much lesser degree than when the licence of credit union - Metropolitní spořitelní družstvo, was revoked in 2013.

The after-tax financial results for the entire credit union sector attained a valued of CZK 75.9 million in 2014 (refer to Table 5.9). This reflects an increase of CZK 95.7 million as opposed to the previous year, when the entire sector suffered a loss. The sector's balance sheet total declined by CZK 284 million to CZK 31.3 billion, which corresponds to 0.43% of the balance sheet total for the entire banking sector. The 0.9% year-on-year decrease in the balance sheet total is an indication of fairly stable development (in spite of the revocation of the operating licences of Metropolitní spořitelní družstvo and WPB Capital in 2013 and 2014, respectively.) Quite to the contrary, as can be seen in Table 5.9 and Graph 5.16, the number of credit union members increased by 6.7% over the course of the year to 57,179 members in spite of the decrease in the balance sheet total.

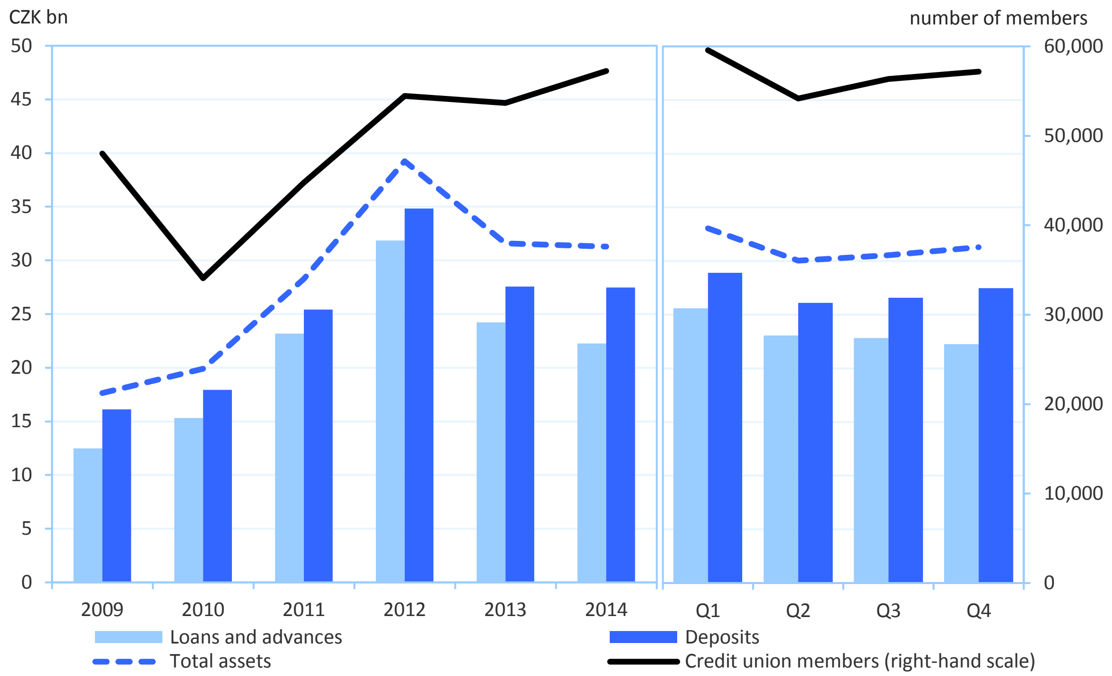
[35] More information is provided in Chapter 4 – Institutional Aspects of the Financial Market.

Table 5.10: Main indicators for the sector of credit unions

As at 31 Dec	2009	2010	2011	2012	2013	2014	Year-on-year change (%)
Number of members of credit unions	47,952	34,003	44,687	54,402	53,594	57,179	6.7
Total assets (CZK bn)	17.6	19.9	28.3	39.3	31.6	31.3	-0.9
Loans and advances (CZK bn)	12.5	15.3	23.2	31.9	24.2	22.3	-8.0
Deposits (CZK bn)	16.1	17.9	25.4	34.8	27.6	27.5	-0.3
Share of loans provided to deposits recieved (%)	77.5	85.4	91.2	91.4	87.9	81.1	-7.7
Share of quick assets to total assets (%)	25.5	17.6	13.1	14.3	18.8	23.1	23.0
Share of non-performing loans to total liabilities (%)	3.4	8.2	13.2	7.8	19.0	22.6	18.6
Coverage of non-performing loans by allowances (%)	16.3	12.8	13.8	16.4	16.6	18.7	12.8
Total capital ratio (%)	14.5	12.2	12.1	13.3	14.3	13.9	-2.9
Profit/loss (CZK mn)	-0.2	-38.8	122.8	303.8	-19.8	75.9	-
Return-on-assets (%)	0.0	-0.2	0.4	0.8	-0.1	0.2	-

Source: CNB – ARAD

Graph 5.16: Main indicators for the sector of credit unions and quarterly development in 2014



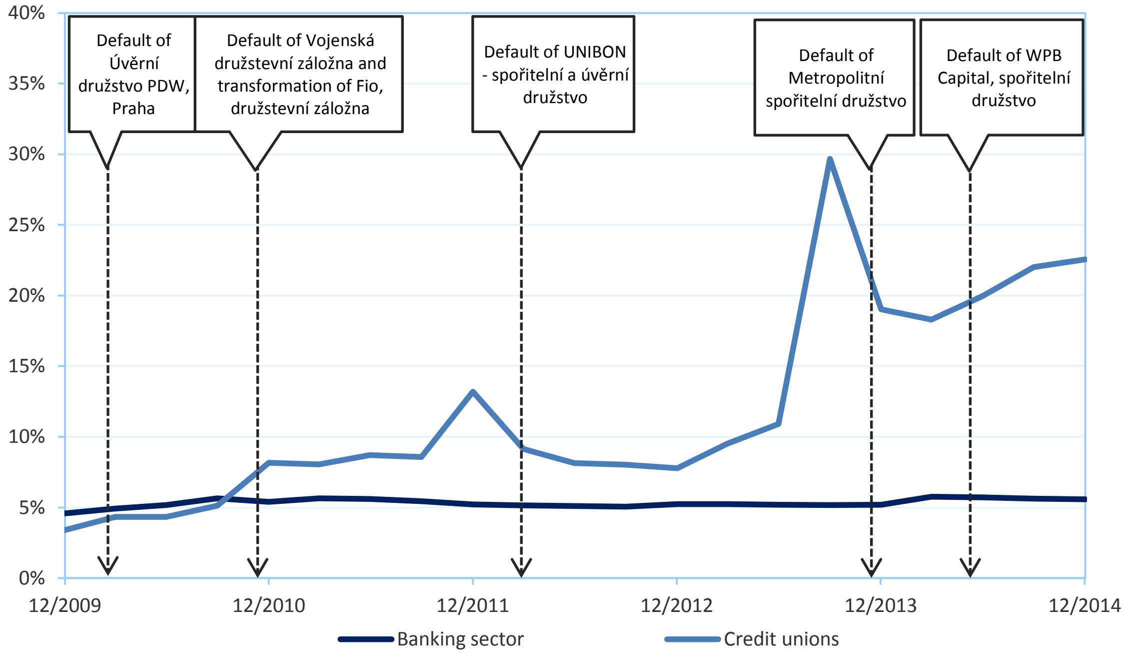
Source: CNB - ARAD

A closer analysis of the impact of the revocation of WPB Capital's operating licence indicates that there was a 9.1% decrease in the number of credit union members between the first and second quarters of the year, but between the second and fourth quarters, the trend was reversed and there was a 5.6% increase during these three quarters. There is a similar pattern in the case of deposits, which decreased by 9.6% between the first and second quarters, but then increased by 5.2% between the second and fourth quarters. This indicates that not all credit union members transferred their deposits to other entities in the credit union sector.

Year-on-year, the volume of deposits received decreased by 0.3% to CZK 27.5 billion, which is a smaller decrease than was seen during the previous period due to the failure of the Metropolitní spořitelní družstvo. The volume of loans granted decreased by 8% over the course of the year to CZK 22.3 billion.

Generally speaking, the long-term growth in the credit union sector is the result of the fact that credit unions pay higher interest rates on deposits than that which is offered in the banking sector. (In 2013, the average interest rate received by credit union clients was 3%, whereas in the banking sector it was only 0.8%.[36]) In addition, in 2008 a 100% guarantee was implemented for deposits in compliance with European legislation. This spurred enormous interest amongst depositors and was subsequently reflected in the volume of deposits. The ratio of deposits to assets decreased at a slower rate than the relative share of granted loans in relation to assets. This level of interest on the part of depositors led the credit unions to invest in assets with a higher level of associated risk. This increased the number of non-performing loans, which is much higher than in the banking sector (refer to the graph below).

Graph 5.17: Share of non-performing loans to total liabilites

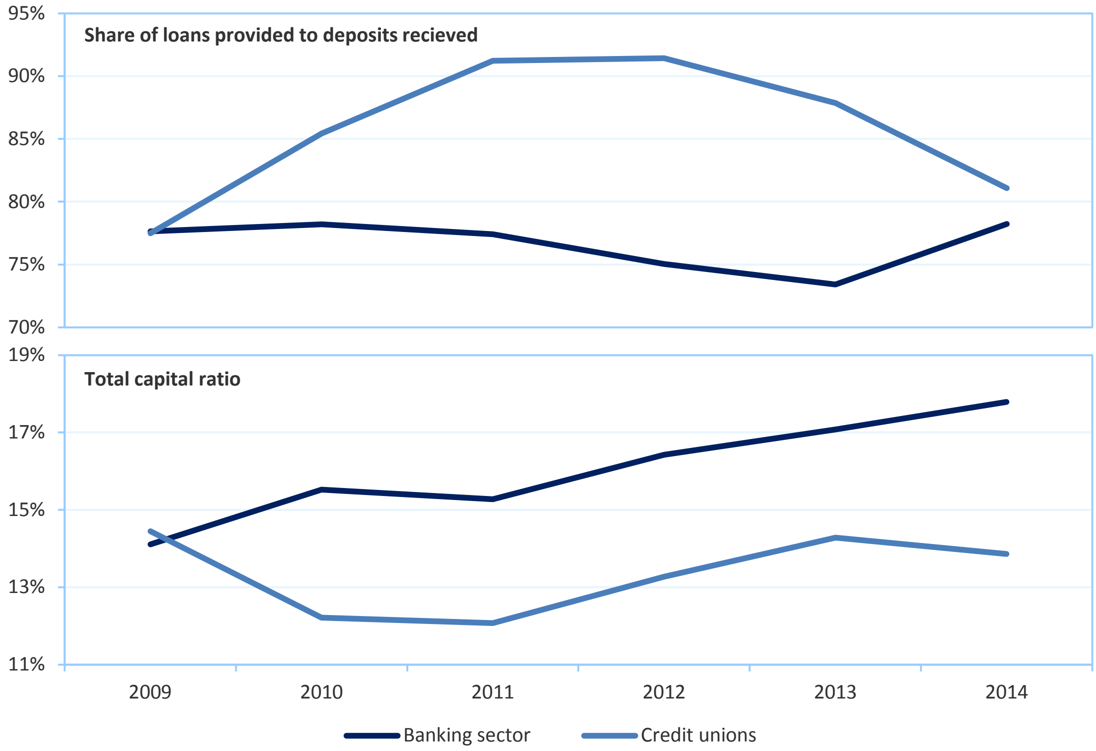


Source: CNB - ARAD, MoF calculations

This indicator shows that the risk associated with the loan portfolio has significantly increased from from 4.6% at the end of 2008 to 22.6% at the end of 2014. This negative development was one of the factors that led to the failure of some credit unions during the monitored period. The increasing instability in the credit union sector also presents a risk for the Deposit Insurance Fund.

[36] The MoF does not have any current data.

Graph 5.18: Share of claims to liabilities and capital ratio



Source: CNB - ARAD, MoF calculations

This same negative development in the loan portfolios of the credit unions between 2009 and 2014 is reflected in the decrease in the total capital ratio, which has not regained its original 2009 values over the course of the entire monitored period. After the noticeable reduction in quick “liquid” assets between 2009 and 2011, this ratio indicator did increase in 2012 to 2014,however, it remained below its original 2009 value during the entire period. This decline and the lower values than those at the beginning of the monitored period may be explained by the decreasing volume of deposits in credit institutions (a year-on-year decrease of 16.3%), which this reduces participation in the interbank market. Another reason is the growing debt saturation of the accepted deposits, which reached a level of 81.1% at the end of 2014 and is approximately 3 pp higher than in the banking sector.

An important event occurred in 2014 from the perspective of the loan and credit union sector. Specifically, the government approved the amended version of Act No 87/1995 Coll. on credit unions, which will have a significant impact on the functioning of credit unions during the post-2014 period.

5.10. Non-Bank Financing Providers

Non-bank financing providers present an alternative to credit institutions with regard to the options available for obtaining loan financing. However, at the same time it applies that a number of entities in this segment are linked financially and through assets with the banking sector through some of the existing financial groups. At the end of 2014 this segment of the financial market reported a balance sheet total of CZK 353.6 billion (refer to Table 5.10), which means that it has not been equal to even 10% of the balance sheet total for the banking sector for a longer period of time.

In 2014, this sector's balance sheet total grew by CZK 11.5 billion (3.4%). However, the asset volume continues to remain below the values reported in 2009, which is the first year of the monitored period depicted in Table 5.10. Historically, the sector’s highest balance sheet total was recorded at the end of 2008 (CZK 448.9 billion) prior to the time that the global financial crisis could have an effect. Between the end of 2009 and the end of 2014 the balance sheet total has cumulatively decreased by 12.5% (if the year 2008 is also taken into consideration, the decrease is 21.2%). The development in the volume of granted loans more or less followed the same pattern as the development in the balance sheet total and remained the most important balance sheet item at a level of 72-75%.

This sector of non-bank financing providers is usually (and also in terms of reporting) split into three segments: financial leasing companies, other lending companies, and factoring and forfaiting companies. From the perspective of the share of overall balance sheet total, the sector is dominated by financial leasing companies (74.0%), followed by other lending companies (20.1%), and factoring and forfaiting companies (5.9%). Over the past four years, these relative shares have not changed in any significant way.

Table 5.11: Main indicators in the non-bank financing providers sector

As at 31 Dec (CZK bn)	2009	2010	2011	2012	2013	2014	Year-on-year change (%)
Total assets [37]	404.2	352.3	356.1	346.3	342.1	353.6	3.4
Loans provided	299.0	260.8	266.3	256.6	246.9	254.9	3.2
Volume of total assets (CZK bn)							
Financial leasing companies	282.5	265.2	265.1	259.3	253.1	261.7	3.4
Other lending companies	100.7	67.7	71.3	70.5	70.3	71.0	1.0
Factoring and forfaiting companies	20.9	19.5	19.7	16.6	18.7	20.9	11.5
Relative share of the sector's assets (in %)							
Financial leasing companies	69.9	75.3	74.4	74.9	74.0	74.0	0.1
Other lending companies	24.9	19.2	20.0	20.3	20.6	20.1	-2.3
Factoring and forfaiting companies	5.2	5.5	5.5	4.8	5.5	5.9	7.8

Source: CNB - ARAD, MoF calculations

For the first time during the monitored period the total assets of financial leasing companies increased in 2014 and recorded a year-on-year growth of 3.4% to CZK 261.7 billion. However, as is the case with the overall development experienced by non-bank financing providers, not even the balance sheet total in this segment reached the levels reported in 2009 (a decrease of CZK 20.8 billion). The balance sheet total in this segment was at its highest at the end of 2008 (CZK 309.4 billion). The volume of loans granted during the monitored period increased by 3.8% to CZK 183.1 billion. This item thus represents about 70.0% of total assets. The volume of equity is approximately 24% of the balance sheet total. However, due to very specific characteristics of this sector and the different business model that is used, this indicator is not fully comparable with capital, or more specifically, the capital adequacy of banks.

The other lending companies reported a slight year-on-year 1.0% increase in their balance sheet totals. This segment's balance sheet total also did not reach the initial levels reported at the start of the monitored period and reflected a decrease of almost CZK 30 billion. The slight growth in the absolute value of the balance sheet total was mainly thanks to short-term loans, the volume of which increased by 2.9% year-on-year. Conversely, long-term loans recorded a decline of 5.7%. For this reason, the total volume of loans decreased by 1.6% year-on-year. This is a continuation of the same trend of the past several years, where short-term loans have a tendency to increase and, conversely, long-term loans are decreasing. From the cumulative perspective, the volume of short-term loans has grown by 31.7% since 2010 and the volume of long-term loans has dropped by 6.7%. The ratio of equity to total assets decreased by 2.5 pp over the course of the year, but still managed to achieve a level of 43.0%.

At the end of 2014 the balance sheet total for factoring and forfaiting companies was CZK 20.9 billion, which represents a year-on-year increase of 11.5 %. This is the second year in a row that this segment has enjoyed a rate of growth that is in the double digits. The lending activity in this segment is dominated by short-term loans granted to residents, which accounted for about 76.0% of asset volume. However, the share of short-term loans granted to residents decreased by 6.4 pp even thought the volume increased by CZK 0.4 billion, or, in relative terms, by 2.7%. The cause behind this development may be found primarily in the rapid increase in the number of short-term loans granted to non-residents, which increased more than six-fold over the course of the year and grew from CZK 0.3 billion to 2.0 billion.

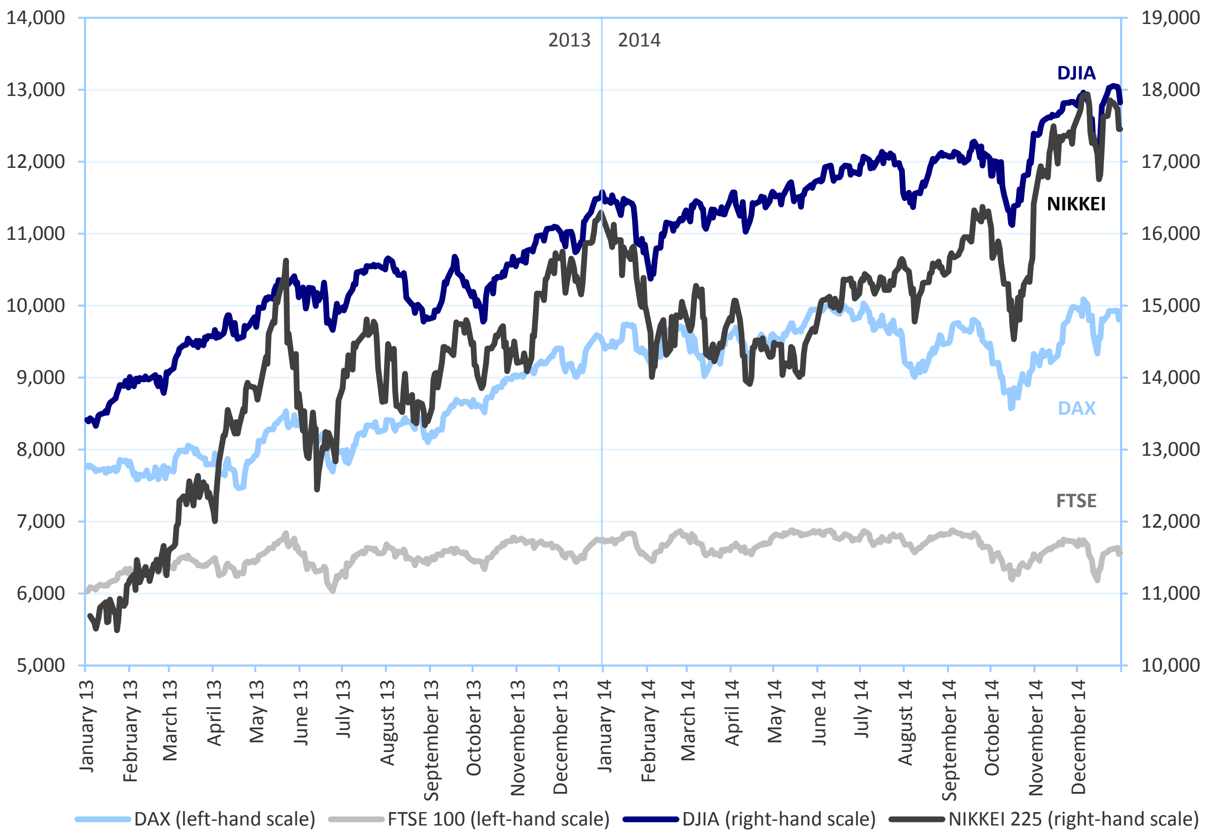
[37] In general it applies that simple sum of the asset volume of the individual sectors showed in the table may not be 100% accurate due to rounding.

6. CAPITAL MARKET

The developments in the global capital markets were affected by several factors in 2014. The most significant of these was the overall level of recovery in the world's largest economies, for example, real GDP grew by 2.4% in the USA and 1.3% in the EU (refer to Chapter 1.1). This fact, combined with the programmes to help credit institutions with their liquidity over the past few years have decreased the earnings on assets over the long-term and this has helped to reduce the aversion to risk on the part of individual economic entities. Another source of significant influence was the decrease in the prices of some commodities. In addition, the effect of deflationary pressure in the majority of the European economies helped to support the eased monetary policy in the form of very low key interest rates. This, together with the effects of the developments in Ukraine and Greece, contributed towards the fragmentation of performance in the capital markets. The end of quantitative easing in the USA and the anticipated start of quantitative easing in the eurozone also had an impact on some markets.

In 2014, of the stock indices in the advanced economies, the highest level of profitability was enjoyed by the American Dow Jones Industrial Average (DJIA), which reported a 9.0% year-on-year improvement and achieved a historically high level of 18,000 points (although this growth was 17 pp lower than in 2013), primarily thanks to the recovery of the American economy and the final effects of quantitative easing. In Japan, the NIKKEI 225 recorded growth of 7.1% (although in comparison with 2013, this reflects a 49.6 pp reduction in the growth rate). In December 2014, it achieved a value of 18,000 points for the first time since 2008, resulting from, amongst other things, the monetary expansion implemented by the Bank of Japan, which weakened the Japanese yen in relation to the US dollar and the euro. The German DAX recorded only slight growth of 2.7% and the British FTSE 100 actually reported a year-on-year decrease of 2.7%, caused primarily by the reduction in iron ore, petroleum, and natural gas prices.

Graph 6.1: Development of major global indices

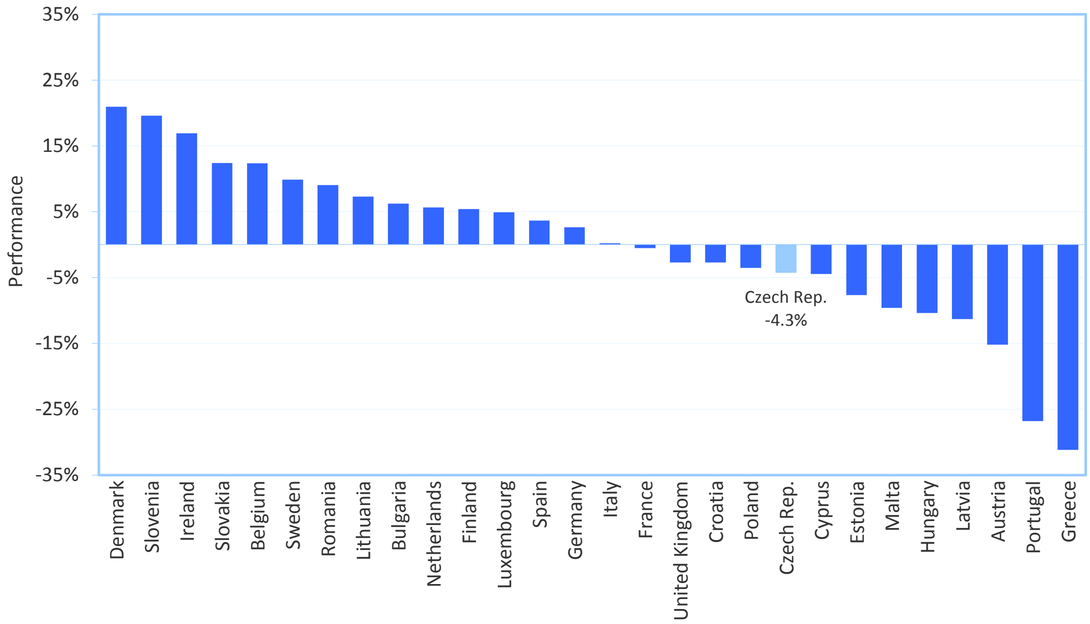


Source: Market organizers

When looking at the European stock indices, it is possible to see a comparable pattern of development according to the factors influencing the individual indices. In 2014, there was primarily a decrease in the Greek FTSE/ATHEX 20, which dropped year-on-year by 31.2% as a result of factors including the deteriorating state of public finances and the Greek parliamentary election. In Portugal, the Euronext Lisbon PSI 20 decreased by more than 26.8% as a result of the failure of the Espirito Santo Group credit institution and the resulting uncertainty within the entire national financial market. Surprising, the third worst stock index results in 2104 were reported by Austria, where the decline of 15.2% was caused by, amongst other things, the drop in the prices of petroleum products, the developments in the manufacturing industry, and the sanctions that were implemented against Russia.

Conversely, the Danish OMX Copenhagen 20 developed in an exemplary manner and reported an increase of almost 21%, partially thanks to the depreciation of the Danish crown in 2014 and the positive development enjoyed by the majority of its constituents. The Slovenian Ljubljana Stock Exchange SBI TOP Index reported the second best results and increased by 19.6%, primarily as a result of the performance of its three largest constituents – the Port of Koper (Luka Koper), the Pozavarovalnica Sava insurance company, and the consumer goods manufacturer Gorenje. The third on the list of the best-performing indices in the EU was the Irish ISEQ 20 Index, which grew by 16.9%, primarily thanks to the relative increase in the value of Ryanair shares. In the member states of the Visegrad Four, the only index that reported growth was the Slovak SAX Index, which increased by 12.4% The remaining three all reported a decrease as follows: Poland's Warsaw SE WIG-20 Single Market Index dropped by 3.5%, the Czech PX by 4.3%, and the Hungarian Budapest SE Index by 10.4%.

Graph 6.2: Performance of significant stock exchange indexes in the EU [38]



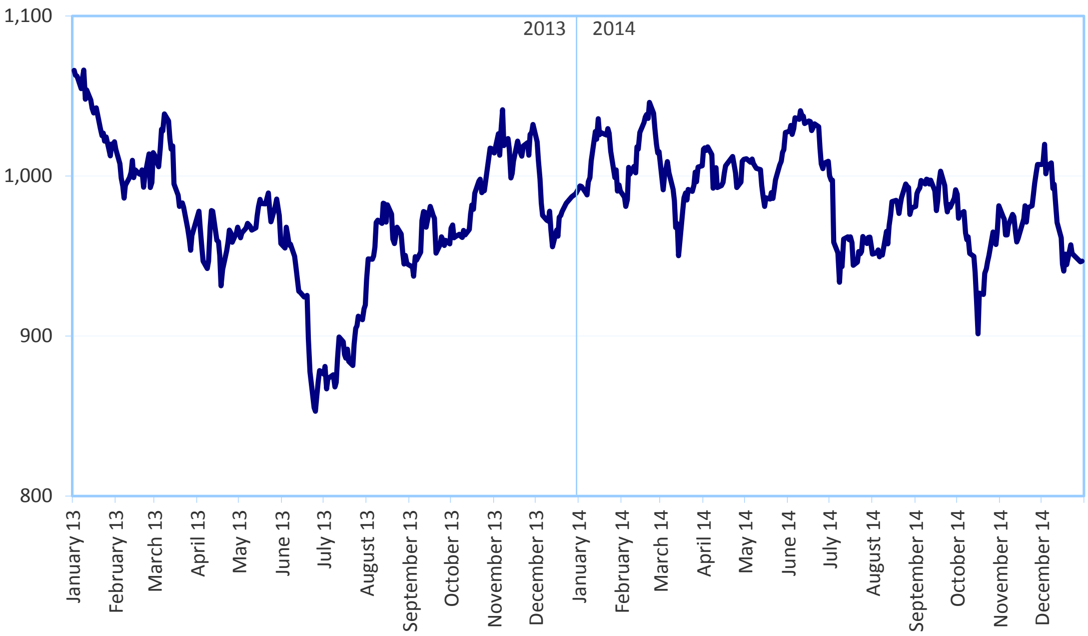
Source: Market organizers

6.1. Regulated Stock Market

The main Czech index – the PX – recorded a decline of 4.3% in 2014. The development over the course of the year was, to a significant degree, comparable to that during the previous two years, when the index ranged from between 850 to 1,080 points, included some standard cyclical fluctuations. The fluctuations in 2014 were not as extreme and the index ranged from 901.3 to 1,046.1 points. While the PX reached its highest value during the first half of the year and, on average, remained at over 1,000 points, there was a significantly higher degree of volatility during the second half the year and corrections had to be made at the end of 2014.

[38] Austria: ATX Austrian Traded Index; Belgium: BEL 20 Index; Bulgaria: SOFIX; Croatia: Crobex Index; Cyprus: FTSE/CySE 20; Czech Republic: PX Index; Denmark: OMX Copenhagen 20; Estonia: OMX Tallinn GI; Finland: HEX25 Index; France: CAC 40 Index; Germany: DAX Index; Great Britain: FTSE 100 Index; Greece: FTSE/ATHEX 20; Hungary: Budapest SE Index; Ireland: ISEQ 20 Index; Italy: FTSE MIB; Latvia: OMX Riga; Lithuania: OMX Vilnius GI; Luxembourg: LuxX; Malta: MSE; Netherlands: Amsterdam Exchanges Index; Poland: Warsaw SE WIG-20 Single Market Index; Portugal: Euronext Lisbon PSI 20 Index; Romania: Bucharest SE BET Index; Slovakia: SAX Index; Slovenia: Ljubljana Stock Exchange SBI TOP Index; Spain: IBEX-35; Sweden: OMX Stockholm 30 Index.

Graph 6.3: PX index development



Source: PSE

From Table 6.1 it is obvious that the PX has been slightly decreasing since 2012 and fluctuation at a threshold level of 1,000 points. From the long-term perspective, the changes in the index between 2013 and 2014 are lower than during the 2009 to 2012 period.

Table 6.1: PX and PX-TR index values

		2009	2010	2011	2012	2013	2014
PX	as at 31 Dec	1,117.3	1,224.8	911.1	1,038.7	989.0	946.7
	Change (%)	30.19	9.62	-25.61	14.01	-4.78	-4.28
PX-TR	as at 31 Dec	1,307.4	1,500.8	1,181.3	1,397.9	1,389.4	1,384.9
	Change (%)	37.75	14.80	-21.29	18.33	-0.60	-0.33

Source: PSE

Within the context of an international comparison, the PX index still reports a very positive dividend profit level, which had an average value of 3.02% over the course of 2014.[39] In this respect, the Prague Stock Exchange (PSE) was one of the best performing markets in the world.[40] However, as compared to 2013, there was a decline of 1.1 pp.

In April 2014, the PSE initiated the calculation of the new PX-TR (Total Return Index), which takes into account the disbursement of dividends for individual stocks. The index was retroactively calculated back to 2006, when the PX50 and PX-D were combined to create the current PX index. This PX-TR index is intended to improve the attractiveness of the Czech stock market, primarily through the shares of companies that offer a high dividend profit, such as Philip Morris ČR, ČEZ, Erste Group Bank, Vienna Insurance Group, and Komerční banka. As was the case in 2013, in 2014 the year-on-year change in the PX-TR index was at about zero, which is a relatively better result than in the case of the PX index, which declined for the second year in a row.

As far as the individual stocks are concerned, the best growth was experienced by the ČEZ energy group, which reported an increase of 14.3%. Although the company had to face decreasing energy prices, it successfully reduced costs and thanks to low interest rates maintained a relatively high level of dividend profit, which, together with a price increase, ensured that shareholders received a year-on-year increase in value of 22.1%. The stock with the second best result were the shares of the Pegas Nonwovens textile manufacture, whose shares increased in value by 8.1% (if the dividend is included, total annual earnings reached a level of 13.3%).

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

[40] For the sake of comparison, the dividend profit level of NASDAQ was 1.29% and in the case of the FTSE 100 it was 4.48%.

In 2014, the shares of the Pivovary Lobkowicz Group (beer brewing industry) were added to the list of companies traded on the Prague Stock Exchange and, over the course of seven months, these shares increased in value by 9.1%. Conversely, the shares of the ORCO Property Development Group were withdrawn from the PSE in September 2014. Particularly the shares issued by NWR, O2 C.R., and Erste Group Bank suffered losses in 2014. The value of the shares issued by the MWR mining company dropped by more than 98%, primarily to low coal prices, high mining and operation costs, a high level of indebtedness, and the restructuring plan, which included an increase in the number of shares from 264 million to 6.6 billion. The value of Erste Bank shares decreased by more than 24% due to the accounting adjustments that had to be made as a result of non-performing loans in Romania, the costs associated with foreign currency loans in Hungary, and the sanctions that were implemented against Russia. The change in the share prices of one of the three largest mobile operators (a decrease of approximately 21%) were the result of the speculations about the steps that would be taken by the new majority owner, who, in 2014, issued two bids for the repurchase of shares from the minority shareholders and made arrangements for financial assistance totalling billions of crowns.

Table 6.2: Companies included in the PX index

As at 31 Dec	Market capitalisation (CZK mn)	Trade volume (CZK mn)	Share price 2013	Share price 2014	Year-on-year change (%)
ČEZ	317,952	60,395	517	591	14.3
KOMERČNÍ BANKA	180,167	40,394	4,421	4,740	7.2
VIG	132,096	1,518	990	1,032	4.2
ERSTE GROUP BANK	227,794	27,620	698	530	-24.1
O2 C.R.	73,546	15,498	295	233	-21.0
STOCK	15,940	166	95	80	-16.1
UNIPETROL	23,664	403	168	131	-22.3
PHILIP MORRIS ČR	20,706	2,458	10,579	10,820	2.3
PEGAS NONWOVENS	5,907	1,218	592	640	8.1
CETV	9,291	1,875	73	69	-6.2
FORTUNA	6,263	787	119	120	1.5
NWR	2,797	746	24	0	-98.2
PLG	2,040	160	-	175	-

Source: PSE

Based on trading volume, shares remained the most important segment in 2014 and reported a volume of 493.4 million shares totalling CZK 153.5 million. The long-term downward trend in share trading activity continued in 2014 and the volume declined year-on-year by 12.2% thus adding to the decline of 30.3% that was reported for the previous year. As compared to 2007 (prior to the financial crisis) investments in shares have decreased by a very significant 84.8%. The most traded share issues over the course of the year continued to be the historically popular shares of ČEZ, Komerční banka, and Erste Group Bank. The second most important segment from the perspective of trading volume consists of bonds. In 2013, they reported a drop of more than 99% due to the redefinition of stock trading transactions in connection with the implementation of the new Xetra system. However, in 2014 the annual volume of bond transactions increased to 8.2 CZK billion, which corresponds to approximately 5% of all PSE trading.

Table 6.3: Trade value

	Annual (CZK bn)	2011	2012	2013	2014	Year-on-year change (%)
PSE	Shares	371.0	250.6	174.7	153.5	-12.2
	Debt securities	628.0	594.2	1.9	8.2	327.2
	Structured products	0.1	0.1	0.1	0.5	340.7
	Total	999.1	844.9	176.8	162.3	-8.2
RM-S		8.0	6.0	4.8	4.2	-13.5
Total		1,007.1	850.9	181.6	166.4	-8.4

Source: PSE, RM-S

The number of registered issues traded on the market declined slightly in 2014, particularly in the category of structured products, specifically certificates and shares. Based on the number of registered issues, bonds remained the only segment that reported growth, however, from the perspective of trading volume, bonds and structured products played only a marginal role.

Table 6.4: Number of registered issues on the PSE[41]

As at 31 Dec	2011	2012	2013	2014	Year-on-year change (%)
Shares	26	28	26	23	-11.5
Debt securities	95	98	110	116	5.5
Structured products	74	30	103	68	-34.0
Total	195	156	239	207	-13.4

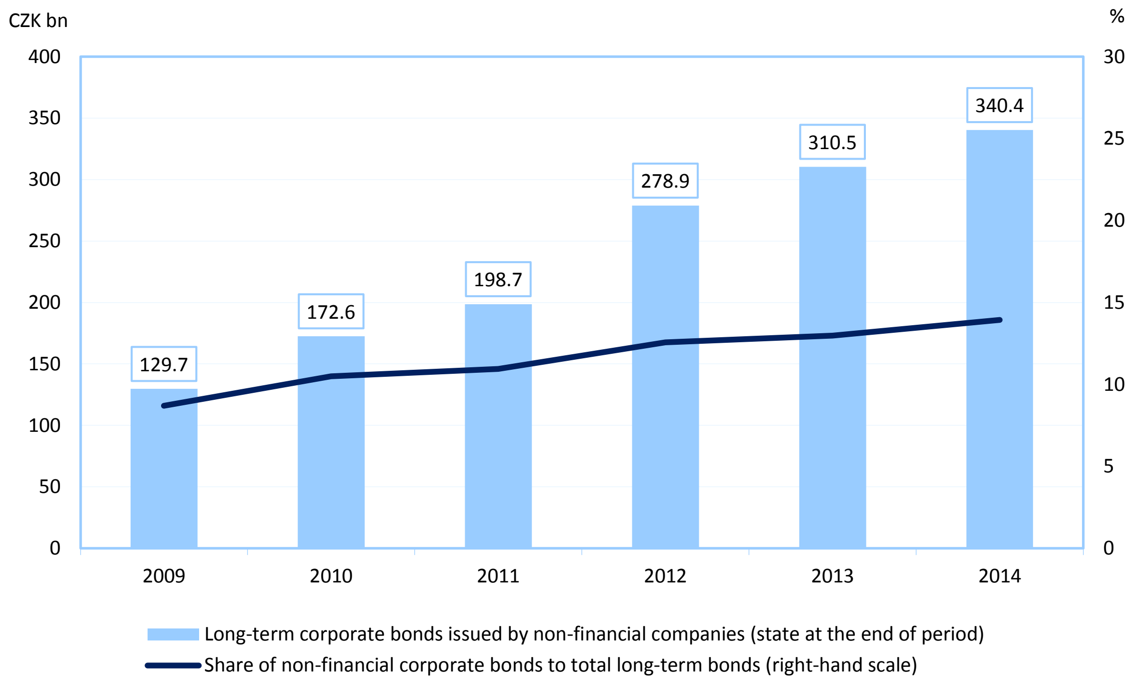
Source: PSE

In general, it is possible to say that this is the seventh consecutive year in which the trading activity on both the Prague Stock Exchange as well as in the retail RM-System (RM-S) has declined. To a certain degree, this is the result of the limited number of issues that are traded and the fact that emerging markets and markets with a large number of attractive (liquid) issues have more long-term growth potential. In 2014, the PSE tried to improve its attractiveness by undertaking such steps as harmonising the period for settlement of all types of transactions, which was decreased from three to two business days (in compliance with the European Union's CSDR, i.e. the directive for improving the settlement of securities trading in the EU and the central securities depositories), and by launching an automated collateral management system in December 2014.

Nevertheless, the future development of both Czech stock markets still remains unclear. The small size of the capital market in the Czech Republic will face the same effects as other developed markets. As a result, it is to be expected that the appreciation of the US dollar in relation to the euro and to the Czech crown, the depreciation of the Russian rouble, the decrease in petroleum prices, and the escalation of tension in petroleum-exporting countries will increase the volatility on the world's financial markets, including the capital markets. Conversely, the capital market could be supported by the current environment of low interest rates, when investors will look for opportunities to increase the value of their funds (primarily through shares). The low interest rates and relatively stable rating received by the Czech economy could lead to further growth in the market of bonds issued by non-financial companies. These manufacturing and business companies use a different method for obtaining financial resources that is different from the traditional bank loan method. As is illustrated in the graph below, the market of long-term corporate bonds issued by non-financial companies has recorded growth over the entire monitored period and, at the end of 2014, achieved a value of CZK 340.4 billion in the value of issued bonds. Just for the sake of comparison, it should be noted that at the end of 2014 bank loans totalling CZK 874.9 billion were reported (refer to Chapter 5.5 – Deposits and Loans).

[41] There was change in the structure of the share and bond market in connection with the implementation of a new trading system, as a result of which the classification into main, secondary, and free markets ceased to be relevant. For this reason, the structure of Table 6.4 published in this year's Reports on Financial Market Developments does not match the structure of the table published by the MoF in its reports for prior years.

Graph 6.4: Development of long-term corporate bonds issued by domestic non-financial companies [42]



Source: CNB – ARAD

The Power Exchange Central Europe (PXE), known as the Prague Energy Exchange until 2009, is a subsidiary of the Prague Stock Exchange and is used primarily for the trading of derivative contracts. In 2014 the PXE recorded a decline in trading volume of 32.1% to EUR 788.3 million. Futures contracts held the most important position on the PXE and the previously already minimal spot trading volume dropped to absolute zero, just as it did in 2012 and 2013. Although the PXE represents a minority market, since September 2014 the offer of electricity futures has been expanded to include Polish and Romanian products and the PXE has also expanded its commodity portfolio to include Czech natural gas futures. One of the more interesting events of 2014 was the first ever auction of electricity for end consumers.

Table 6.5: Main indicators of trading on the PXE

Indicator	Market	2010	2011	2013	2014	Change	
						abs.	(%)
Trading volume (EUR mn)	Futures	1,327.4	943.6	1,161.2	788.3	-372.9	-32.1
	Spot	1.7	0.0	0.0	0.0	0.0	-
	Total	1,329.1	943.6	1,161.2	788.3	-372.9	-32.1

Source: PXE

6.2. Securities Dealers and Asset Management

The trading volume in the securities dealer sector increased by 28.6% year-on-year to CZK 93.1 trillion. This significant increase in trading volume is due to the combination of the activity of both non-bank and bank securities dealers. The non-bank segment closed trading deals involving the assets they manage for clients at a level that was CZK 11.9 trillion higher than in 2013, bringing the total volume of these transactions up to CZK 31.1 trillion by the end of the year. In the case of bank securities dealers, they closed transactions on their own account that were CZK 11.3 trillion higher than in 2013 and, at the end of the year, the volume of these transactions achieved a level of CZK 53.5 trillion.

[42] Data on the long-term bond issues implemented by Czech residents without regard to location, method, or currency of the issues. The aggregate sum of total long-term bonds corresponds to the cumulative sum of securities issued by government institutions, deposit institutions, other financial institutions, and non-financial companies.

The dominant position of ban securities dealers was weakened in 2014, as, within the context of the entire sector, they participated in only 64.3% of all transactions (as compared to 68.8% in 2013 and 96.2% in 2012). However, bank securities dealers have maintained their dominant position with regard to the volume of transactions performed on own account. Non-bank securities dealers, together with investment companies, continue to hold a much larger share with respect to managing their clients' assets.

Table 6.6: Selected indicators for the securities dealers sector [43]

As at 31 Dec (CZK bn)	2013	2014				Year-on-year change	
	Total	Bank securities dealers	Non-bank securities dealers	Investment companies[44]	Total	Abs.	(%)
Total number of licensed entities	71	28	30	8	66	-5	-7.0
Total value of executed transactions[45]	72,391.0	59,837.9	33,214.8	76.7	93,129.5	20,738.5	28.6
of which: on the basis of assets management contracts	19,383.0	108.2	31,104.5	76.7	31,289.5	11,906.4	61.4
of which: on the basis of other than asset management contracts	10,503.3	6,267.7	1,756.9	0.0	8,024.6	-2,478.7	-23.6
of which: on own-account basis	42,504.7	53,461.9	353.5	0.0	53,815.4	11,310.7	26.6
Value of managed funds	616.4	68.5	362.6	245.6	676.6	60.3	9.8
Value of clients' assets	2,987.3	2,622.0	457.8	250.1	3,329.9	342.5	11.5
Number of clients (according to contracts, in thousands)	894.4	757.6	249.0	0.8	1,007.4	113.0	12.6

Source: CNB

Asset Management

The volume entrusted to asset managers increased by 13.1% in 2014 to CZK 1.1 trillion at the end of the year. With the exception of only one, all for the financial groups saw an increase in the volume of assets they manage. The concentration in the asset management market has continued to decline over the past four years. At the end of 2014, the three largest financial groups controlled 58% of all managed assets, which is 0.4 pp lower than in 2013. As can be seen in Table 6.7, a greater relative level of growth in the volume of managed assets was achieved without regard to the actual volume of managed assets. This reflects a change in market behaviour, as, in 2013, it was only the smaller asset managers that reported any growth.

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

Table 6.7: Financial groups by value of assets under management

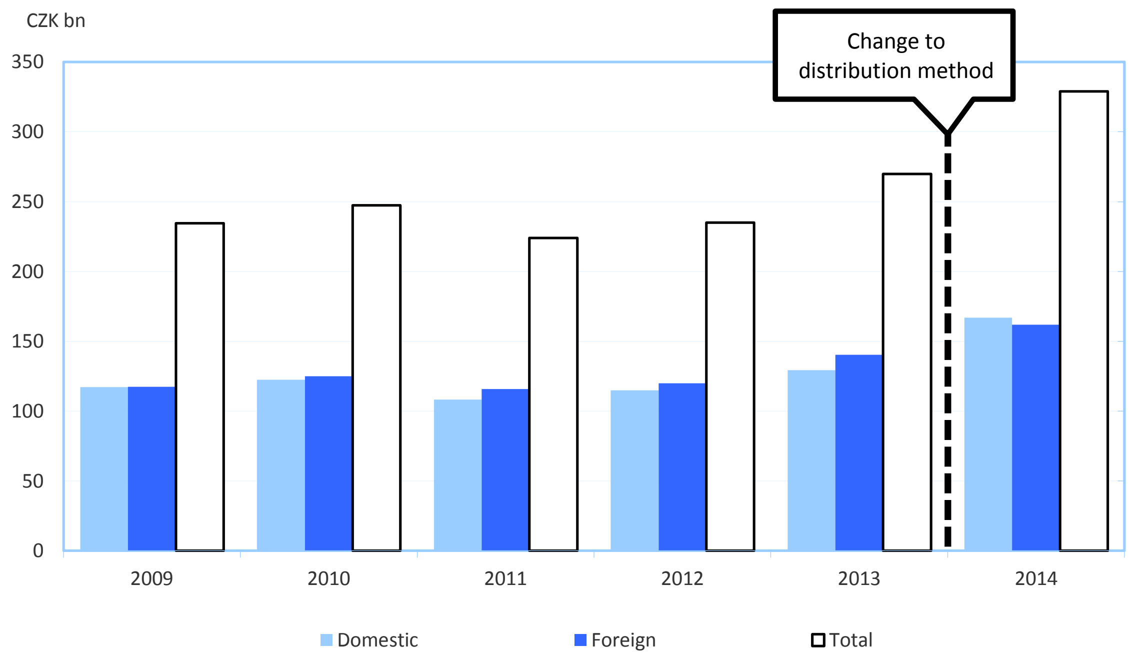
As at 31 Dec (CZK bn)	Value of assets under management		
	2013	2014	Change (%)
Generali Investments CEE, a.s.	230.5	241.5	4.8
ČS (group)	176.7	212.3	20.1
ČSOB (group)	162.5	185.7	14.3
Komerční banka (group)	118.1	140.2	18.7
ING (group)	109.1	115.0	5.4
AXA Investiční společnost, a. s.	57.8	58.0	0.3
Conseq Investment Management, a. s.	27.3	37.1	35.9
UniCredit Bank Czech Republic, a. s.	21.8	23.5	8.1
AMISTA investiční společnost, a. s.	21.4	21.4	-0.1
Raiffeisenbank a.s.	17.3	20.1	16.5
Others	32.6	48.0	47.2
Total	975.1	1,102.7	13.1

Source: AKAT

6.3. Investment Funds

In 2014, the volume invested in collective investment funds grew by 21.9% (CZK 59 billion) and, at the end of the year, CZK 328.9 billion was invested in these funds. The value of the assets in domestic funds increased by CZK 37.5 billion as opposed to only CZK 21.5 billion in the case of foreign funds. This reflects a reversal in the share of assets invested in foreign and domestic funds, as, in 2014, the domestic funds reported a value of CZK 167.0 billion, which is CZK 5.1 billion more than the amount kept in foreign funds (refer to Graph 6.4). To a certain degree this reversal is the result of the change in methodology that occurred in 2014, when the way in which the assets kept in domestic mutual funds started to be reported differently. Up to that point, the volume of that particular category corresponded to the volume invested in domestic funds. Since then, the new method reports data about investments kept in domestic funds in the Czech Republic, i.e. the funds are no longer viewed from the point of where they are managed, but rather according to the way they are distributed.

Graph 6.5: Allocation of investments in mutual funds by domicile



Source: AKAT

As can be seen in Graph 6.8, mixed funds saw the greatest influx of new resources and their assets increased by CZK 52.2 billion, reflecting a relative growth of 101.4%. These were followed by bond funds, which recorded an increase of CZK 20.2 billion, reflecting a relative growth of 22.9%. The increase in the volume of managed assets is, for the most part, the result of the economic recovery. The greatest relative increase in assets was reported by mixed funds, bond funds, and real estate funds. As was the case in the previous year, bond funds and mixed funds have retained their dominant position and together they make up more than 64.5% of the total volume of managed assets.

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

As at 31 Dec (CZK bn)	2013			2014			Year-on-year change (%)		
Mutual fund type	Domestic	Foreign	Total	Domestic	Foreign	Total	Domestic	Foreign	Total
Bond	54.4	34.0	88.4	64.2	44.5	108.6	17.9	30.9	22.9
Equity	18.2	34.0	52.3	23.1	35.1	58.2	26.6	3.1	11.3
Guaranteed	1.3	35.6	36.9	0.1	31.9	32.1	-89.5	-10.4	-13.1
Mixed	26.3	25.2	51.5	61.6	42.0	103.6	134.2	67.0	101.4
Fund of funds	24.0	0.5	24.5	12.7	0.5	13.2	-47.1	6.0	-46.1
Money market	1.8	10.2	12.0	1.3	6.6	7.9	-29.7	-35.0	-34.2
Real estate	3.4	0.9	4.3	4.0	1.2	5.3	18.4	34.5	21.8
Total	129.5	140.4	269.8	167.0	161.9	328.9	29.0	15.3	21.9

Source: AKAT

The change in the volume of managed assets is influenced by two key factors: the increase in value achieved by the fund, and net sales. Net sales represent the change in fund assets resulting from the purchase and sale of investment units that do not have an effect on fund performance but only on the volume of assets. Looking at Table 6.9, which provides information only about the sale and redemption of investment units in domestic funds, it is obvious that, as was the case in 2013, domestic funds of funds recorded the best results in absolute terms and were followed by mixed funds, when viewed from the perspective of net sales. As regards an increase in value, mixed funds and bond funds fared the best.

However, given the lower volume of administered assets, in 2014 the share funds reported a relatively higher level of growth than the bond funds.[46] Money market funds recorded unfavourable development from the perspective of both aspects. To a certain degree, this is the result of the low interest rates for short-term instruments and the growing popularity of savings accounts, which can be considered as a substitute for those collective investment funds that have a lower level of associated risk. It is very likely that the outflow of assets from monetary funds will continue in 2015 due to the ongoing low level of interest rates.

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

(CZK bn)	Sales	Redemptions	Net sales	Change in the asset value	Change adjusted for net sales
Bond	21.2	17.6	3.7	9.7	6.1
Equity	6.3	4.1	2.2	4.8	2.7
Mixed	14.6	6.1	8.5	-1.1	-9.6
Guaranteed	0.0	0.0	0.0	35.3	35.3
Fund of funds	17.0	4.9	12.1	-11.3	-23.5
Money market	0.5	1.1	-0.5	-0.5	0.0
Real estate	1.7	0.9	0.8	0.6	-0.1
Total	61.4	34.7	26.7	37.5	10.8

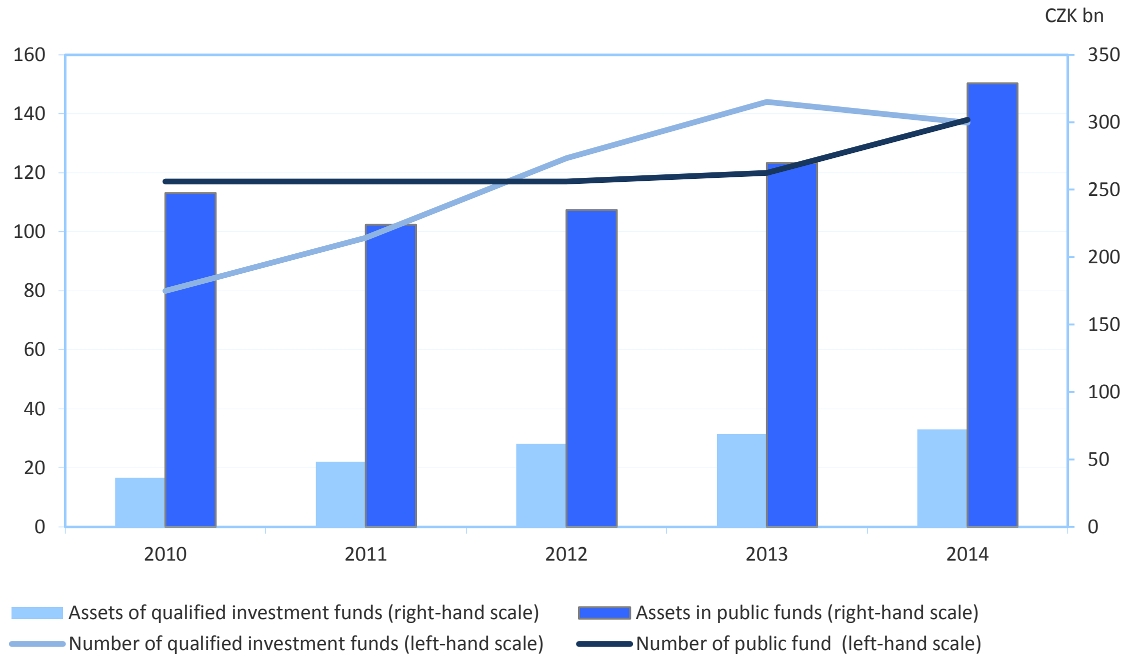
Source: AKAT

[46] Expressed as the relative change in the volume of assets in domestic mutual funds, decreased by net sales, in relation to the volume of domestic mutual funds in the previous year.

The assets kept in public mutual funds may continue to grow in the coming years, primarily in relation to the economic recovery that is starting to be apparent even on the capital markets. The MoF, working in cooperation with AKAT, have been supporting the Czech capital market over the long term and are currently preparing the document entitled "Concept for the Development of the Capital Market".

In recent years moderately dynamic growth has been recorded for the growing sector of non-public funds (qualified investment funds). During the monitored period, the number of these funds has increased by 57 (71.3%) and, between 2012 and 2103, their number exceeded the number of public funds. This trend was reversed in 2014, and the total number of qualified investment funds was one less than the number of public funds. Although the volume of the assets managed in qualified investment funds increased by CZK 3.4 billion in 2014 to CZK 72.2 billion, it only achieved a level corresponding to a 22% share of the total volume of assets in public funds, which reflects a 3.5 pp decrease when compared to 2013. A large part of the funds invested in qualified investment funds are focused on real estate, there is growing interest in private equity investments.

Graph 6.6: Structure of investment funds[47]



Source: AKAT, CNB

Within the context of a further analysis of the development in qualified investment funds, it is difficult to differentiate qualified investment funds that have been established for collective investment from those funds established for the purpose of tax optimisation. In relation to this fact, there was an amendment made to the tax legislation when the lower tax rate for legal entities was newly allowed only for basic funds in 2013. Other legislative responses include the amended government directive about investing in investment funds and the techniques that are used to manage these funds. This same directive also aims to ensure that qualified investment funds obtain investments from multiple investors with the goal of collective investment. It is thus possible to expect that the share of funds originally established more to optimise taxes will continue to decrease in the future. On the other hand it is possible to predict that both the number of qualified investment funds as well as the volume of assets managed in these funds will continue to grow, as, starting in 2013, the Act on Investment Companies and Investment Funds entered into force. This legislation is aimed at promoting the attractiveness of entrepreneurial undertakings on the capital market within the Czech legal environment and it is therefore possible to expect further growth in the number of parties interested in qualified investment funds. At the same time, in connection with the EU directive on European long-term investment funds, a proposal has been made on the basis of which the minimum investment amount for qualified investment funds would be reduced from EUR 125,000 to EUR 10,000, which would contribute towards the further development of the Czech capital market. The competitiveness of Czech qualified

[47] Status at the end of period.

investment funds would thus increase. It is, however, not possible to make any unambiguous conclusions about the impact that the change in the tax exemption test for individuals from six months to three years, which entered in effect on 1 January 2014, will have on the Czech capital market over the long-term. This tax measure may decrease the appeal of capital market investments. However, on the other hand, in the case of an actively managed portfolio, it will make it more advantageous to invest through funds rather than by purchasing individual securities.

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

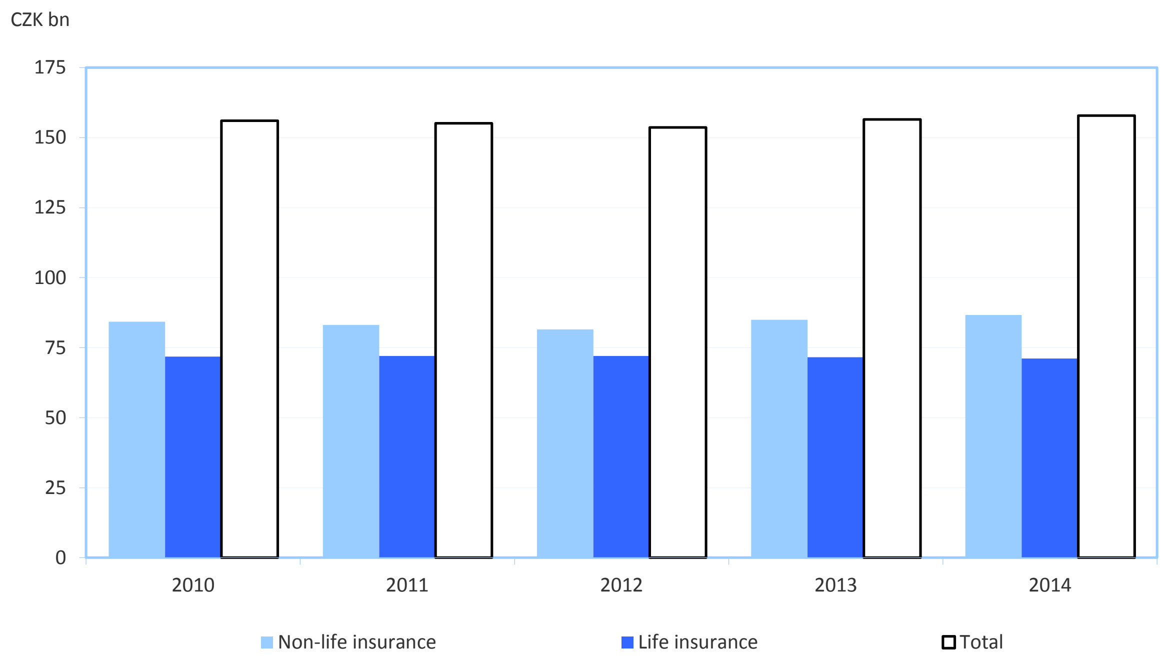
7. INSURANCE COMPANIES

The insurance market continued to grow slightly over the course of 2014 in a manner comparable to 2013. The gross premiums written reached a level of CZK 157.8 billion, which reflects a year-on-year growth of 0.8%.[48] Only the non-life insurance segment contributed to the slight growth, as there was a decrease in the life insurance sector. The three largest insurance companies (Česká pojišťovna, Kooperativa, and Allianz) dominate the market and, based on the volume of gross premiums written, hold a market share of more than one half. Of the total of fifty-three entities[49], as at 31 December 2014 thirty-two operated only in the non-life insurance segment, six were life insurance companies, and fifteen provided mixed services, i.e. both life insurance and non-life insurance products.

The very gradual growth in the market is the result of the continuing savings measure in the corporate sphere, which started being eased only during the course of 2014. The insurance sector is significantly dependent on the development in the economic situations of it clients, and thus respond to the real economic results with a certain delay. This is why greater growth dynamics have not been achieved in the insurance market.

As can be seen in Graph 7.1, the volume of gross premiums written in 2014 was comparable to the level reported in 2010 (CZK 156 billion) and even in the other years the differences in volume are insignificant. As a result, the insurance market may be characterised as stagnating for the past five-year period.

Graph 7.1: The volume of gross premiums written



Source: CNB

As a result of renewed GDP growth, there was a slight decrease 0.3 pp decrease in the indicator of insurance penetration[50], to a level of 3.7%. From this indicator it is apparent that the insurance market continues to have great growth potential because its values in more developed insurance markets is often many times higher. Based on the information provided by insurance companies, every second household does not have any property insurance and, in those households that do have insurance, their insurance policies are generally not updated. As a result, the property of many households is underinsured, i.e. the insured amounts do not correspond to the actual value of the insured property. In the case an insured event were to occur, there is then the risk that the insurance settlement the household receives will not fully compensate all the actual damage. A similar type of underinsurance exists in the case of life insurance policies, when in the case

[48] The data in Chapter 7 – Insurance Companies specify the unreduced insurance market values, which differ from the data published by the Czech Insurance Association as they include lump-sum insurance premiums paid in their full annual amount.
[49] Including the Czech Insurers' Bureau, which was established on the basis of Act No 168/1999 Coll.
[50] This indicator expresses the ratio of gross premiums written to nominal gross domestic product.

of the unforeseen need to cash in the policy, the amount that is received is not enough to cover the loss of income from the family budget.

The proportionate market shares held by the two main segments of the insurance market – life and non-life – changed only slightly to the disadvantage of life insurance and were at a level of 45:55 at the end of the year. This means that the Czech insurance market has strayed even further from the unwritten optimal benchmark value for this ratio in advanced economies (60:40). This ratio, which indicates that the share of life insurance is slightly higher, cannot be given any absolute value, as it may be influenced in various countries by different historical development, such as by the effects between different proportions of national and private social security and more significant deviations.

In 2014, the insurance market had to deal with a number of new issues associated with the new Civil Code entering into force. The main issue is the significantly expanded new definition of pain and social impairment in the case of damage to health. In addition, the individual circumstances of each insured event are now taken into account and a much broader group of individuals may claim a lump-sum settlement than was the case in the past.

7.1. Development of Life and Non-Life Insurance

The results in the non-life insurance segment show that even though the total number of new policies increased, the volume of gross premiums written grew only slightly. The results reflect an increase of 1.9% to CZK 86.6 billion. The growth is primarily due to the good results for motor vehicle insurance, which, including third-party motor vehicle liability insurance, accounted for 43.6% of the volume in the non-life insurance segment.

The growth in the motor vehicle third-party liability insurance market is associated with the increase in the number of registered vehicles[51] and the higher insurance premiums, which, based on the data provided by the Czech Insurance Association, grew by approximately 7% to an average value of CZK 2,774. Thanks to the increase in premium rates, the insurance companies have reversed the downward trend of the past several years. This decline in insurance premiums was the result of increased competitive pressure. By implementing a policy of low insurance premiums, the insurance companies strived to acquire the largest possible market share without taking into account the profitability of this widely distributed product.

Motor vehicle third-party liability insurance is offered by twelve insurance companies who have obtained a special licence from the CNB allowing them to provide this product. The majority of these companies define their insurance premiums according to segment, i.e. the amount is based on the age of the vehicle owner, the place of their residence, the age of the vehicle, engine volume, engine performance, and possibly some other criteria as well. Motorists who present a greater level of risk generally pay higher insurance premiums.

From the start of 2014, insurance companies have started contributing 3% of the premiums received for motor vehicle third-party liability insurance to the Damage Prevention Fund. The aggregate contribution exceeded CZK 0.5 billion and will be distributed amongst the various entities implementing projects to improve road safety. Starting at the end of 2013, the calculations for the premium rates have also taken into account a flat fee paid to the fire service if they are called to the scene of an accident.

The insurance companies are also registering the first effects of the new Civil Code, which makes it possible to receive an increased level of compensation for damage. As compared to 2013, the average settlement paid by insurance companies for damage to health increased by about one half to approximately CZK 600,000. As far as the legislation is concerned, there are still no uniform procedures to apply when determining the settlement to be paid to parties who suffer damage as a result of a car accident. Some insurance companies take into account the depreciation of replacement parts and reduce the amount of the settlement. In addition, there are still differing opinions regarding the settlement to be paid if a travel agency goes bankrupt. The Ministry of Industry and Trade believes that the settlement should cover all of the costs associated with the clients' return from abroad, whereas the representatives of the insurance market limit the amount of the settlement to the negotiated limit.

[51] According to the info provided by the Czech Insurance Association, there are 7.2 million registered motor vehicles (an increase of 156,000). The Central Register contains records for 7.8 million motor vehicles.

From the perspective of climate conditions and damage caused by natural disasters, 2014 was relatively uneventful, resulting in a 5.1% decreased in the gross amount of insurance claims paid in the non-life insurance segment.

Table 7.1: Main indicators for the insurance sector

As at 31 Dec		2012	2013	2014	Year-on-year change	
					Abs.	(%)
Number of policies (in thousands)		26,880	27,321	28,157	836	3.1
of which:	non-life insurance	18,278	19,252	20,417	1,165	6.0
	life insurance	8,602	8,061	7,740	-321	-4.0
Number of newly concluded policies (in thousands)		11,575	11,874	11,955	81	0.7
of which:	non-life insurance	10,035	10,738	10,889	152	1.4
	life insurance	1,540	1,137	1,066	-71	-6.2
Total gross premiums written (CZK bn)		153.6	156.5	157.8	1.3	0.8
of which:	non-life insurance	81.6	85.0	86.6	1.6	1.9
	life insurance	72.1	71.6	71.2	-0.4	-0.6
Total gross claims paid (CZK bn)		88.2	100.6	105.0	4.4	4.4
of which:	non-life insurance	41.8	49.2	46.7	-2.5	-5.1
	life insurance	46.4	51.4	58.3	6.9	13.5
Total insurance penetration (%)		4.0	4.0	3.7	-0.3	-

Source: CNB

Note: The number of life insurance policies does not include policies for supplementary insurance.

In the life insurance segment, the total number of insurance policies decreased by 321,000 and the number of new policies by 71,000. Gross premiums written decreased 0.4% to CZK 71.2 billion. This decline was primarily the result of the 1.8% drop in products with lump-sum premiums. The insufficient insurance coverage amounts in the insurance policies continue to be a long-term problem. In addition, the policies do not make it possible to flexibly adapt the insurance conditions to the changing needs of the policyholder during different phases of their life.

Certain amendments to the Income Tax Act entered into effect at the start of 2015, and they have significantly changed the conditions under which it is possible to enjoy the tax benefits of life insurance policies. The tax benefits can be retained only if the insurance policy conditions make it impossible to collect any additional income that is not an insurance settlement and does not lead to the termination of the insurance policy. This amendment was implemented with the aim of limiting tax evasion and the non-payment of social security and health insurance contributions, as some employers used contributions to life insurance as an alternative form of wages and this employee income was never taxed. It is no longer possible to enjoy the tax benefits in the case of insurance policies that allow extraordinary withdrawals unless the policy is amended. The legislative amendment set a deadline of 31 March 2015 for making the required modifications to the insurance policies.

At the start of 2015, the CNB decided that it will reduce the technical interest rate[52] from its current level of 1.9% to 1.3%. This measure applies only to new life insurance policies with a guaranteed rate of return (capital policies) and is a response to the continuing decrease in the financial market interest rates. The measure will enter into effect on 15 July 2015, because insurance companies were given a timeframe of six months to adapt to the change. Due to the new Solvency II regulation, the CNB will no longer use this instrument in the life insurance segment. Each insurance company will have to use its internal risk management system to monitor the level of the guarantee that it provides to its clients.

[52] The technical interest rate represents the guaranteed share of the yield from financial placement. It does not therefore include the increase in value of the total premium paid by the client, but only the share of the increase in the insurance reserve, i.e. the savings component of the premium.

7.2. Economic Results of Insurance Companies

The insurance market is an important part of the financial market in the Czech Republic and has been stabilised over the long-term. The balance sheet total reported by the insurance sector grew by 1.8% to CZK 488 billion, of which the level of financial placement, i.e. investment, 88%. The capital adequacy in the sector decreased by 0.9%, primarily as far as the registered capital and share premium account entries are concerned. Conversely, the creation of gross technical reserves increased by 2.1% to CZK 397 billion at the end of the year.

The overall financial placement in which the technical reserves are invested attained a level of CZK 431.3 billion, reflecting a growth of 1.7%. The financial placement must comply with strict regulatory criteria associated with security, diversification, and profitability. The majority of the financial placement assets are in debt securities (70.4%) and equity securities (19.8%). A detailed breakdown of the financial placement is provided in Appendix 2. The available solvency margin in the non-life insurance sector is more than four times higher than the required solvency margin, and, in the case of the life insurance sector, it is three times higher.[53]

Net profit generation decreased to CZK 6.8 billion. The 36.5% drop in profit was influenced primarily due to the worse results for the technical reserve account in the non-life insurance segment (a decrease of approximately 49.8 %). The results for the technical reserve account in the life insurance segment also declined (by 15.1%). The overall higher costs associated with paid insurance settlements also contributed to the reduction in profit.

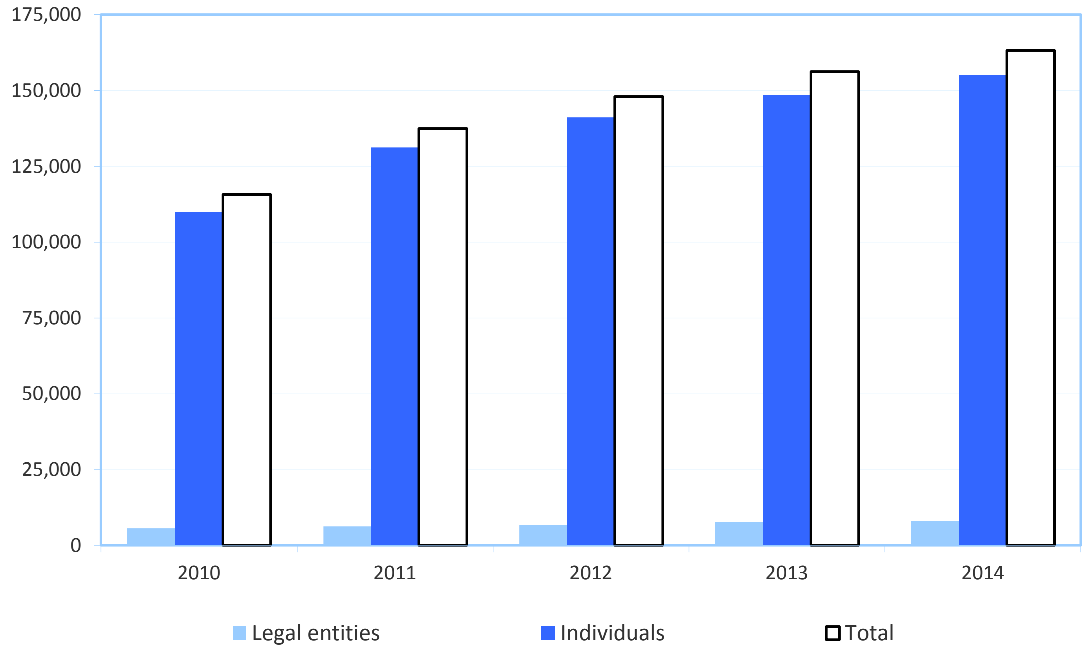
The financial results reported by insurance companies are also directly affected by their success in the battle against insurance fraud. The value of the overall volume of insurance fraud that was proven in 2014 exceeded CZK 1 billion, which is comparable to the results in the previous year. Car insurance fraud continues to head the list, however, there are more and more cases of fraud being uncovered in the property insurance and life insurance segments. The cases of life insurance fraud often involve the activity of organised groups who use falsified information provided by cooperating physicians. From the perspective of geographical distribution, the most cases of fraud occur in Prague and the Central Bohemian Regions and the fewest in the Zlín and Vysočina Regions. Insurance companies do not rely only on the human factor in their efforts to uncover insurance fraud. A number of insurers have invested in new software systems that are able to identify and evaluate suspicious cases in advance.

[53] The most recent data available from the ARAD system as of 31 December 2013.

7.3. Insurance Intermediation

As in the previous years, the number of insurance intermediaries continued to increase. At the end of 2014 there were over 163,000 registered insurance intermediaries and independent loss adjusters. As is obvious from Graph 7.2, the majority are individuals (95%) as compared to legal entities.

Graph 7.2: Number of insurance intermediaries



Source: CNB

Subordinated insurance intermediaries and exclusive insurance agents are the largest two categories and together represent 87% of the total number of intermediaries. The competition in the market is strengthened by almost another 5,700 intermediaries from the other EU member states (refer to Table 7.2). During the year the licences of 17,500 were withdrawn, however, in most of the cases it was at the intermediary's own request.

Particularly the sale of reserve-creating life insurance (unit linked and capital products) are the key factor affecting the amount of intermediary commissions, but the quality of the work performed by these individuals is not assessed over the long term. There are still many cases of reinsurance occurring within the system which consists of the unjustified termination of policies and the conclusion of new policies solely for the purpose of receiving a commission. In this respect it is possible to say that the insurance companies, which are also negatively affected by the current situation in the market that they themselves have helped to create over the long-term, have already initiated steps to take greater responsibility over the quality of the work performed by their external sales networks. Nevertheless, the conversion of policies, which may not be in the client's best interest, also occurs within the direct (internal) sales of insurance by insurance companies.

Due to the continuing critical problems that exist with regard to the distribution of insurance, the Ministry of Finance has resubmitted its draft amendment to Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters. The prepared legislative standard is almost identical to the previous amendment, for which the legislative process was not completed due to the dissolution of the Chamber of Deputies in 2013. The amendment is aimed at simplifying and clarifying the entire system for regulating the distribution of insurance and improving consumer protection. During the final approval phase for the draft legislative amendment, intense discussions are underway about the need to regulate the commissions paid to the intermediaries.

Table 7.2: Number of insurance intermediaries by category[54]

Entity registered as at 31 Dec	2013			2014			Year-on-year change (%)		
	IN	LE	Total	IN	LE	Total	IN	LE	Total
TIE	12,374	304	12,678	12,448	305	12,753	0.6	0.3	0.6
SII	96,046	2,688	98,734	100,601	2,963	103,564	4.7	10.2	4.9
EIA	36,480	301	36,781	38,378	333	38,711	5.2	10.6	5.2
IA	510	943	1,453	501	944	1,445	-1.8	0.1	-0.6
IB	155	627	782	151	639	790	-2.6	1.9	1.0
ILA	94	119	213	127	119	246	35.1	0.0	15.5
FII (EU)	2,942	2,634	5,576	2,922	2,773	5,695	-0.7	5.3	2.1
Total	148,601	7,616	156,217	155,128	8,076	163,204	4.4	6.0	4.5

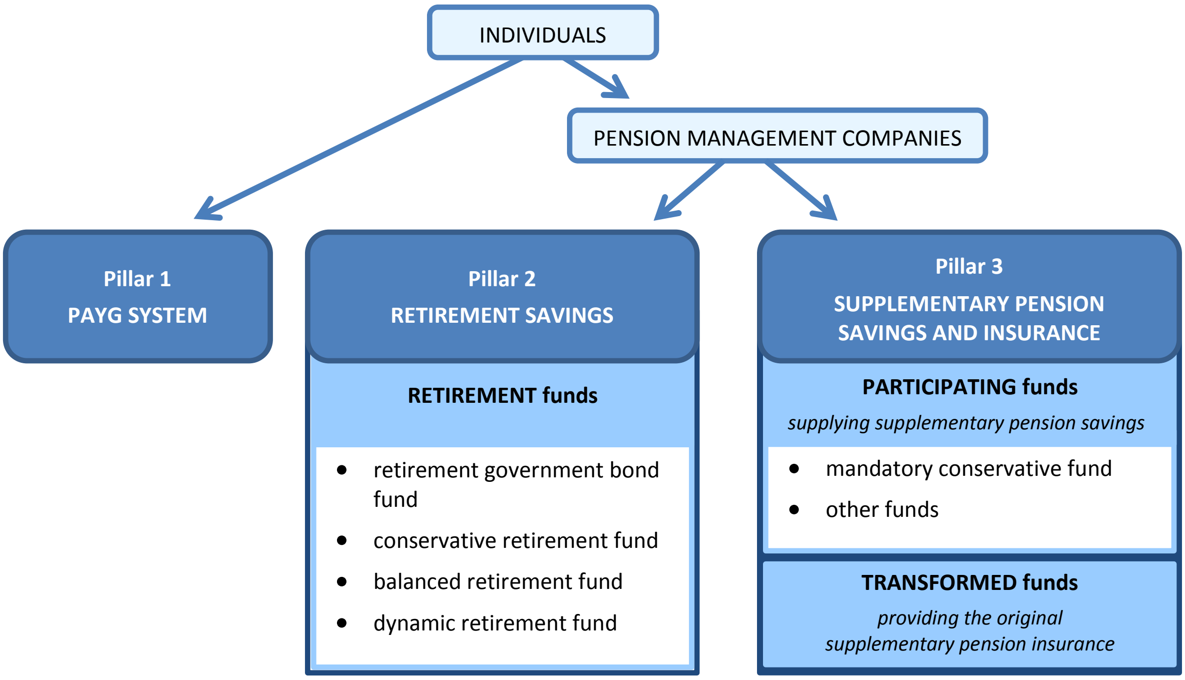
Source: CNB

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

8. PENSION SYSTEM

Since the start of 2013, at which time the Czech Republic's pension system underwent a reform, the country has had a three-pillar system as depicted in Figure 8.1 below.

Figure 8.1: Structure of the pension system since 2013



Source: MoF

Pillar 1 represents the standard pension system, i.e. the mandatory pay-as-you-go system financed by the state. In 2013, the pension system was expanded to include voluntary retirement savings, which makes up Pillar 2. This savings plan consists of transferring 3% of the employee's gross salary that is currently deducted for national pension insurance to a private individual retirement account managed by a pension management company under the condition that the employee contributes an additional 2% of their gross salary. Pillar 3 also represents the voluntary saving of funds for retirement, which the state supports in the form of a state contribution and tax relief. Up to the end of 2012, the function of Pillar 3 existed only under the supplementary pension insurance scheme, which continues to exist as a part of Pillar 3 in the form of the transformed funds. These are the funds to which the savings of the participants in the original supplementary pension insurance scheme were automatically transferred. At the same time, the conditions of their supplementary pension insurance contracts were retained (namely the no-loss guarantee, the ability to receive an early pension, and the conditions that make it possible to terminate the contract and receive payments). It is no longer possible to join the supplementary pension insurance scheme. Individuals interested in saving under Pillar 3 may only join the supplementary pension savings scheme, where their savings are placed in one of the participating funds according to the investment strategy which the participant chooses from the pension management company's offer.

8.1. Pension Management Companies

Since 2013 the pension management companies have managed the participants' assets that are kept in the individual pension accounts that make up the retirement, participating, and transformed funds. The pension management companies were established as new entities, usually through the transformation of the original pension funds as a part of the overall pension system reform. The main purpose behind their establishment was to guarantee the safety of the participants' funds through separating the assets of the participants from the assets of the shareholders, i.e. the fund managers.

The legislation assigns to the pension management companies the obligation to offer participants four types of retirement funds under Pillar 2: dynamic, balanced, conservative, and a government bond fund. In addition, the legislation defines the investment limits for each of these retirement funds. Within Pillar 3, the pension management companies are legally obliged to offer one conservative participating fund with the investment limits defined in the law. They may, however, offer a range of other participating funds with variously structured portfolios (within the broader limits defined in the law). In both Pillar 2 and Pillar 3, the fees charged for asset management are regulated by law.

As can be seen in Table 8.1, there were nine pension management companies active in providing pension products in 2014. Whilst all of these companies managed assets under Pillar 3, only five of them performed activities including the management of the retirement funds under Pillar 2 (refer to column 2 of Table 8.1).

Table 8.1: Number of funds of licensed pension management companies in Pillars 2 and 3 as at 31 December 2014[55]

Pension management company	Pillar 2	Pillar 3	
		TF	PF
Allianz penzijní společnost, a.s.	4	1	3
AXA penzijní společnost a.s.	-	1	3
Conseq důchodová penzijní společnost, a.s.[56]	-	1	2
Conseq penzijní společnost, a.s.[56]	-	-	5
Česká spořitelna - penzijní společnost, a.s.	4	1	3
ČSOB Penzijní společnost, a.s., člen skupiny ČSOB	4	1	4
ING Penzijní společnost, a.s.[57]	-	1	4
KB Penzijní společnost, a.s.	4	1	4
Penzijní společnost České pojišťovny, a.s.	4	1	4
Total	20	8	32

Source: APS CR

As compared to the end of 2013, when the pension management companies managed a total of sixty-eight pension funds, the number of these funds was reduced by the seven funds administered by the Raiffeisen penzijní společnost, which decided to terminate its activities in Pension Pillars 2 and 3 (refer to Chapter 4 for more information). Another reduction in the number of funds resulted from the merger of the two participating funds managed by the Allianz penzijní společnost. Additional mergers of the participating funds may be expected in 2015, as this is one way in which the pension management companies can increase the value of the assets in the funds to the CZK 50 million the law states they must reach in each fund, with the exception of the conservative participating fund, within the first two years of its existence.[58] As of 31 December 2014, eight of the participating funds did not meet the condition of containing assets totalling CZK 50 million and some of these funds were already merged at the start of 2015. Some pension management companies decided to resolve the issue of the required level of assets by creating a new fund, thus starting a new two-year time period, and they will subsequently merge this new fund with the fund that does not satisfy the requirements.

The pension management companies sector reported CZK 528.6 million in pre-tax profit from standard activities in 2014. The ratio of the pension management companies' capital to their cumulative capital requirements dropped by 8.7 pp as compared to 2013. This development cannot be viewed favourably, particularly due to the possible future risk of increased yields on securities, which make up the majority of the portfolio of transformed funds managed by the pension management companies. The cause of this risk faced by the pension management companies sector is the guarantee that the transformed funds will not decrease in value. If interest rates increase from their currently very low levels, and, as a result, there is an associated decrease in the price of the bonds held at market value, the pension management companies would have to make up any losses from their own equity.

[55] TF = transformed funds; PF = participating funds

[56] The two pension companies of the Conseq Group were merged in January 2015. Conseq důchodová penzijní společnost, a.s. became the successor company and was subsequently renamed to Conseq penzijní společnost, a.s.

[57] In March 2015 ING Penzijní společnost, a.s. was renamed to NN Penzijní společnost, a.s.

[58] The majority of the participating funds started activities as at 1 January 2013.

Table 8.2: Selected indicators in pension management companies sector

Indicator as at 31 Dec (in CZK mn or %)	2013	2014	Year-on-year change (%)
Profit (loss) for the accounting period before taxation	-271.4	528.6	294.8
Equity, total	9,129.5	8,322.5	-8.8
Capital ratio (%)	148.5	139.8	-5.9

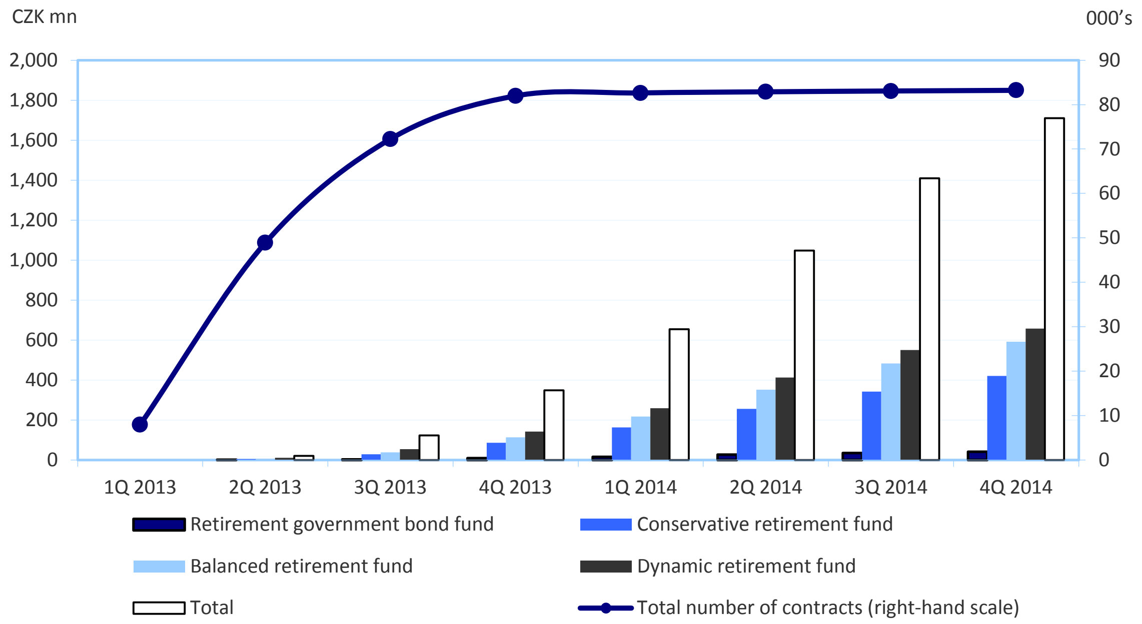
Source: CNB – ARAD

8.2. Retirement Savings

The developments in retirement savings have, since the very start of Pillar 2, been affected by the intent of the representatives of the opposition party – who, after the early election held in October 2013, now represent the current ruling coalition – to do away with the retirement savings component of the pension system. In November 2014, the government decided to terminate Pension Pillar 2 as of 1 January 2016. The participant assets kept in the retirement funds will be disbursed to the participants in autumn 2016 either in cash by means of a postal money order, through an electronic bank transfer, or through a transfer to Pillar 3 according to the disbursement option chosen by the participant.

The volume invested by the participants in the retirement funds reached a level of CZK 1.7 billion at the end of 2014, which is almost four times the value reported at the end of 2013. However, as compared to the end of 2013, the number of participants in the retirement funds increased by only about 1,250 to a total of 83,200 individuals as a result of the declared intention to terminate Pillar 2. As far as the placement of the participants' savings in the individual types of retirement funds is concerned (refer to Graph 8.1), it is obvious that the participants tended to select higher risk investment strategies, as, at the end of the year, 38.4% of all assets were placed in the dynamic retirement funds.

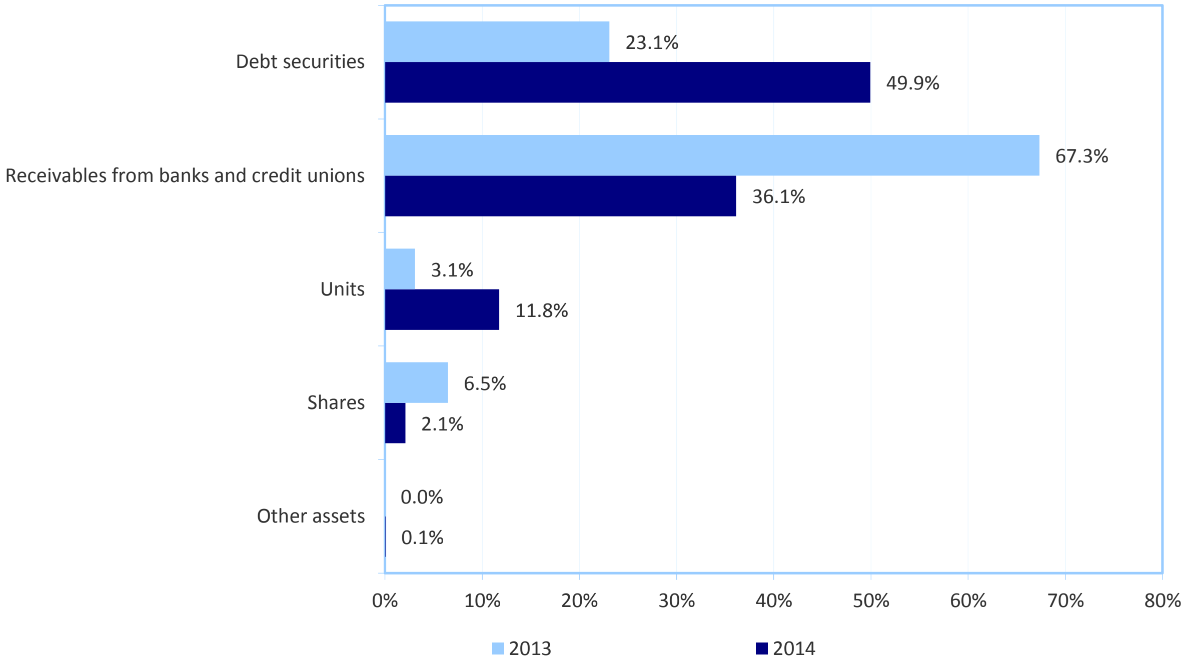
Graph 8.1: Volume of assets managed in different types of retirement funds



Source: APS CR

When compared with 2013, in 2014 the asset structures of the retirement funds saw a transfer of a portion of the assets to higher-risk financial instruments, which should generally better correspond to the dominant position of the dynamic retirement funds from the perspective of the placement of the participants' savings. Within the investment portfolio, there was an increase in the volume of units to the detriment of shares. Then, in the debt securities category, corporate bonds attained a much greater share and make up 10.9% of the total value of retirement fund assets allocated to debt securities. The government's decision to terminate the retirement funds was thus apparently also reflected to a certain degree in the asset structure, particularly in the still relatively high volume of assets placed in demand and term deposit accounts in credit institutions.

Graph 8.2: Allocation of retirement funds assets



Source: CNB – ARAD, MoF calculation

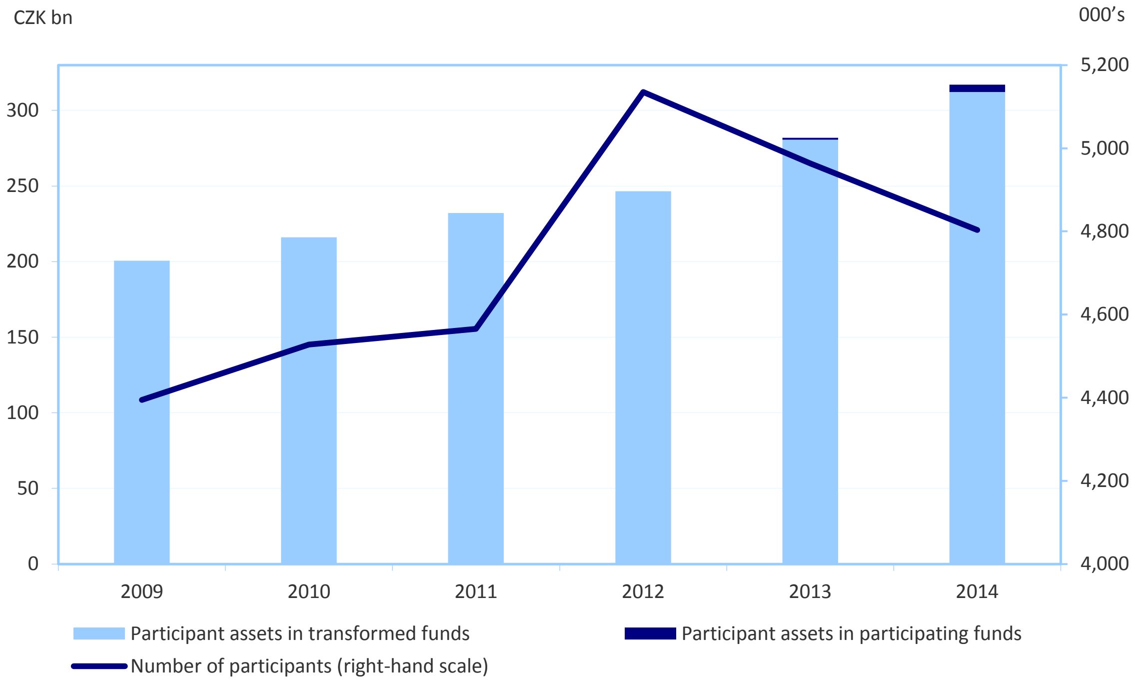
8.3. Supplementary Pension Insurance and Supplementary Pension Savings

The participant assets in the transformed funds and in the participating funds totalled CZK 317 billion at the end of 2014, reflecting a year-on-year increase of 12.4%. Of this amount, assets totalling CZK 4.8 billion, i.e. 1.53% of all of the Pillar 3 assets, were managed by the pension management companies in the participating funds at the end of the year.

The high number of new participants who joined the system in 2012 (an increase of 569,000 individuals), due to the ability to enter into a contract according to the old supplementary pension insurance conditions only until the end of November 2012, and who, if the system were not closed, would have entered the system gradually over the next two to three years, has led to the continuing relative saturation of the market. The gradual growth in the number of individuals in the participating funds has thus far not been sufficient to cover the decrease in the clients of the transformed funds. As a result, the number of participants in Pillar 3 once again decreased in 2014, specifically by 160,000 to 4.8 million individuals. As of 31 December 2013 there were almost 218,000[59] active supplementary pension savings contracts registered in the participating funds. In 2014, 145,000 new participants entered into supplementary pension savings contracts, and 14,221 of these new participants transferred their savings to the participating funds from the transformed funds. In 2013, the participants who did perform this type of transfer numbered only 1,284.

[59] This number of participants in the participating funds is based on the data that the MoF receives on a quarterly basis from the individual pension management companies. According to the data of the APS CR, as of 31 December 2014 there were 229,000 participants in the participating funds; according to the CNB's data, there were 224,000.

Graph 8.3: Participant assets and number of participants in Pillar 3



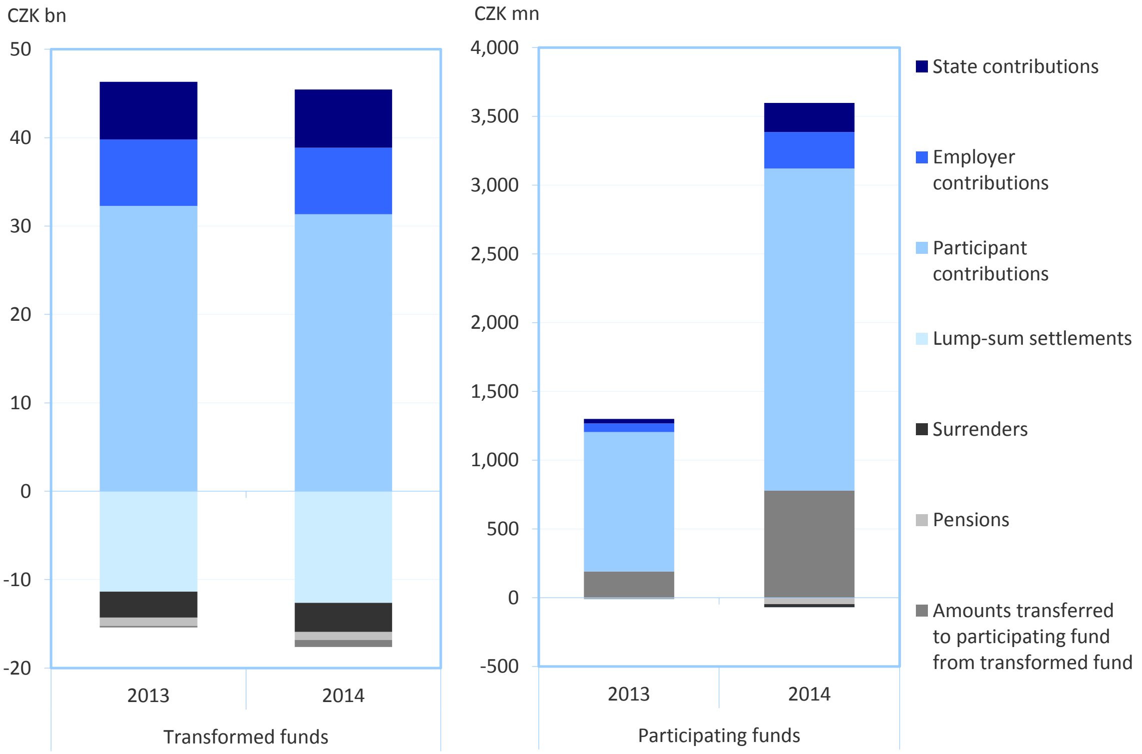
Source: MoF, APS CR

While the transformed funds reported a decrease in the difference between the volume of contributions received and the volume of contributions disbursed because they are closed to new participants, the participating funds reported more positive development as compared to 2013 and achieved a significantly higher level of income over expenses. This was the result of not only the higher volume of contributions due to more participants, but also a greater increase in the number of participants moving from the transformed funds. The disbursements from the transformed funds are most commonly made in the form of a lump-sum settlement. In the case of the participating funds, the disbursements tend to be made in the form of regular pension payments. The preference to receive the pension savings in the form of regular payments at the time the supplementary pension savings period ends is due to the short period of time the participating funds have been functioning and is connected primarily with the option to collect a "pre-retirement"[60] pension which is chosen by participants who have moved their savings from the transformed funds to the participating funds. Those participants who move their savings from the transformed funds may also choose to collect a retirement pension for tax optimisation purposes in the case of the disbursement of the contributions made to the pension management company by their employer.[61]

[60] Five years prior reaching pension eligibility age, the participants have the ability to either start collecting their pension in the form a retirement pension for a predefined period of time, or to pay a one-time premium in order to start collecting a lifetime annuity or fixed amount annuity payments for a specific period of time. The ability to select a lump-sum distribution is conditional on reaching pension eligibility age.

[61] The contracts for supplementary pension insurance that were made starting in 2000 offer two ways in which the savings can be paid out at the end of the savings period—a lump-sum settlement or lifetime pension payments. In the case of a lump-sum settlement, however, the employer contributions are taxed at a rate of 15%. If the participant wants to collect their savings within a relatively short period of time, without having to pay the tax on the employer contribution, they can transfer their savings to a participating fund prior to the end of their contract. The, within the supplementary pension savings system, the participant can choose to receive pension payments for a specific period of time (no less than three years), during which the employer contribution is not taxed.

Graph 8.4: Contributions received and paid in transformed and participating funds



Source: CNB – ARAD

From the perspective of the age structure of the participants in Pillar 3, the "middle" generation (the 30-59 age group) continues to hold the dominant position with a 62 % share. This group consists of persons of working age with statistically higher and more stable incomes, which provide a better environment to create financial reserves for retirement. The absolute highest number of participants at the end of 2014 consisted of people in their thirties, followed very closely by individuals in their forties. Looking at Table 8.3 it is obvious that there was a decrease in the number of participants from all age categories, with the greatest decrease for the 18-39 age group. The change in the number of participants within the individual age groups may, however, be caused by people moving from one age group to another as they age. For example, the continual increase in the number of participants in the 40-49 age group is apparently the result of the gradual shift of participants from the heavy birth years of the 1970s as they move into this age category.

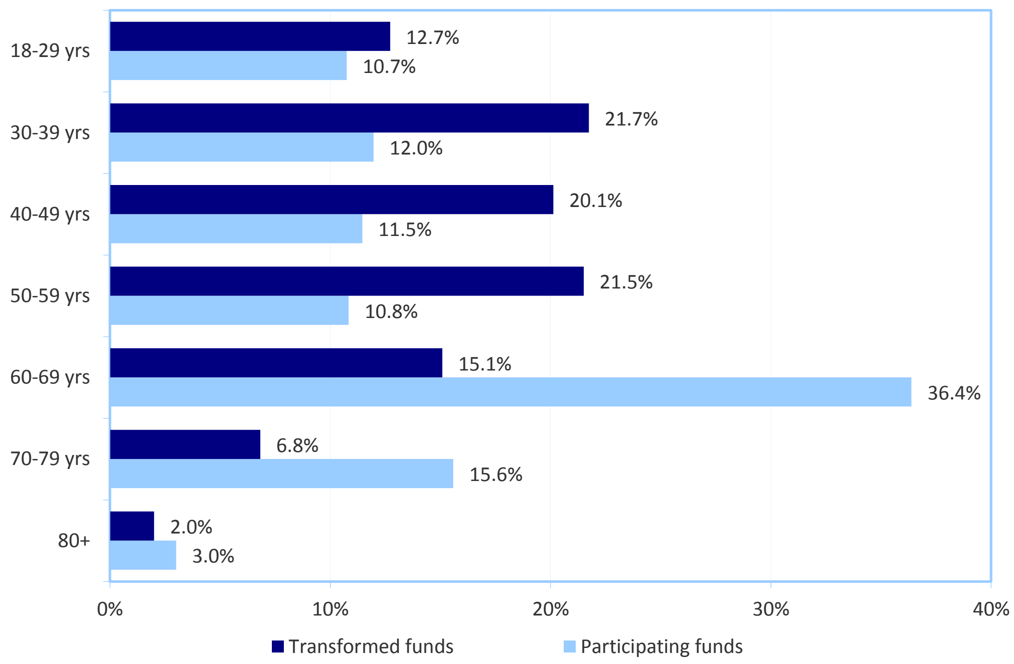
Table 8.3: Participants in Pillar 3 by age

As at 31 Dec	2010	2011	2012	2013	2014	Year-on-year change	
						Abs.	(%)
18 - 19 yrs	22,150	19,569	67,014	28,143	2,154	-25,989	-92.3
20 - 29 yrs	537,701	526,835	718,693	667,795	604,287	-63,508	-9.5
30 - 39 yrs	965,683	977,023	1,127,029	1,082,619	1,022,808	-59,811	-5.5
40 - 49 yrs	867,483	885,169	996,302	1,002,963	1,009,655	6,692	0.7
50 - 59 yrs	998,104	973,152	989,126	965,540	947,657	-17,883	-1.9
60 - 69 yrs	765,997	786,776	814,754	786,819	771,081	-15,738	-2.0
70 - 79 yrs	292,809	311,402	328,867	334,139	346,909	12,770	3.8
80 +	77,847	85,795	93,077	95,326	98,583	3,257	3.4
Total	4,527,774	4,565,741	5,134,862	4,963,344	4,803,134	-160,210	-3.2

Source: MoF

The age category that reported the greatest increase in the number of participants in 2014 is the group of articipants aged 70 and above. This is partially related to the fact that, in 2014, people aged 60 and above made up more than half of the total number of participants in the new participating funds (refer to Graph 8.5). It is most likely that these participants are continuing to use the supplementary pension savings scheme as a means for investing their available funds, which, as they have reached retirement age, they will be able to start withdrawing, together with the state contributions, after a five-year saving phase. In the case of the participating funds, prior to the pension reform, it was expected that a higher level of interest would be expressed by people in the lower and middle age groups due to the ability to select a more dynamic investment strategy. In 2014 almost 13,000 new participants in the under-30 age group entered into contracts for supplementary pension savings, reflecting a 57% increase as compared to the previous year. It is therefore also possible to conclude that supplementary pension savings products are becoming more popular even amongst the youngest generation.

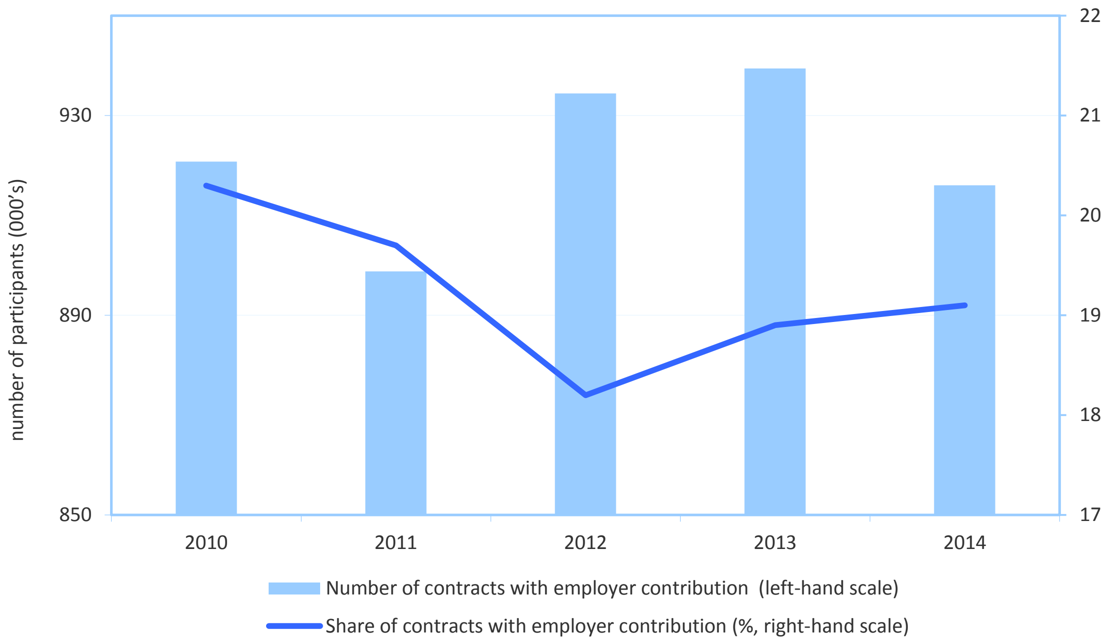
Graph 8.5: Age structure of participants in transformed and participating funds



Source: MoF

As can be seen in Graph 8.6, the number of participants for whom their employer also makes a contribution towards supplementary pension insurance or supplementary pension savings decreased by 2.5% in 2014 to 916,000. In relative terms, given the decline in the total number of participants, there was a slight increase in the share of participants who receive an employer contributions, specifically by 0.2 pp to 19.1%. However, as compared to period prior to 2012, this is still a fairly low share, which may be explained by the austerity measures that are still in place in the business sector even though they are gradually being eased. Taking into account the fact that the employer contribution is often used to motivate and stabilise employees, it is most frequently found in the case of participants in the 35-59 age group (in 85% of the cases).

Graph 8.6: Number of contracts in Pillar 3 with an employer contribution[62]



Source: MoF

One of the objectives of the reform of Pillar 3 that entered into effect in 2013 was to motivate participants to regularly save higher amounts through the new conditions for receiving the state contribution and obtaining tax relief.[63] In the case of supplementary pension insurance, the average monthly participant contribution did indeed significantly increase (by 22.2%) in 2013 to reach CZK 568. However, the year-on-year increase in 2014 was only CZK 6, which indicates that the potential participants' response to the new conditions was basically already exhausted in 2013. The average contribution amount for the participating funds is still at a higher level than for the transformed funds, however, it reported a year-on-year decrease to level of CZK 722.[64] Given the increase in the average state contribution for the participating funds, this decline resulted from the lower use of the tax relief. As can be seen in the average contribution amounts for the individual quarters of 2014 as presented in Table 8.4, there was a faster growth rate for both types of funds in the fourth quarter, as was the case in 2013 as well. This is due to the fact that a number of participants made an extraordinary contribution at the end of the year in order to be able to take advantage of the tax relief. However, when compared to 2013, fewer participants took advantage of this opportunity.

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

Average CZK/month		2010	2011	2012	2013	2014	2014				Year-on-year change	
							1Q	2Q	3Q	4Q	Abs.	(%)
TF	Participant contribution	440	442	465	568	574	563.8	561.4	566.8	605.3	6	1.1
	State contribution	105	105	108	117	119	119.0	118.8	119.7	120.2	2	1.7
PF	Participant contribution	-	-	-	749	722	689.8	692.7	692.1	815.2	-27	-3.6
	State contribution	-	-	-	143	148	146.8	148.1	148.5	149.0	5	3.5

Source: MoF

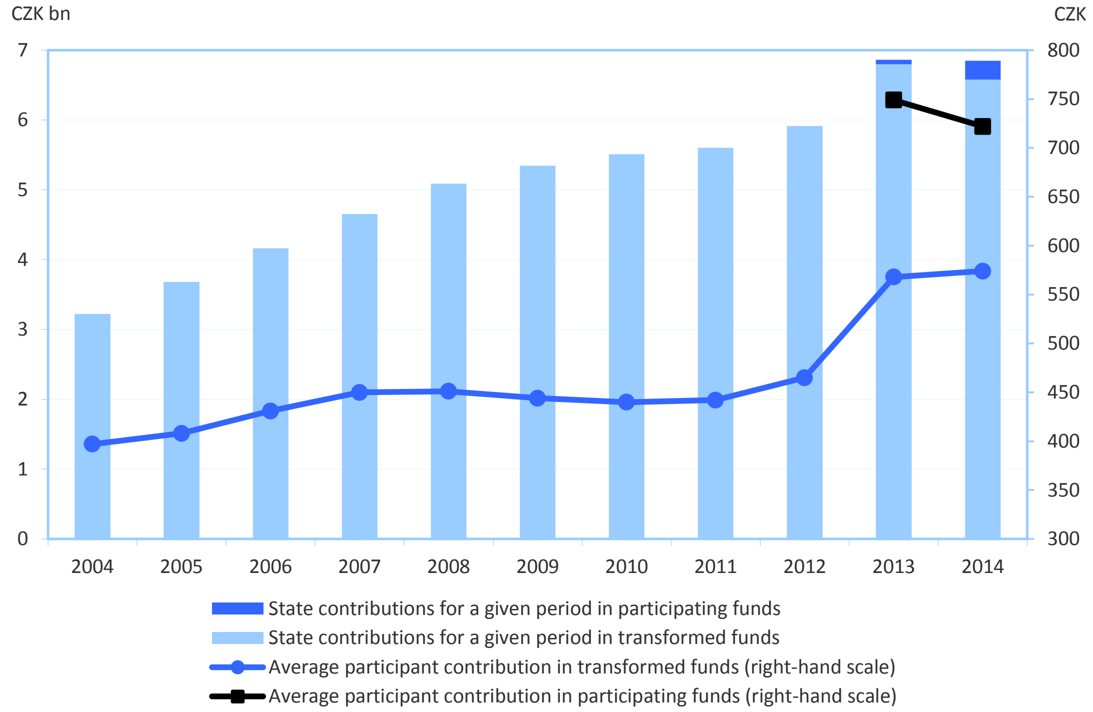
[62] Status as at 31 December for each given year.

[63] Starting 1 January 2013, the minimum monthly participant contribution which receives a state contribution was increased from 100 to CZK 300, and the monthly state contribution from CZK 50 to CZK 90. The minimum monthly participant contribution for receiving the maximum state contribution was increased from CZK 500 to CZK 1,000, and the maximum monthly state contribution from CZK 150 to CZK 230. At the same time that the minimum contribution amount for receiving the maximum state contribution was increased, the rules for tax relief were also changed and this relief could only be claimed for monthly contributions of over CZK 1,000 as opposed to the previous CZK 500.

[64] This is the average for the full calendar year 2014 and it is thus lower than the average specified for the fourth quarter of 2014 in Table 8.4.

Although the average state contribution per participant increased in 2014, the total volume of the direct state support in the supplementary pension insurance and supplementary pension savings sector decreased in 2014 by CZK 13 million to a final total of CZK 6.85 billion due to the decreasing number of participants. Of this amount, CZK 270 billion was used for the state contributions for the participating funds.

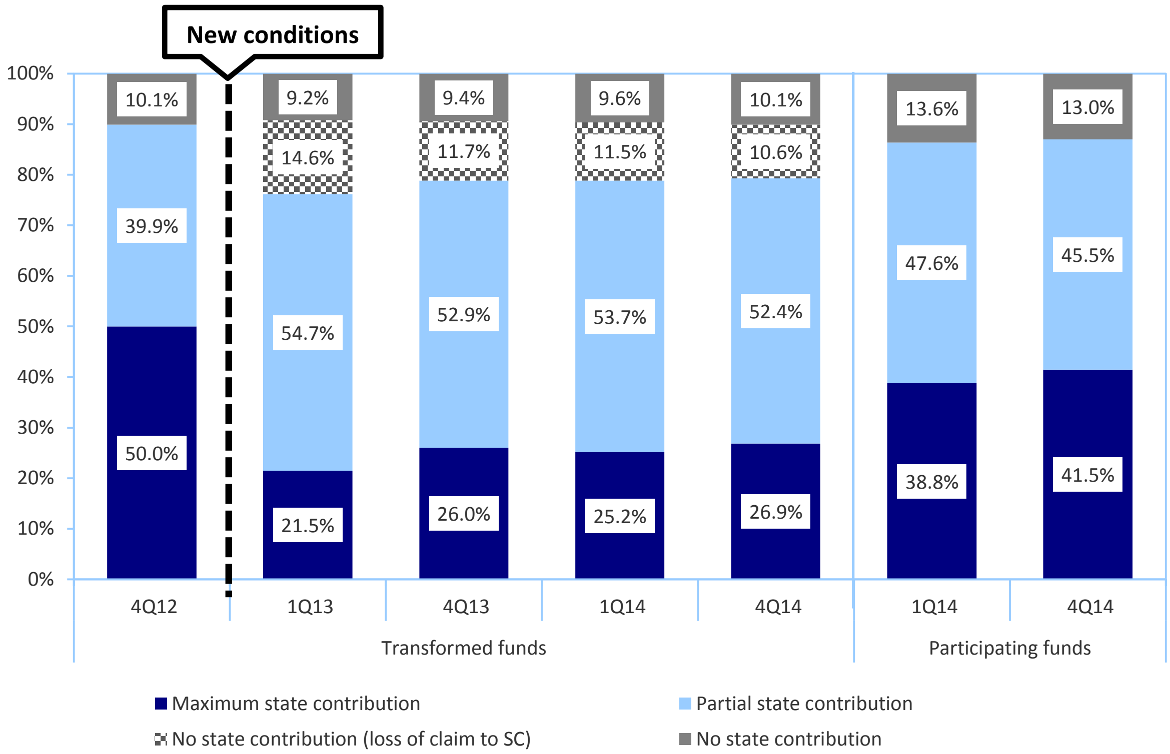
Graph 8.7: State contributions and average participant contribution in transformed and participating funds



Source: MoF

Graph 8.8 presents a comparison of the share of supplementary pension insurance and supplementary pension savings contracts that receive no state contribution, a partial contribution, or the maximum state contribution. Looking at these results, it is apparent that there still remains sufficient room in the transformed funds for the potential growth of the average participant contribution. However, in 2014, there was only a slight increase in the monthly contributions made by the participants in connection with the changed conditions for receiving the state contribution, even though it was possible to expect that there could be a change in the savings behaviour of a certain group of participants in the transformed funds in relation to their improving financial situation as a result of the overall developments in the Czech economy. It is therefore also possible to conclude that the shares of participants with no state contribution, only a partial contribution, and the maximum contributions is more or less stabilised to a certain degree and only slight changes are to be expected in the future.

Graph 8.8: Shares of supplementary pension insurance contracts with no, partial, and maximum state contribution (SC)[65]

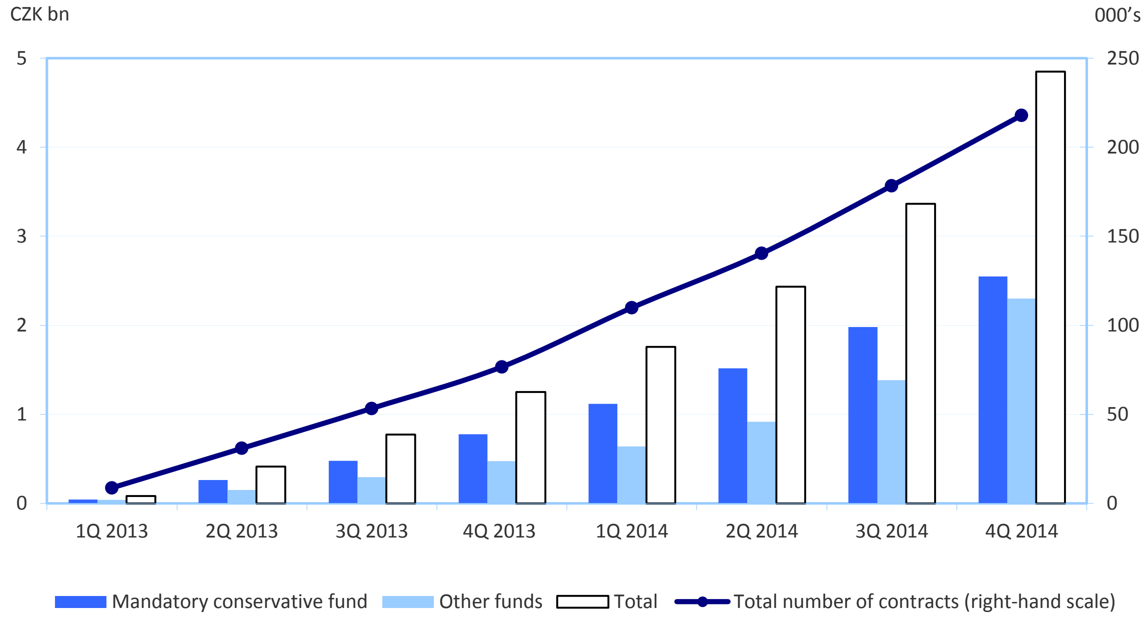


Source: MoF

In 2014, within the framework of saving in the participating funds, the pension management companies generally offered two to five different investment strategies, ranging from a conservative fund that includes assets with the lowest associated level of risk (e.g. government bonds, treasury bills, money market instruments, etc.) up to dynamic (share) funds with a significantly higher associated level of risk but with the possibility of higher yields. As can be seen in Graph 8.9, as compared to the participants in the pension savings scheme, the participants in the supplementary pension savings system prefer to invest conservatively as, in terms of the placement of their assets in the participating funds, the mandatory conservative fund, which has specific investment limits defined in the law, is the most popular (containing 53% of the total volume of assets). Every pension management company that offers supplementary pensions savings through the participating funds is obliged to offer this type of fund. The dominance of the mandatory conservative funds in terms of volume is, however, the result of the age structure of the participants. As was mentioned above, more than one half of the participants in the participating funds are over 60. The participant assets invested in the dynamic (share) funds are equal to approximately 9.5% of the total volume in the participating funds.

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

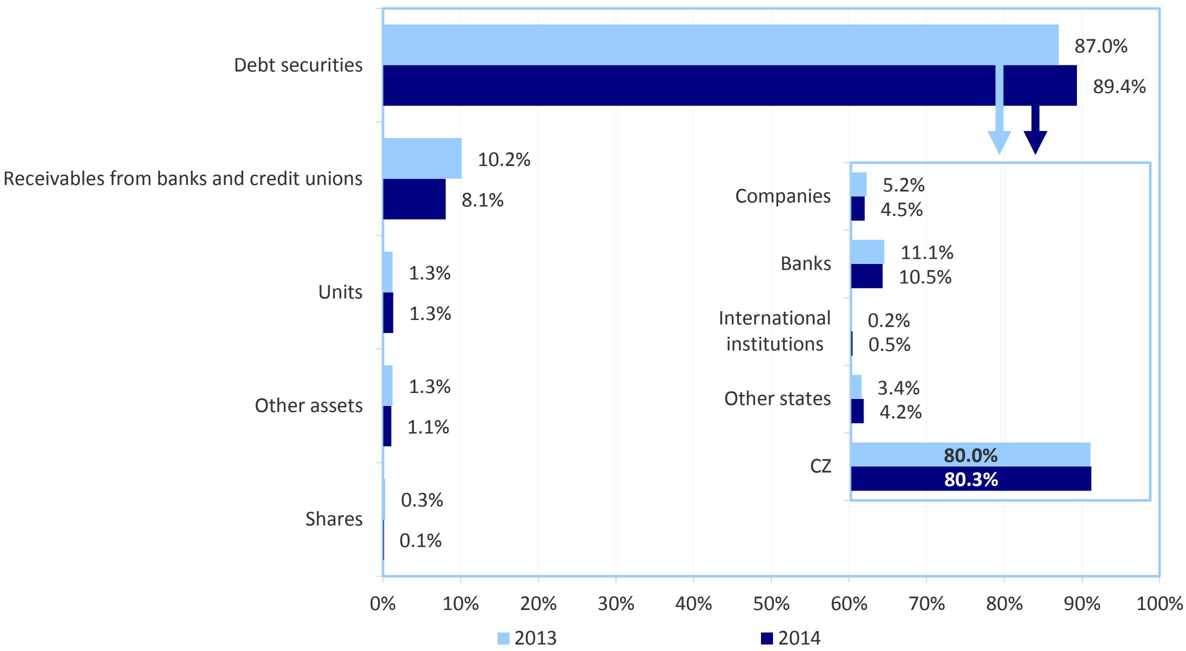
Graph 8.9: Volume of assets managed in different types of participating funds



Source: APS CR

The investment portfolio for the transformed funds (refer to Graph 8.10) is retaining a very conservative nature, which is, however, due to the regulatory framework. When compared with 2013, the share of debt securities in relation to total assets increased by 2.4 pp to 89.4% and the portfolio is dominated by government bonds issued by the Czech Republic. Approximately 8% of the total assets are allocated in deposits kept at credit institutions. The other possible options, including shares, make up only a very small proportion of the portfolio.

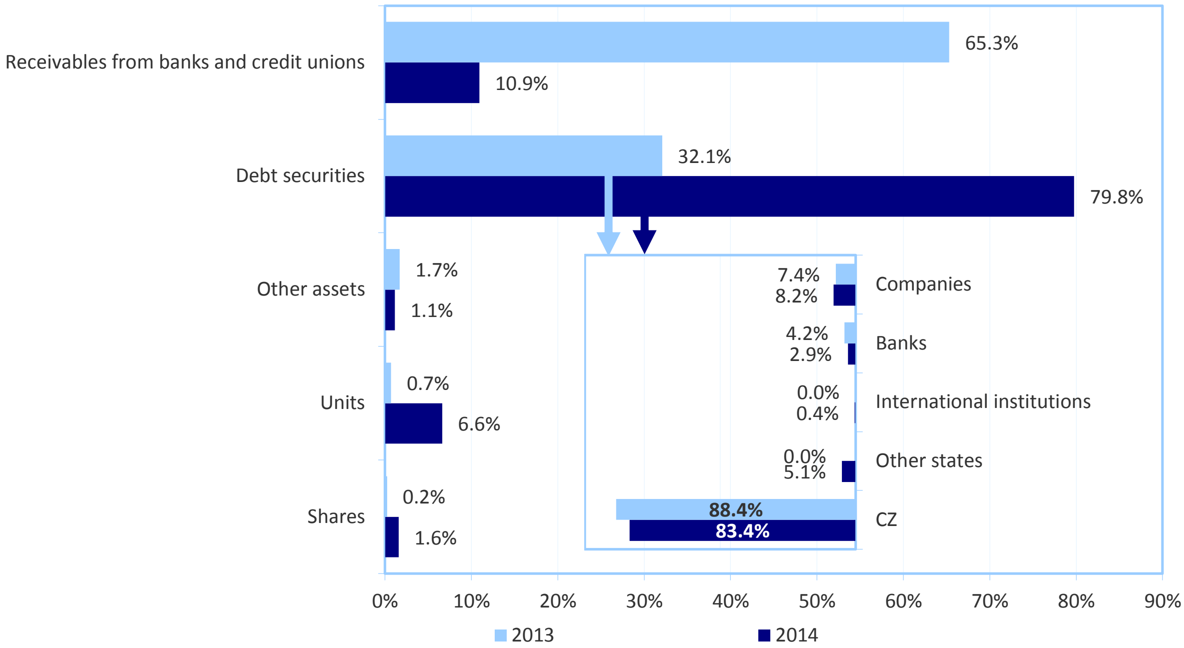
Graph 8.10: Allocation of transformed fund assets and structure of debt securities according to their issuers



Source: CNB – ARAD, MoF calculation

The structure of investment portfolio for the participating funds, which in 2013 reported even a more conservative placement of assets than in the case of the transformed funds (refer to Graph 8.11), underwent a significant transformation over the course of 2014. Given the important position of the mandatory conservative funds in relation to the total volume of assets, the majority of the assets are invested in debt securities, represented primarily by the government bonds issued by the Czech Republic. However, as compared to the transformed funds, the participating funds have more assets placed in corporate bonds. The share of assets kept in demand and term deposit accounts at credit institutions decreased to 10.9%. Conversely, the proportion allocated in shares increased and the share of units grew by almost 6 pp.

Graph 8.11: Allocation of participating fund assets and structure of debt securities according to their issuers



Source: CNB – ARAD, MoF calculation

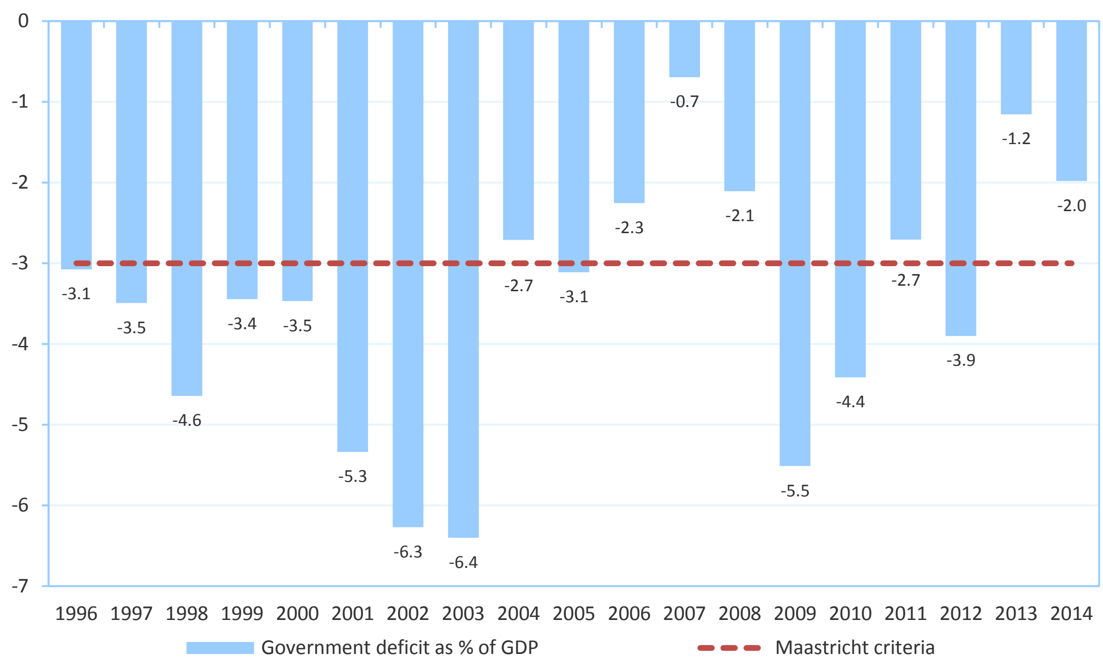
Some of the more detailed information about the supplementary pension insurance and supplementary pension savings sector, which is regularly published on the MoF website (www.mfcr.cz), is included in Tables P2.6 and P2.7 in Appendix 2.

9. GOVERNMENT SECTOR

9.1. Economic Results of the Government Sector

According to preliminary CSO statistics, in 2014 the economic results in the government sector recorded a deficit equal to 2.0% of GDP. When compared to 2013, this reflects a deterioration of 0.8 pp. The resulting balance was strongly influenced, both by the new financial institutions included in the government sector (in 2014, the Deposit Insurance Fund disbursed more than CZK 14 billion in compensation to the clients of defaulted credit unions; refer to Chapter 4.2 – Guarantee Schemes), as well as by the large one-time accrual drop in excise taxes and the renewal of investment activity.

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



Source: MoF, CSO

Total revenue increased by 2.6% in 2014, of which the income from taxes and social contributions grew by 2.4%. The growth in tax revenue was primarily driven by direct taxes, which increased year-on-year by 7.2%, mainly thanks to the positive development in corporate income tax resulting from the economic recovery. The government sector deficit was negatively affected at a level equal to 0.2% of GDP due to the personal tax credits for working pensioners that had to be refunded based on a Constitutional Court Finding. Other discretionary effects of direct taxes were more or less compensated each other. In the case ofsocial contributions, which grew by 3.6%, the main contributing factor was the increase in the social contributions made on behalf of the state welfare beneficiaries to the public health insurance system.

From the perspective of revenue, indirect taxes developed unfavourably overall (a decrease of 1.7%) due to the development in the excise taxes for tobacco products. This is because in 2014 the government approved measures that limit the sale of tobacco stamps with the immediately preceding rate, thus significantly reducing the motivation to stockpile these stamps. The excise tax for tobacco products is due and payable within approximately two months after the revenue stamps are ordered, and, as a result, the income from this tax is accrued retroactively by this two-month period. The total drop in the accrued income from this tax totalled approximately CZK 24 billion. However, this is only a one-time effect and should not reoccur in 2015. In contrast, the revenue from value added tax developed very positively. It increased year-on-year by more than 5%, thus reflecting the new trend of a higher level of taxes being collected thanks to the gradual implementation of measures that prevent tax evasion.

The largest relative year-on-year growth can be seen in capital income transfers, which increased by 25.4% due to the significant increase in investments made using European sources. The overall balance is then influenced only by a portion of national financing. This is accrual income, which reflects the volume of invested European resources in the given year. Revenue in 2014 was also positively affected by the income from the sale of frequency band licences to mobile operators, which totalled CZK 8.5 billion.

Total government expenditure grew by 4.7% in 2014. The nominal final consumption of government institutions increased by 3.3%. This growth was primarily driven by the development of social payments in kind (particularly the payments made by health insurance companies for healthcare), which increased by more than 6% when compared to 2013. The health insurance companies used the additional resources obtained from payments made by the state for welfare beneficiaries to compensate healthcare facilities for the loss of income resulting from the cancellation of the regulatory healthcare fees. In addition, the compensation paid to employees increased by 3.5% as a result of pay rises in the state administration sector. As compared to 2013, intermediate consumption (consisting primarily of purchases of goods and services) developed more moderately and grew by only 1.7%.

The expenditure for financial social benefits increased only slightly (by about 2%) in spite of the aforementioned larger payments made on behalf of state welfare recipients to the public healthcare system. In this respect, primarily the significantly limited pension indexation that was implemented in the past had an effect.

Government investment increased by more than 17%. This reflects the renewal of investment activity after many years of a decline and this indicator reached the same level as in 2011, in spite of a significantly better structural balance. The main growth in investments was reported by local government institutions (although there was also an increase in the central government sector) and includes investments financed from both national as well as European sources.

Expenditure subsidies (primarily capital transfers and subsidies for production) also reported considerable growth. In the case of subsidies for production, this involved an increase in subsidies for renewable sources equal to 0.1% of GDP. As far as capital transfers are concerned, the aforementioned compensation paid by the Deposit Insurance Fund to the clients of failed credit unions had an overall effect corresponding to approximately 0.3% of GDP.

9.2. Economic Outlook for the Government Sector for 2015-2018

The MoF expects that the deficit will reach a level of 1.9 % of GDP in 2015[66], which is a 0.1 pp improvement as compared to the results for the previous year, but still well below the Maastricht deficit criteria. As compared to 2014, the financial results next year should not be affected by the income from the sale of non-financial assets (frequency band licences), the loss in excise tax revenue, or the disbursement of compensation form the Deposit Insurance Fund. Last year’s negative fiscal effort should therefore be significantly reduced to -0.3 pp.

According to the most recent estimates, government revenue is expected to grow by 5.2% and it is anticipated that tax income will increase by 3.8%. The growth dynamics on the income side are accelerating due to the income subsidy accrual for the expenses co-financed from European funds.

As far as tax income is concerned, indirect taxes are expected to increase by 3.5%, primarily due to a sharp increase in the excise taxes for tobacco products, which, after last year’s slump, should return back to the long-term trend that follows the volume of consumption of tobacco products. The growth rate for income from value added tax is expected to slow down (to 1.5%), due to the implementation of a second reduced VAT rate of 10% for drugs, books, and essential child nutrition products. The collection of direct taxes should grow by 3.4% as compared to 2014 and social contributions will increase by more than 4%, which corresponds to the development of wages and salaries in the economy.

According to the predictions, government expenditure will increase by 4.9% as compared to 2014. The main driving force will be the rapid growth in the government’s investment activities funded both from national as well as European sources. Both the investment volume and the deficit in 2015 will be affected by the lease of the supersonic JAS-39 Gripen aircraft, which will lead to an expense of CZK 10.5 billion. Financial social benefits should grow at a faster rate than last year (by 4.3%) due to the higher indexation of pensions. The year-on-year growth in final consumption is expected to decrease to 2.2%. The main contributing factors

[66] According to the Convergence Programme of the Czech Republic.

to this decline in the growth rate are the increased salaries paid to public sector employees (up by 3.5%) and social benefits in kind (up by 2.8%). Intermediate consumption is expected to grow moderately at a rate of 1.5%

The medium-term outlook for the government sector for the 2016 to 2018 period expects a gradual decrease in the government sector deficit down to a level of 0.6% of GDP. Starting in 2016, there should be a gradual increase in tax income as a result of measures implemented with the aim of reducing tax evasion. The key measures in the area include monitored VAT reporting, electronic sales tracking, and the restructuring of financial administration. According to the predictions, the Czech Republic will remain safely below the 3% threshold required by the Stability and Growth Pact during the entire timeframe. In 2018, it will almost be at its medium-term target for the structural balance, which has been set at -1% of GDP.

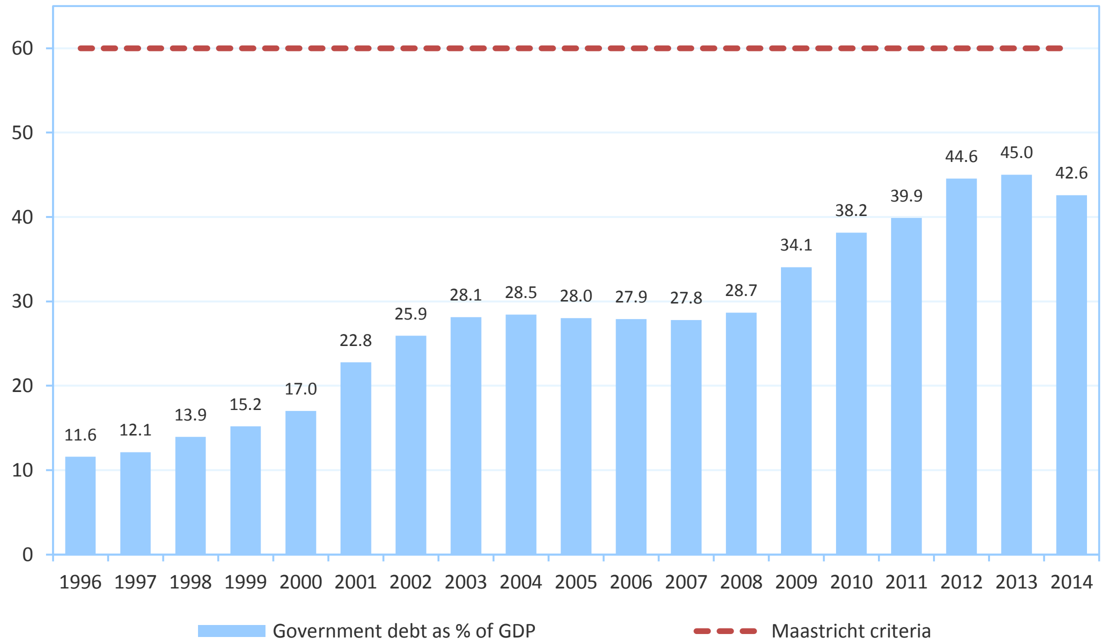
9.3. Government Sector Debt

In 2014, the total debt of the government sector reached a level equal to 42.6% of GDP. As compared to the previous year, this reflects a significant 2.5 pp decrease in the ratio of indebtedness to GDP. There was also a slight decrease in indebtedness in absolute terms, due to the inclusion of the available monetary resources of central government institutions in the state treasury single accounts maintained by the CNB.

It is expected that nominal value of government debt in 2015 will reach a value of CZK 1,828.6 billion (which corresponds to 40.9% of GDP). This increase from the CZK 1.816.1 billion reported at the end of 2014 will mainly be the result of the CZK 10.5 billion of principle associated with lease of the JAS-39 Gripen aircraft.

The relative level of the government sector's indebtedness has been showing significant improvement over the past several years. The level of the debt quota is safely below the criteria defined in the rules for financial debt defined in the Stability and Growth Pact and the limits set in the proposed national debt rules. It is predicted that the debt quota will continue its gradual decline during the 2016 to 2018 period and will decrease by approximately 0.8 pp to a level of 40.2%.

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



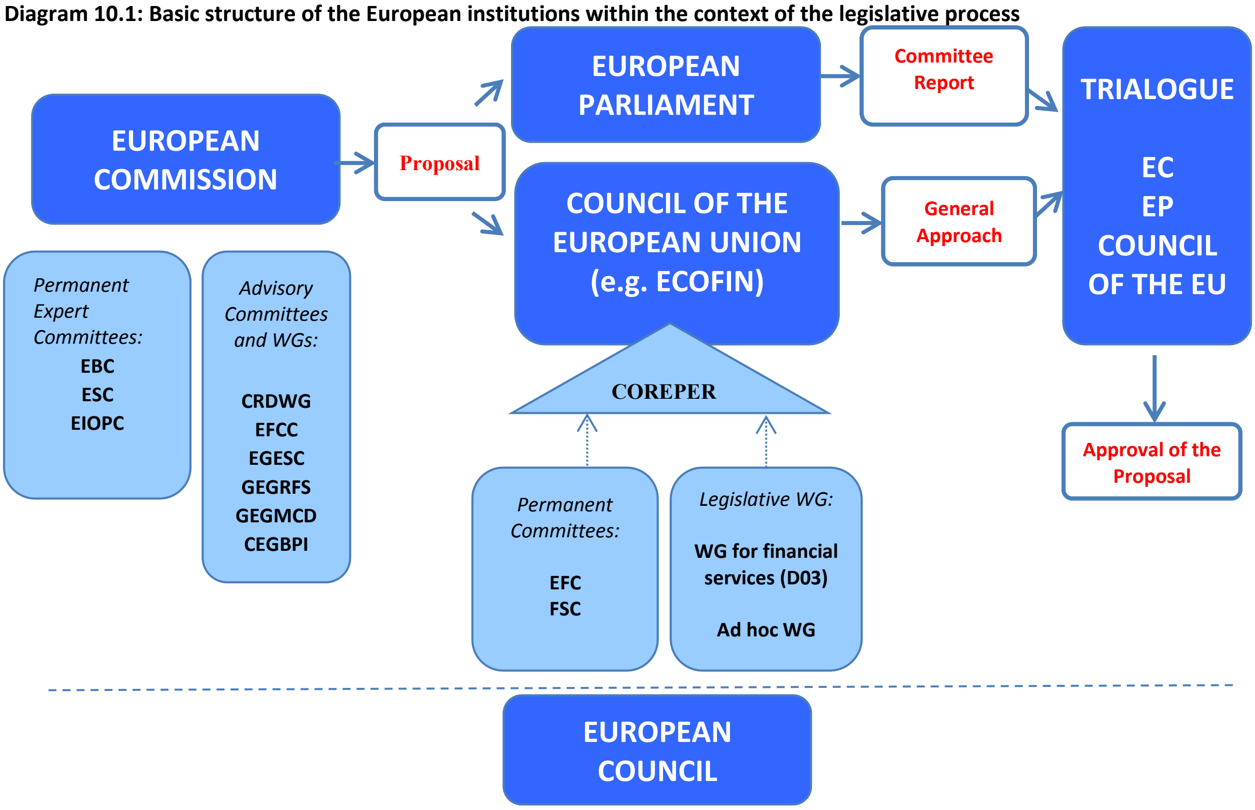
Source: MoF, CSO

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

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

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

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



Source: Prepared internally

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

European Commission

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

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

<u>European Banking Committee (EBC)</u>
The EBC acts as the Commission's advisory body during the preparation of EU implementing acts in the banking sector The EBC meetings held during 2014 were primarily focused on certain draft implementing acts and their adoption (such as the draft implementing decision on the equivalence of supervisory and regulatory requirements of certain third countries, and the draft implementing regulation on the extension of the transitional periods related to the own fund requirements for exposures to central counterparties). The first meeting of 2015 was held on 24 April. The discussion was focused on approving the transitional periods in the case of the implementing act on the own fund requirements for exposures to central counterparties.

<u>European Securities Committee (ESC)</u>
The ESC is the Commission's advisory body which is responsible for preparing legislation associated with securities. The ESC plays an important part in fulfilling the objectives defined in the Action Plan for Financial Services and ensuring consistency during the implementation of EU legislation. The ESC held two meetings in 2014 – one in February and the second in June. At the first meeting, the discussion was focused on the legal and supervisory framework in the USA and Japan with regard to the provisions for the central counterparty according to EMIR. At the second meeting, the subject of discussion was the classification and delineation of FX spot and derivative contracts under MiFID.

<u>European Insurance and Occupational Pensions Committee (EIOPC)</u>
The EIOPC functions as the Commission's comitology council when discussion and approving implementing acts at Level 2. This committee did not meet in 2014.

Other selected European Commission platforms

<u>Capital Requirement Directive Working Group (CRDWG)</u>
The CRDWG is involved in the preparation of regulations for the banking sector, or more specifically, the regulatory framework for credit institutions and certain types of investment firms. The aim of this group's work is primarily to take over the recommendations of the Basel Committee on Banking Supervision and to incorporate them into European legislation with the understanding that they will be revised in order to take into account the specifics of the European banking market. This working group did not meet at all in 2014.

European Financial Conglomerates Committee (EFCC)
The EFCC resolves expert issues associated with financial conglomerates. This committee's meetings include the participation of observers from Level 3 bodies, specifically from the EIOPA, EBA, and ESMA. This committee did not meet at all in 2014.

Expert Group of the European Securities Committee (EGESC)
This expert group met twice in 2014 – in June and in December. The June meeting was focused primarily on the preparations for the transposition of MiFID II into the national legislation of the member states and the ongoing ESMA meetings regarding the implementing regulations for this directive. Issues associated with the adaptation and application of the Regulation on Credit Ratings Agencies were also discussed. The December meeting concerned a discussion about the legal framework that is being considered for crowdfunding.

Government Expert Group on Retail Financial Services (GEGRFS)
The GEGFRS deals with the issues associated with retail financial services. Its tasks are primarily based on the Green Paper on Retail Financial Services in the Single Market published in May 2007. The EC's legislative and non-legislative proposals are presented during the group's meetings as well as various topics that are at the expert discussion stage. This group did not formally meet in 2014.

Government Expert Group on Mortgage Credit Directive (GEGMCD)
The GEGMCD address issues associated with the legal provisions for the mortgage market. In 2014, this working group focused on coordinating the transposition of the Mortgage Credit Directive (MCD).[67]

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

In its configuration for the insurance industry, it addresses not only expert issues, but also discusses various political topics associated with insurance and occupational pension insurance, including intermediation in the insurance industry. The meetings of the expert group are held with the participation of representatives from the member state and the Commission. The representatives of the EIOPA supervisory authority and the countries of the EEA participate in the role of observers. As far as the insurance sector is concerned, in 2014 CEGBPI discussed the delegated acts to the Solvency II Directive. The main topic of the discussion concerned the handling of insurance products with long-term guarantees and the options for decreasing the capital requirements for long-term investments with the aim of supporting long-term investments. At the start of 2015, the expert group launched discussions regarding the proposal for the recovery and resolution policy for insurers.

In 2014 the group's configuration for the banking sector met a total of twenty-one times. The working group addressed a broad range of topics. During the first half of 2014, the meetings were focused primarily on the progress that the member states have made with the implementation of the Capital Requirements Directive (CRD IV)[68] and the Capital Requirements Regulation (CRR)[69], as well as on assisting the Commission with the preparation of the reports and implementing acts, which is one of the tasks assigned to the Commission under CRD IV. For a significant part of 2014, the working group was involved in the preparation of the delegated acts that implemented the required changes and supplement the provisions of the CRR, which defines liquidity and leverage requirements. Other topics addressed by the working group include the issues associated with the equivalence of the EU's regulatory and supervisory framework in relation to third countries; various macroprudential issues, including the revision of the macroprudential instruments included in CRD IV and the CRR; the submission of reports according to individual countries; and other regulatory aspects ensuing from CRD IV and the CRR. First meeting of

[67] Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010.

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

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

the group in 2015 was held on 24 April. The discussion was focused on the use of the leverage indicator as a mandatory regulatory instrument and indicator; liquidity standards, including the long-term financing indicator; the revision of the existing exceptions and limits for large exposures as specified in the CRR; and the impact of the CRR on long-term financing.
The group's configuration for payment services discusses issues associated with the Payment Services Directive in the internal market (PSD), the Electronic Money Directive, Regulation (EC) No 924/2009 on cross-border payments in euros, and Regulation No 260/2012 establishing technical and business requirements for credit transfers and direct debits in euros. This platform's agenda also includes general issues associated with payment services, innovations in payment services, and topics associated with virtual currencies.

Council of the European Union / ECOFIN

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

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

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

In 2014 the ECOFIN configuration of the Council of the EU approved the General Approach documents for the Commission's proposals that were discussed by the Working Party on Financial Services. Other tasks included discussion and the provision of information about the agendas associated with implementing a supervisory mechanism and resolving the financial market crisis.

During the individual meetings, the ECOFIN Council:

- approved the proposal for the Mortgage Credit Directive (MCD) (28 January 2014);
- received information from the ECB regarding the implementation of the Single Supervisory Mechanism (January and February 2104);
- informed the ministers about the process and the trialogue underway with the European Parliament regarding the regulation for establishing a single resolution mechanism for use during times of crisis (February and March 2014);
- approved the General Approach document for the proposed regulation for establishing a single resolution mechanism, and requested the Presidency to initiate a discussion with the European Parliament with the aim of reaching an agreement during the first reading prior to the end of the current term of the European Parliament (May 2014);

- adopted the General Approach document of the Council relating to the proposed directive of the uropean Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision, referred to as IORP II (June 2014);
- received information from the Commission regarding the preparation of the implementing legislation that will define the contributions to be paid by banks to the crisis resolution funds according to the BRRD and the SRM (June, July, and October 2014);
- discussed the revision of the functioning of the European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB) (November 2014);
- reached a political consensus regarding the conditions for the application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the Single Resolution Fund (9 December 2014);
- appointed the permanent members of the Crisis Resolution Board and approved the methodology governing bank contributions to the Crisis Resolution Funds (19 December 2014); and
- provided information regarding the current status of the implementation of the BRRD and the ratification of the IGA (March 2015).

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

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

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

The financial market topics discussed by these committees in 2014 included, amongst others, the issues associated with the Banking Union, state aid in the financial sector and the developments in the financial markets, financial markets development, asset quality reviews (AQRs) and stress tests, recovery plans and crisis resolution (BRRD), the Single Supervisory Mechanism (SSM), issues associated with the functioning of the European Supervisory Authorities and the European Systemic Risk Board. Both committees also participated in the preparation of a common position regarding the issues discussed by the Financial Stability Board (FSB) and at the G20 summits.

In 2015 the committees are continuing in their discussion of the issues associated with the implementation of a single resolution mechanism (SRM) for credit institutions, the Single Supervisory Mechanism (SSM), recovery and resolution procedures (BRRD), state aid in the financial sector, and developments in the financial markets.

Working Party on Financial Services (D03)

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

The Council's Working Party on Financial Services discussed the following topics in 2014:

- the proposal for a regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions (referred to as the BSR);
- the proposal for a regulation on the central securities depositories and the securities settlement systems they operate (referred to as the Central Securities Depositories Regulation, or CSDR);
- the proposal for a regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions (referred to as the SFT Regulation); The General

Approach was approved in January 2014 and in April 2015 the proposal for the regulation entered the trialogue stage.

- the proposal for a directive on the transparency and comparability of payment account fees, payment account switching, and access to basic payment accounts (referred to as the Payment Accounts Directive, or PAD);
- the proposal for a regulation on interchange fees for card-based payment transactions (referred to as MIFR);
- the proposal for a directive on payment services in the internal market (referred to as PSD II);
- the proposal for the directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision (referred to as IORP II). The General Approach of the Council was adopted at the COREPER meeting on 10 December 2014 and trialogues will be launched in 2015.

Ad Hoc Working Party

The Ad Hoc Working Party held meetings in parallel with the Working Party on Financial Services and continued in their tasks associated with the proposal for the regulation on the Single Resolution Mechanism (SRM) and the Council Implementing Regulation (EU) 2015/81 specifying uniform conditions of application of the SRM regulation with regard to ex ante contributions to the Single Resolution Fund.

Intergovernmental Conference

In relation to the discussions concerning the proposal for a regulation on a single resolution mechanism for credit institutions (the SRM Regulation), an Intergovernmental Conference was convened in 2014, which discussed the proposal for the Intergovernmental Agreement (IGA) for a single resolution fund for credit institutions.

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

European Council

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

At its meetings in 2014, the European Council addressed, amongst other things, the issues associated with the creation of the Banking Union. Additionally, in relation to the acts for establishing a single resolution mechanism (SRM) for credit institutions and the provisions establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD), discussions were held particularly with regard to implementing a single supervisory mechanism (SSM).

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

OECD

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

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

Committee for Financial Markets (OECD CMF)

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

A very specific characteristic of the committee's activities consists of the regular meetings with representatives from the private financial sector, at which important topics of common interest to both the public as well as the private sectors are discussed, particularly development trends in the global financial market. The topics addressed at both of the meeting held in 2014 (in April and in October) continued on from last year's discussions. As a result, the Committee returned to the analysis of the implicit government guarantees towards the financial sector and also discussed current market developments around the world. A discussion was also held about existing experiences with the options available for the development of small and medium-sized enterprises through debt and capital instruments accessible in the financial markets. At their meeting in autumn, the OECD's analysts presented an analysis of certain aspects of the interlinking that exists between the financial markets, the real economy, and the investment activities of companies in various regions of the world. Their future research regarding the comprehensive links between the developments in indebtedness and global economic activity could be of benefit, particularly for small, open, export-oriented economies, such as the Czech Republic.

At their meeting in April 2015, the CMF once again returned to previously discussed topics, such as market development, financing for small and medium-sized enterprises, long-term and corporate investments, and implicit government guarantees towards the financial sector. A new topic was opened regarding market liquidity and discussions were also started about the sustainability of the commitments of pension funds and life insurance companies within the context of, for example, low yields around the world and other risks.

The *Advisory Task Force on the OECD Codes of Liberalisation* usually meets during the same timeframe as the CMF. The main participants at these meetings include some of the members of the CMF, the IPPC, and the OECD Investment Committee from various countries. Their discussions address individual regulatory measures in relation to the financial markets within the context of the OECD Code of Liberalisation of Capital Movements. The topics discussed included, amongst others, bank contributions, the regulation of foreign exchange operations and positions, changes affecting insurance companies and pension funds, and other provisions regulating the banking sector in some countries.

Task Force on Financial Consumer Protection (OECD TF)

The key objective of the Task Force on Financial Consumer Protection under the OECD is to prepare international standards for consumer protection on the financial market, particularly as regards the supervisory architecture, the rules for dealing with clients, the resolution of consumer disputes, financial education, and financial inclusion. These high-level principles reflect to a considerable degree the examples of already functioning regulatory practices in the EU, however, the process also acts retroactively as a sample for new regulation (particularly for the OECD countries that are not EU member states). In 2014 the Task Force launched a debate about the possibility of establishing an on-line international platform for sharing experience and the approaches applied in the OECD member states as regards regulatory practices for consumer protection.

Insurance and Private Pensions Committee (OECD IPPC)

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

The main topics that the IPPC focused on in 2014 include the following: annuity issues (pension insurance); longevity risk (i.e. the risk of higher than expected growth in the middle-age group); the relationships between institutional investors and long-term investments, or, more specifically, the effect that the insurance sector has on long-term growth and stability; and the impact that long-term low interest rates have on insurers and pension funds. In addition, the IPPC addressed the topics of insurance against catastrophic risks and its financing; insurance against terrorism; monitoring and transparency in the insurance sector; and the trends and development in the insurance markets in individual countries.

Working Party for Private Pensions (WPPP)

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

International Network on Financial Education (OECD INFE)

The International Network on Financial Education is a platform comprising the institutions of the OECD member states (as a rule, the ministries of finance and the central banks). Its role is to create strategic documents at the global level. The Network's web pages[70] provides a gateway to information about financial education and the data, resources, research, and news from the individual member states.

In 2014, INFE adopted rules for involving private entities and non-profit organisations in the financial education process and also approved a handbook for implementing national strategies and assessing financial education programmes. The basic financial competencies for the 15-18 age group started to be defined as well as a set of tools for measuring financial literacy. The INFE also addresses the issue of improving financial education in vulnerable groups and amongst immigrants.

In addition to completing the work in progress, during the upcoming period the INFE plans to prepare a definition of the basic financial competencies for adults, focus on financial education for micro, small, and medium-sized enterprises, and promote interest in pension plans and financial education, consumer inclusion, and consumer protection in the digitalised world of financial services.

G20

The G20 brings together the finance ministers and the central bank governors from nineteen countries[71] and the EU (which is represented by the presiding member state and the ECB). The G20 was established in 1999 as a forum in which the leading world economies are able to exchange their opinions regarding key issues related to the global economy. The Czech Republic is not a member of the G20 but is de facto represented by the representative for the European Union.

Australia was the presiding country of the Network in 2014. The following is a partial list of the activities that took place during the summit held in Brisbane in November 2014:

- an evaluation of the progress that has been achieved with the implementation of regulatory reforms in the financial market; and
- a discussion of the concept behind TLAC (total loss-absorbing capacity), which aims to better protect taxpayers against shared expenses in the case of the failure of a G-SIB (global systematically important bank).

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

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

10.3. European Financial Market Legislation

Single Supervisory Mechanism for Credit Institutions (SSM)
On 4 November 2014, on the basis of Council Regulation (EU) No 1024/2013[72] and Regulation (EU) No 1022/2013[73] of the European Parliament and of the Council, a mechanism came into effect establishing common supervision over the credit institutions in the eurozone and transferring the supervisory powers from the national supervision authorities to the ECB (Single Supervisory Mechanism). The member states outside of the eurozone are allowed to establish close cooperation with the ECB and thus place even the banks in their territories under ECB supervision.

Single Resolution Mechanism (SRM)
On 30 July 2014, the following was published in the Journal: Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (SRM). This regulation implements a centralised mechanism within the framework of the banking union for the eurozone (other member states may participate voluntarily) with the aim of helping those banks who have been weakened as a result of the European debt crisis. In October and November the Commission presented proposals for legislative measures addressing the issues associated with the contributions to be paid by banks to the Single Resolution Fund. On 9 December 2014, the Council reached a political consensus regarding the conditions for the application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the Single Resolution Fund. This was subsequently published in the Journal on 22 January 2015 as Council Implementing Regulation (EU) 2015/81.

Important details regarding the functioning of the Single Resolution Fund that should be created on the basis of the SRM regulation and other related provisions are addressed in the form of an Intergovernmental Agreement (IGA), which, as of 21 May 2014, was signed by twenty-six member states. However, as of 4 February 2015, only two member states have ratified the IGA.

Crisis Management (BRRD)
31 December 2014 marked the end of the deadline for transposing into national legislation Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (referred to as the Bank Recovery and Resolution Directive, or BRRD). This objective of this directive is to prevent crises and to resolve any crises that may be faced by selected entities in the financial market, specifically credit institutions and investment firms, and to ensure that any subsequent costs resulting from the crisis will be borne primarily by the shareholders and creditors of the entity in question with the aim of protecting the stability of the financial markets and public finances. The subject of the provisions is therefore the crisis resolution of a particular entity or group of entities through the application of the competencies and instruments of the newly established authorities ("resolution authorities"). The deadline for transposing the provisions for the bail-in instrument is set for 1 January 2016.

Guarantee Schemes (DGSD)
On 12 June 2014, Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (referred to as the Deposit Guarantee Scheme Directive, or DGSD) was published in the Journal. The aim of the legislative provisions is primarily to harmonise the functioning of the national guarantee schemes applied in the banking sector, thus improving the effectiveness of how depositors are protected. The deadline for transposing this directive in national legislation (with the exception of certain provisions) is 3 July 2015.

[72] Council Regulation (EU) 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

[73] Regulation (EU) No 1022/2013 of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a uropean Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013.

Payment Accounts (PAD)
In July 2014 the Council of the EU and the European Parliament approved the directive on the comparability of payment account fees, payment account switching, and access to basic payment accounts (referred to as the Payment Accounts Directive, or PAD). The measures contained in this directive affect three specific areas: 1. Transparency and comparability of payment account fees – the objective is to make it easier for consumers to compare the fees charged by the payment service providers in the EU; 2. Payment account switching – the objective is to implement an easy and fast process for changing payment account providers; and 3. Access to basic payment accounts – the objective is to make it possible for all consumers in the EU to open a payment account that provides basic services (payments, collections, cash withdrawals, and the use of a payment card) in any of the member states regardless of the consumer's member state of origin.

Payment Services (PSD II)
During 2014 the Council of the EU discussed the proposal for a directive on payment services in the internal market. This proposal is based on the existing Payment Services Directive (PSD). The new rules establish a regulatory framework for access to services provided by third-party payment service providers (TPPs). The European Commission believes that this new type of provider will improve competitiveness, primarily with regard to payments made over the internet. The directive also defines the conditions for: protecting monetary resources, the access of payment institutions to payment systems, and the co-participation of consumers in the event that a payment means is misused. The Council reached an agreement in December 2014. Meetings of the Council and the European Parliament are planned for 2015 with the aim of finalising the text of the directive.

Interchange Fees (MIFR)
The regulation on interchange fees for card-based payment transactions has the objective of regulating the interbank fees charged for card transactions made within the framework of four-party card schemes. The interbank fees are paid for each card transaction by the bank receiving the transaction to the bank that issued the card. The implementation of this regulation should lead to a higher acceptance of payment cards and will strengthen economic competitiveness. The regulation also defines the conditions for accepting payment cards and for sharing one payment means between multiple schemes. The text of the regulation was published in the Journal on 19 May 2015.

Capital Requirements (CRD IV and CRR)
The aim of the provisions contained in the directive on capital requirements (CRD IV) and the regulation on capital requirements (CRR) is to strengthen the regulatory framework and to create the conditions that will ensure stability, safety, and the sufficient resilience of the banking sector and the overall financial system. They also aim to enhance the protection of consumer interests, support the integration of the internal banking services market, modernise the rules for prudent supervision, and strengthen the cooperation of the supervisory authorities. CRD IV and the CRR introduce a new concept for the regulatory framework referred to as Basel III, which was prepared by the Basel Committee on Banking Supervision in response the crisis on the financial markets.
Both the directive (CRD IV) and the regulation (CRR) were published in the Journal on 27 June 2013. The deadline for transposing CRD IV and the CRR into the national legislation was set as 31 December 2013. The legislative act that implements CRD IV and the CRR entered into force on 22 July 2014.

Alternative Dispute Resolution (ADR)
On 18 June 2013 both the directive on alternative dispute resolution for consumer disputes (ADR) and the regulation on the online dispute resolution for consumer disputes (ODR) were published in the Journal. The directive and the regulation entered into force on 8 July 2013 and the member states are obliged to transpose the directive into their national legislation by 9 July 2015. With the exception of certain provisions, the regulation will become effective on 9 January 2016. As the issue involves general consumer provisions, the delegated owner of the ADR and ODR legislation is the Ministry of Industry and Trade. However, the provisions also affect financial services and, as a result, the MoF reviewed both proposals on an ongoing basis and actively cooperated with the delegated owner.

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

Starting in September 2013 the MoF has actively participated in ensuring the transposition and adaptation of the specified European regulations as a part of the working group under the Ministry of Industry and Trade. This was followed by the inter-ministerial procedure and, in autumn 2014, the draft proposal for implementing the ADR directive was submitted to the Government. It is expected that the new legislative act will enter into force by the end of 2015.

Consumer Credit Directive (CCD)
In 2013, the Commission initiated the review of the transposition of the directive on credit agreements for consumers (the CCD) and repealing the directive for the approximation of the laws, regulations and administrative provisions of the member states concerning consumer credit. The aim of the review is to determine how the directive was implemented, which of the regulatory options the member states selected, and whether or not it is necessary to modify the directive. For this purpose, the Commission initiated a series of meetings with the representatives of the member states who are involved in the issues associated with the transposition of the CCD. These meetings continued in 2014.

Mortgage Loans (MCD)
The proposal of the directive of the European Parliament and of the Council on credit agreements relating to residential property (referred to as the Mortgage Credit Directive, or MCD), which aims to unify and support the internal mortgage loan market, was approved by the ECOFIN Council on 28 January 2014. The directive was published in the Journal on 4 February 2014 as the directive on credit agreements for consumers relating to residential immovable property.

The main basic building blocks of the new directive, which, in many respects, contains provisions that are parallel to the legal provisions for consumer credit laid down in Directive 2008/48/EC, consist of the obligation to provide information (in advertising and in the pre-contract information); rules regarding the annual percentage rate of charge; the assessment of the consumer's creditworthiness and the appropriateness of providing credit to the consumer, including access to the databases of borrowers; the consumer's right to early repayment of a loan; the requirements for the regulation of credit intermediaries, including a European passport for these entities; the requirements for adequate regulation and supervision of non-bank mortgage lenders, including requirements for the professional competence of persons dealing with the consumer. The directive also lays down provisions limiting the foreign exchange risk exposure of consumers in the case of foreign currency loans, the requirements for setting an upper limit for ate penalties, and other requirements ensuring a certain tolerance on the part of a creditor towards a borrower in default.
The Commission Delegated Regulation (EU) No 1125/2014 was published in the Journal on 19 September 2014 and supplements the Mortgage Credit Directive with regard to regulatory technical standards on the minimum monetary amount of the professional indemnity insurance or comparable guarantee to be held by credit intermediaries. The regulation establishes the following minimum monetary amounts: a) EUR 460,000 for each individual claim; and b) in aggregate, EUR 750,000 per calendar year for all claims.

Markets in Financial Instruments (MIFIR and MIFID II)
After long preparations, the mainstay provisions for the capital market were published in the Journal on 12 June 2014, specifically the Directive on Markets in Financial Instruments (MiFID II) and the Regulation on Markets in Financial Instruments (MiFIR).

MiFID II has the objective of establishing a basic regulatory framework for the provision of investment services by banks and investment firms and for operating trading venues. MiFID II replaces the former MiFID I. MiFID II brings a number of changes. In particular, these include the inclusion of emission allowances as investment instruments, provisions for a new trading venues (organised trading facility), provisions for algorithmic trading, the harmonisation of administrative sanctions, and the harmonisation of access to service providers registered outside of the European Union. The directive also implements a new key investment service in the form of operating an organised trading facility and also requires a licence to be obtained for providing certain data reporting services in the capital market in the form of providing consolidated market data, using an approved mechanism for providing the required data, and using a system for publishing market data. MiFID II also responds to the expansion go algorithmic and particularly high-frequency trading, and defines new conditions for their application. The deadline for the transposition of MiFID II is set for 3 July 2016.

MiFIR replaces the original implementing regulation for MiFID (1287/2006) and, in particular, newly defines the provisions for publishing trading information (pre- and post-trade transparency for non-equity instruments, i.e. bonds and derivatives), the mandatory trading of derivatives in organised trading facilities, and some of the competencies of the supervisory authorities with regard to the trading of financial instruments. The aim of the implemented level of transparency is to provide investors with access to information, to facilitate pricing and the execution of transactions, and to ensure that participants in the market all have equal conditions. The deadline for adapting MiFIR in the national legislation is set as 3 January 2017.

Market Abuse (MAR)
The Market Abuse Regulation (MAR) was published in the Journal on 12 June 2014. MAR replaces the former Market Abuse Directive (MAD). Basically, the regulation broadens the scope of the current legal provisions by responding to important rulings passed down by the European Court of Justice in this area (C-45/08 Spector Photo and C-19/11 Geltl). As opposed to the previous directive, MAR introduces a number of new aspects and also responds to the changes implemented by MiFID II, particularly to the provisions for a new organised trading facility (OTF). In addition, provisions regarding multilateral trading systems (MTF) are now also included. MAR has also been expanded to include emission allowances trading. The definition of inside information has also been broadened and explicitly forbids any attempts of market abuse. The new provisions are also a response to the manipulation of the LIBOR interest rate and, in this respect, any manipulation of benchmarks values is explicitly forbidden. Another aspect that is definitely new as compared to previous provisions is the harmonisation of sanctions, primarily through unifying the minimum amount of the maximum penalty.

European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF)
On 4 June 2014 the Commission Implementing Regulations (EU) 593/2014 and 594/2014, which pertain to laying down implementing technical standards, were both published in the Journal. Specifically, this is with regard to the format of the notification according to Article 16(1) or, as applicable, Article 17(1) of Regulation (EU) No 346/2013 of the European Parliament and of the Council on European social entrepreneurship funds. Slight implementing modifications have been made to the regulations for EuVECA and EuSEF, which were adopted in 2013. These modifications concern the formats of the notifications that the EuVECA and EuSEF funds send to the supervisory authorities and to ESMA.

Revision of the UCITS IV Directive (UCITS V)
An amendment to the directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with respect to the activities of depositaries, the rules for remuneration, and sanctions, was published in the Journal on 28 August 2014.

This directive proposal brings the provisions contained in the UCITS directive into line with the provisions of the AIFMD with regard to the depositary regime and remuneration, and also into compliance with other legislative proposals for harmonising sanctions. The deadline for transposing the directive into national legislation is set as 18 March 2016. It is expected that the legislative act that will implement this directive in the Czech legal code will be approved in 2015.

European Long-Term Investment Funds (ELTIF)
In June 2013, the European Commission published its proposal for a regulation on European long-term investment funds. The proposed regulation is linked to the AIFM directive and supplements a number of issues to meet its purposes. Any fund that intends to use the designation of European Long-Term Investment Fund (ELTIF) must invest at least 70% of its resources in long-term assets; the remainder may be invested in the same way as a UCITS fund. It will be possible to market ELTIFs to both qualified as well as retail investors. In the case it is marketed to a retail investor, additional requirements will apply, specifically in the form of a initial minimum investment amount and a mandatory suitability test.

Meetings of the Council's Working Party regarding the proposal for the regulation were initiated in March 2014 and an agreement on the General Approach was reached in June. Trialogues were launched in October 2014. These were successfully completed at the start of 2014 and the final text of the proposed regulation was approved without any further discussion by COREPER II on 11 December 2014. The proposal for the regulation was approved by the European Parliament on 10 March 2015 and by the Council on 20 April 2015, and will subsequently be published in the Journal.

Money Market Funds (MMFs)
In September 2013 the Commission published a proposal for a regulation on money market funds, which, in response to the experience during the financial crisis, recommends measures aimed at strengthening the stability of money market funds and ensuring their adequate liquidity (referred to as MMFs). The proposed regulation places strict requirements particularly on money market funds with a constant net asset value (CNAV MMFs). Meetings of the Council's Working Party were not initiated until July 2014, which is a relatively long time since the publication of the proposal for the regulation. At the moment, the Working Party's meetings are underway at the seconded expert level. Given the political nature of the future regulation of CNAV MMFs, a suitable compromise solution has not yet been reached during the negotiations. Therefore, it is expected that a number of associated meetings of the working party will be held in the following year.

The Czech Republic considers the broad scope of the proposal to be problematic. It also believes that the rules defined in the proposal lack proportionality from the perspective of the size of the funds and their importance within the system. As a result, the Czech Republic would like to see the proposed regulation to be at least explicitly applied in relation to those investment funds that use the designation "money market fund". In addition, the Czech Republic believes that the new obligations assigned to CNAV MMFs should not have a negative impact on their future existence in the EU.

Benchmarks
On 18 September 2013 the Commission published a proposal for a regulation on the indices that are used as benchmark values for financial instruments and in financial agreements. The proposal is a response to the manipulation with the LIBOR and EURIBOR interest rate benchmarks. All of the published indices that are used as benchmarks for various financial purposes should be regulated. Particularly strict regulation should be applied in the case of critical benchmarks. COREPER II approved the General Approach on 13 February 2015 and continuing negotiations are currently underway in trialogues. During these negotiations, the Czech Republic will continue to stress the issue of the scope of regulation, where the regulatory activities should be focused primarily on the critical benchmark values and the other benchmarks (including the Czech PX Index and PRIBOR) should be regulated only to the minimum required degree. The discussions also cover the topic of the use of benchmarks from third countries, as overly restrictive requirements would make it practically impossible to use these benchmarks in the EU and could thus negatively affect the competitiveness of the European capital market.

Management of Alternative Investment Funds
The Commission Delegated Regulation (EU) No 694/2014 determining types of alternative investment fund managers was published in the Journal on 24 June 2014. The regulation specifies the definitions of open-ended and closed-ended types of investment funds for the purposes of the AIFMD. This determination is of importance primarily with regard to liquidity management and the valuation of the assets and debt of a particular investment fund.

Corporate Governance Reporting
On 12 April 2014 the Commission Recommendation on the quality of corporate governance reporting ("comply or explain" approach) was published in the Journal. This recommendation sets the rules for the corporate governance reports that are a part of the annual reports and consolidated annual report published by issuers.

Insurance Sector (Solvency II and Omnibus II)
The legislative preparations for implementing the regulatory regime defined in the directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II)[74] were completed in 2014.

At the start of the year, legislative tasks were underway for Directive 2014/51/EU of the European Parliament and of the Council[75] (referred to as Omnibus II). This directive, amending Solvency II, was adopted in April. The main purpose of Omnibus II is to adapt Solvency II within the context of the Lisbon Treaty and to reflect

[74] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

[75] Directive 2014/51/EU of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

the establishment of the European supervisory authorities (particularly the European Insurance and Occupational Pensions Authority – EIOPA).

Solvency II, and Omnibus II, require the adoption of a number of implementing acts and delegated acts. The tasks required to prepare the standards and the Level 3 acts, which were started during the previous years, continued in 2014. The regulation that supplements the directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) was adopted in October 2014.[76] This directive contains all of the Level 2 acts. It is, however, expected that all of the Level 3 acts associated with the Solvency II Directive will be adopted over the course of 2015.

Given that the transposition deadline for the Solvency II Directive will expire in 2015, in 2014 the MoF started working intensively on the amendments to Act No 277/2009 Coll., on the insurance industry, as amended, which will transpose the aforementioned directive into national legislation. As the Omnibus II directive amends Solvency II, the Czech legislative amendment also includes the transposition of Omnibus II. The draft bill was submitted to the government at the start of October 2014. At the time this report was published, the amendment to the Act on the Insurance Industry was being discussed by the Parliament of the Czech Republic.

Insurance Mediation (IMD II)

In June 2012 the Commission published a proposed amendment to the directive on insurance mediation (IMD II). This legislative initiative reflects the need to resolve certain problems that arose in relation to the transposition of the original Insurance Mediation Directive from 2002 into the national legislation for this particular sector of the financial market. The Commission had already promised to perform a revision at the start of 2010 with regard to the links between the amendment and the Solvency II directive, the revision to the markets in financial instruments directive (MiFID), the prepared UCITS V directive, and the initiative regulation for packaged retail investment products (PRIPs). The proposal for IMD II was finally published in mid-2012. Based on the results from the Commission’s review of the directive, it became apparent that there is a need to limit the existing level of variations that exist in the national provisions for insurance mediation, to strengthen consumer protection, to ensure the internally consistent and mutually neutral (with regard to products and distribution) regulation of financial services as a whole, to unify the approach towards supervision and administrative sanctions; and to simplify and clarify the regime for cross-border activities within the EU’s internal market. In 2014, the adoption of the General Approach (November 2014) ended the discussions at the level of the Council's working party. The subsequent trialogues will continue during 2015. Given the large volume of amending proposals that have been collected at the level of the European Parliament (numbering in the hundreds) and the dissenting opinions that some of the member states have with regard to the Council’s General Approach, it is not possible to expect that the legislative process will be completed any time in the near future.

Key Information Documents for Investment Products (PRIPs)

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

[76] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive the Solvency II Directive.

through the standard legislative process, it was published in the Journal on 26 November 2014 as Regulation (EU) No 1286/2014. The effective date for this regulation is set as 31 December 2016.

Financial Transaction Tax (FTT)
In September 2011 the Commission submitted a proposal for a directive on a common system for a financial transaction tax (FTT). Due to the opposition of some of the EU's member states, on 22 January 2013 the ECOFIN Council adopted a decision that allows eleven member states to continue working on a financial transaction tax system within the scope of enhanced cooperation in accordance with Article 326 et seq. of the Treaty on European Union. The decision was adopted by a qualified majority vote. The Czech Republic, together with Luxembourg, Malta, and the United Kingdom abstained from voting. The negotiations of the states participating in the enhanced cooperation process have moved on to the next stage, and these states are now working on a minimised option for taxing transactions with shares and selected derivatives. However, there are no tangible results as of yet. Although the Czech Republic's current position does not include the implementation of a financial transaction tax, the Czech Republic will actively participate in the negotiations and material discussions regarding the impact of a FTT fn the financial market and will try to convince the countries involved in the enhanced cooperation process that they must very carefully consider what will be subject to the tax.

OTC Derivatives, Central Counterparties, and Trade Repositories (EMIR)
The regulation on OTC (over-the-counter) derivatives, central counterparties, and trade repositories is referred to as EMIR, or the European Market Infrastructure Regulation. Implementing measures are published for this regulation on a regular basis. Thus far, there has been no obligation defined that would require centralised clearing for selected derivatives (the current estimate for such an obligation being announced is mid-2015). However, the requirement to submit notification of trading transactions to the trade repositories has already been implemented. At the moment, a dialogue is underway between the EU and the USA regarding the mutual acknowledgement of the legal regulatory framework for the central counterparties and mandatory clearing with the goal of avoiding conflicts between Union and US rules.

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

Central Securities Depositories (CSDR)
The regulation on central securities depositories is a part of a recently popular trend in the regulation of the market infrastructure. The CSDR was published in the Journal in July 2014 and the process transposing it into the national legal codes has been initiated. It is expected that implementing measures for the regulation will be published in 2015.

The main objective of the regulation is to increase the security of settlement system operations and to remove the legal obstacles that exist due to the national provisions on the functioning of the systems and the central depositories as the operators of these systems, particularly the obstacles associated with differing provisions for settlement periods and the standards for central securities depositories from the perspective of prudential regulation and the ability to access to the national central securities depositories and the systems operated by them. In the long run, there should be a full dematerialisation or immobilisation of all securities held in the central securities depositories.

Banking Structural Reform (BSR)
The Commission published its proposal for a regulation on banking structural reform (BSR) in January 2014. The Commission's proposal is based on the ideas presented in the Liikanen Report, however, it deviates from then quite significantly.

At the general level, the aim of the proposed regulation is to create a resilient, transparent, and responsible banking system and to decrease the risk of the failure of banks that are of such significance that the member states cannot afford to not rescue them. These are referred to as too-big-to-fail banks, or TBTF banks. The proposed regulation also has the objective of supplementing the ongoing reform of the regulatory framework in the banking sector at the Union level.

The regulation will apply to approximately thirty of the largest banks in the EU and the banking groups to which these banks belong. Within these defined banking groups, a further differentiation will be made between core credit institutions (CCI) and trading entities (TE). The criterion for this differentiation will be whether the institution in question manages accounts for its clients that are included in the deposit guarantee scheme should the institution fail (if such accounts are maintained, it is a CCI). Czech banks are typically CCIs (i.e. deposit banks). All of the CCI in the banking groups affected by the regulation will be prohibited from participating in proprietary trading (i.e. on own account, with the aim of achieving a profit and without a link to the services they provide to clients). In addition, the trading activities of the entire group will be subject to audits to ensure that they have not exceeded the defined trading thresholds for investment instruments. If they are found to have done so, the supervisory authority will require them to separate their trading activities from the CCI to a TE. This TE will not be allowed to offer its clients' accounts that are covered by a deposit guarantee scheme.

It appears that a general problem that exists with both the Liikanen Report as well as the Commission's proposal is the fact that since the Liikanen Report was published, certain regulatory measures have been adopted with the goal of strengthening the stability in the banking sector, including the possible separation of certain activities. Unfortunately, not even the Commission's proposal takes this extensive regulatory reform into account. The largest reform in this respect was the adoption of CRD IV, which has introduced considerably stricter prudential requirements for credit institutions, including TBTF banks. Another important regulatory directive is the BRRD, which gives the resolving authorities the ability to order the separation of certain activities if such a step is necessary to ensure the resolvability of a given credit institution or securities trader. The risks associated with OTC derivatives are very thoroughly addressed in the regulation on OTC derivatives (i.e. EMIR). In addition, at this time there is an initiative underway at the level of the G20 to implement TLAC (total loss absorption capital), which would also address the issue of TBTF banks.

Reporting of Securities Financing Transactions (SFT)
The proposal for a regulation on the reporting and transparency of securities financing transactions (SFTs) was published by the Commission on 29 January 2014.

The proposal for the regulation defines binding requirements for submitting reports and for the transparency of transactions used to obtain financing and applies to all financial instruments submitted as collateral in accordance with Annexe 1, Section B of the Directive on Markets in Financial Instruments (MiFID). The aim of the regulation is to limit the unintentional effects of ongoing parallel reforms of the banking system, which could lead to a shift of certain activities to a less regulated area, such as the shadow banking sector, and to thus decrease the room for regulatory arbitrage.

The proposal for the regulation defines the obligations of the contracting parties participating in rehypothecation (the reuse of collateral that is received as security for a different transaction). Rehypothecation will only be possible if the receiving contracting party is provided with written notification about the associated risk, and with the prior consent of the providing contracting party incorporated in the contract, and under the condition that the appropriate transactions are included in the securities accounts.

Institutions for Occupational Retirement Provision (IORP II)
In April 2014 the European Commission submitted to the Council of the EU and to the European parliament its proposal for a directive on the activities and supervision of institutions for occupational retirement provision (IORP II). The general objective of the proposal is to promote savings activities within the framework of occupational pension schemes, to facilitate the cross-border activities of institutions for occupational retirement provision by removing the remaining obstacles, and to contribute towards the equitability and sustainability of pensions through the effective and prudent management of resources and risk management. The proposal also expands the obligations for providing information to pension plan participants. On the basis of Resolution No 71 of 29 May 2014, the Chamber of Deputies of the Parliament of the Czech Republic took the proposal under consideration and stated that it is of key importance to monitor the developments in order to prevent any intervention in the state's right to organise its pension system. The General Approach of the Council was adopted on 10 December 2014 and trialogues will be launched in 2015.

10.4. National Financial Market Legislation

Deposit Guarantees
The year 2014 saw the continuation of the legislative tasks required for amending the Act on Banks and the Act on Credit Unions in order to transpose the Directive of the European Parliament and of the Council

on Deposit Guarantee Schemes (DGSD) into the national legislation. The aim of the provisions contained in the DGSD is to harmonise the level of protection afforded to depositors and to ensure the same level of stability for the deposit guarantee schemes in all of the EU member states. Thanks to broader and more clearly defined provisions for the guarantee schemes, depositors will not have to wait as long to receive compensation; they will be better informed and receive properly defined requirements; and they will have overall better access to the deposit guarantee system. The deadline for transposing this directive into national legislation (with the exception of certain provisions) is 3 July 2015. The draft amendment was submitted to the government in April 2015.

Framework for the Recovery and Resolution of Credit Institution and Investment Firms
In 2014 the tasks associated with transposing the Bank Recovery and Resolution Directive (BRRD) into national legislation were underway. These include the preparation of a draft bill on recovery procedures and crisis resolution in the financial market, and a draft bill amending certain other legislation in relation to the draft bill on recovery procedures and crisis resolution in the financial market. Although the deadline for the transposition was set as 31 December 2014, it is expected that the new legislation will enter into force sometime during 2015.

Implementation of the CRD IV/CRR
On 22 January 2014, the government approved the draft bill implementing the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) and submitted it to the Chamber of Deputies. This new act amends certain other legislation in relation to establishing access to the activities of banks, credit unions, and securities dealers and the supervision of these institutions. The draft bill went through the third reading on 14 May 2014 and was approved. On 26 May 2014, the Chamber of Deputies submitted the draft bill to the Senate. The final act was signed by the president on 8 July 2014 and subsequently published in the Collection of Acts as Act No 135/2014 Coll. on 22 July 2014.

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

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

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

Capital Market
On 26 January 2015 a draft bill was submitted to the government for amending Act No 256/2004 Coll. on capital market undertakings, as amended, and certain other related legislation. The draft bill primarily contains the changes required to implement the European legal regulations (see above), specifically Transparency Directive (TD II), Omnibus II, the CSDR, UCITS V, and the recommendations for the quality of corporate governance reporting. Certain changes at the national level that are included in the amendment are the result of the need to respond to market developments and reflect findings from practice. The proposed amendments are meant to increase the attractiveness of capital undertakings, to simplify the procedural issues in the capital market, and to harmonise the administrative fees in the capital market segment of the financial market.

The draft bill amends the following acts:

- Act No 256/2004 Coll. on capital market undertakings, as amended;
- Act No 15/1998 Coll. on on supervision in the capital market area and on the amendment and supplementation of other Acts,, as amended;
- Act No 240/2013 Coll. on management companies and investment funds, as amended;
- Act No 634/2004 Coll. on administrative fees, as amended; and
- Act No 586/1992 Coll. on income tax, as amended.

Investment Companies and Investment Funds
On 29 December 2014 Act No 336/2014 Coll., amending Act No 240/2013 Coll. on management companies and investment funds and certain other capital market legislation, was published in the Collection of Acts. The act amends a total of four other acts that are applied in the capital market. At the most general level, it contains primarily individual changes of a formal nature, which make the text of the legislation more precise with the aim of ensuring an unambiguous interpretation.

The amendments to the Act on Investment Companies and Investment funds and the Act on Capital Market Undertakings are a response to the first experiences from practice. The changes have been made to improve the accuracy of the provisions in the text of the legislation in order to prevent possible ambiguities in interpretation. As a result of these changes, it was necessary to make the corresponding modification in the Act on Capital Market Undertakings.

In the case of the Act on Activities of Institutions for Occupational Retirement Provision, there is a slight amendment associated with the transposition of the Union directive, which amends the directive on the activities and supervision of institutions for occupational retirement provision in the case of excessive reliance on ratings. In addition, according to the European requirements, the amendment incorporates the obligation to not rely solely and automatically on the ratings published by ratings agencies.

The amendment to the Act on the Financial Arbitrator corrects a legislative error that led to inconsistencies between the terminology used in this act and in the Act on Investment Companies and Investment Funds. The amendment thus unifies the terminology used in the capital market. In relation to this change, the scope of the financial arbitrator’s competencies is defined more passively as well as the groups of active and passive individuals legitimately involved in the proceedings heard before the financial arbitrator.

On 1 February 2014, Government Regulation No 11/2014 Coll. entered into force, amending Government Regulation No 243/2013 Coll. on the investing of investment funds and techniques used for their management. This amendment is a response to current issues and ambiguities that occurred as a result of the implementation of the above-specified legislative package.

On 17 July 2014 the MoF issued a request for the submission of suggestions for amendments to Government Regulation No 243/2013 Coll. on the investing of investment funds and techniques used for their management, as amended. On the basis of the comments received on the basis of this request, the MoF is preparing an amendment to the aforementioned government regulation. This amendment will take into consideration all of the changes resulting from other amendments under preparation.

Bonds
On 1 August 2014, Act No 137/2014 Coll., amending Act No 190/2004 Coll. on bonds, as amended, entered into force. The new act clarifies the legal status of hybrid debt securities, i.e. securities that have an associated right to the repayment of a certain amount if a certain condition, which may or may not occur, is met (e.g. the issuer ceases to exist). It also reduces the volume of required information for a bond associated with the enhanced material definition for a bond, and clearly defines the types of bonds.

Distribution of Insurance Products
In 2013 the Chamber of Deputies discussed the Government Bill amending Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters and an amendment to the Trade Licensing Act, which included the insurer’s obligation to provide information during the pre-contract stage. However, in August 2013 (after the second reading of the bill), the Chamber of Deputies was dissolved and the legislative process remained unfinished. This led to quite a complicated situation as, due to the recodification of private law, the first part the Act on Insurance Contracts, which contained the provisions for the insurers’ obligation to provide information during the pre-contract stage, was repealed, but, at the same time, the amendment to the Act on Insurance Intermediaries and Independent Loss Adjusters, which would have contained these provisions (based on the relevant directives), was not adopted. The MoF responded to this situation by preparing a draft bill that was approved as Act No 261/2014 Coll. amending certain financial market legislation. The third part of this act incorporates the obligation of insurers to provide information in Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters, and, from the perspective of context, these provisions are identical to the provisions in the repealed section of the Act on Insurance Contracts.

Act No 261/2014 Coll. thus resolved the very acute issue regarding the obligation of insurers to provide information, however the more comprehensive amendment that would also resolve distribution issues in the insurance industry was still not implemented. For this reason, in 2014 the MoF resubmitted the draft amendment to Act on Insurance Intermediaries and Independent Loss Adjusters. This amendment contextually follows up the previous submission of the bill in 2013. The main pillars of the amendment consists of the new system for the classification of insurance intermediaries, changes in the registration process and the supervisory framework, new provisions for the system used to verify professional qualifications, measures to prevent conflicts of interest, and increasing the level of information provided to clients.

Distribution of Consumer Loans

In 2014 the MoF started the preparations for transposing the Mortgage Credit Directive (MCD) into national legislation. The MoF will propose one single act on consumer loans, which will contain the existing provisions for consumer credit (Act No 145/2010 Coll. on consumer credit and amendments to certain other legislation, as amended by Act No 43/2013 Coll.), as well as the provisions for housing loans that are contained in the EU's MCD. In relation to Resolution No 367/2014 issued by the Chamber of Deputies of the Parliament of the Czech Republic in response to Parliamentary Document No. 41 (originally discussed as the Parliamentary Anti-Usury Initiative), which requests the government to increase the demands placed on non-bank loan providers and intermediaries, the legal provisions being prepared includes the requirements for the licensing and supervision of consumer loan providers and intermediaries who have thus far carried out their activities on the basis of a trade licence.

Pension Reform

On the basis of the coalition agreement and the government's declared programme, an Expert Committee for Pension Reform was established in 2014 under the auspices of the Minister of Labour and Social Affairs and the Minister of Finance. One of the main goals of this committee was to propose the way in which the retirement savings system (referred to as Pension Pillar 2) should be terminated. In addition to proposing the way in which Pillar 2 could be terminated, the Expert Committee also focused on possible changes to the supplementary pension savings system with the aim of improving the parameters in Pension Pillar 3. On 31 July 2014, the Committee's members approved a set of materials containing recommendations for the government. The specified document recommends the retirement savings system be terminated in a way that fully respects the ownership rights of the participants and ensures that the impact on the affected parties is minimised, both with regard to the administrative burden on the part of the state administration and the pension companies, as well as in relation to the participants in the system. At the time that the retirement funds are shut down, the participants will be able to choose to have all their saved funds paid into an account they designate, or to have it delivered by means of a postal money to the address they designate, or to transfer the funds into the supplementary pension insurance scheme or supplementary pension savings scheme.

In accordance with the coalition agreement and the government's declared programme, on 12 November 2014 the Government of the Czech Republic issued Resolution No. 917, in which it states its decision to terminate the retirement savings system and specifies the way in which it will be terminated and the participants' savings settled on the basis of the recommendations made by the Expert Committee for Pension Reform. On the basis of this Government Resolution, the MoF, in cooperation with the Ministry of Labour and Social Affairs, have prepared draft bills for the appropriate legislation that will be discussed in 2015.

On 22 December 2014, the Government of the Czech Republic adopted Resolution No. 1100 on the draft bill amending Act No 426/2011 Coll. on retirement savings, as amended. The objective of this draft bill is to prevent new participants from joining this fund system. It will thus no longer be possible to enter into this system prior to the time it is terminated and this will limit any increase in the number of participants prior to the system's actual termination. This will also decrease the administrative burden that will be required for settling the monetary resources of the participants and limit the collection of contributions for retirement savings in Pillar 2.

Insurance Sector

During 2014 intensive preparations were underway to prepare a draft bill amending Act No 277/2009 Coll. on the insurance industry, as amended. The purpose of the proposed amendment to the Act on the Insurance Industry is to transpose the EU's Solvency II directive and the other associated directives into the legal code of the Czech Republic. At the time this report was prepared, the amendment to the Act on the Insurance Industry was being discussed by the Chamber of Deputies of the Parliament of the Czech Republic, to whom it was submitted at the end of February 2015.

Legislative tasks were also started for the amendment to Act No 168/1999 Coll. on liability insurance for damage caused while operating a vehicle and amendments to certain related legislation, as amended. Amongst other things, the amendment is a response to the ruling passed down by the European Court Justice on 4 September 2014 in Case C-162/13 (Vnuk) in order to ensure that the national legislation is in compliance with EU law.

Restriction of Cash Payments
On 1 December 2014 an amendment to the Act on the Restriction of Cash Payments entered into force and decreased the limit CZK 350,000 to CZK 270,000 (i.e. amounts of over CZK 270,000 cannot be paid in cash). This amendment also responds to the judgement passed down by the Supreme Administrative Court under Ref. No. 1 Afs 91/2010-45 of 23 February 2011, which restricts the application of the act only to situations when an obligation is being paid. This type of restriction is not reasonable justified and thus the act was amended so that it affects a broader scope of payments.

10.5. Non-Legislative Financial Market Activities of the MoF

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

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

In 2014 the Alliance's activities within the framework of the working groups focused primarily on the issues associated with voluntary debt relief, which is a legislative initiative of the Ministry of Justice; the register of borrowers; the creation of a recovery fund; and unfair business practices in the area of debt relief. The Alliance also addressed the topics of accounts protected against collection orders; stricter rules for providing consumer loans; and the issues associate with reducing the costs of debt collection proceedings.

The Alliance also prepared a seminar on the topic of "Alternative Debt Relief Programmes", which was held under the auspices of the Member of Parliament Jan Chvojka on 19 June 2014 in the Chamber of Deputies building.

Financial Education
The MoFheads the Working Group on Financial Education (WGFE), which provides a platform for the exchange of the opinions and information about the experience of its members. These members include representatives from the public sector (the MoF, the MoE, other ministries, representatives from professional associations active in the financial market, organisations that implement financial education projects (primarily NGOs and consumer groups), representatives from the academic sector, and education professionals. The members of the WGFE try to find a common approach for improving the financial literacy of the Czech population.

In June 2014, the MoF launched an internet portal for financial education and financial literacy entitled "Why to get financially educated?" www.psfv.cz, which is designed for both the professional as well as the general public. The portal provides a single point for accessing information about the functioning and risks of the financial market, and about financial education in the Czech Republic and abroad. The topics include, amongst others, family finances and how to create a household budget; the structure, institutions, and products of the financial market; dispute resolution; advice and guidelines focused primarily on over-indebtedness, debt relief, and debt collection orders; links to interesting Czech and foreign websites containing projects, games, and calculators; contacts for consumer and debt advisory organisations that provide assistance free of charge during disputes with financial market institutions or during periods of personal hardship.

In 2015, the MoF started working on the revision of the National Financial Education Strategy. The revision process includes an assessment of the level of financial literacy amongst the adult population (this is a joint project with the OECD that will include other countries from around the world in addition to the Czech Republic); the revision of strategic documents (including the MoF's General Policy for Consumer Protection in the Financial Market); preparing a roadmap of financial education projects; and the subsequent revision of the text of the National Strategy of Financial Education.

LIST OF TABLES

LIST OF GRAPHS

LIST OF ACRONYMS AND ABBREVIATIONS

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

G20	Group of Twenty Finance Ministers and Central Bank Governors
GDP	Gross Domestic Product
HICP	Harmonized Indices of Consumer Prices
ML	Mortgage loan
HUF	International currency code for the Hungarian forint
IBRD	International Bank for Reconstruction and Development
IMD	Insurance Mediation Directive
incl.	including
INFE	International Network on Financial Education
IPPC	Insurance and Private Pensions Committee
KB	Komerční banka a s (commercial bank)
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
max	maximum
MCD	Mortgage Credit Directive
MEYS	Ministry of Education, Youth and Sports of the Czech Republic
mn	million
MoF	Ministry of Finance of the Czech Republic
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MIT	Ministry of Industry and Trade of the Czech Republic
MI	Ministry of the Interior of the Czech Republic
MLSA	Ministry of Labour and Social Affairs
MRD	Ministry of Regional Development of the Czech Republic
No	number
OECD	Organisation for Economic Co-operation and Development
OL	overdraft loan
OTC	over-the-counter
OTF	Organised Trading Facility
p.a.	per annum
PAD	Payment Accounts Directive
pp	percentage point
PF	participating fund
PLN	international currency code for the Polish zloty
PRIPs	Packaged Retail Investment Products
PSE	Prague Stock Exchange
PXE	Power Exchange Central Europe
PX-TR	Total Return Index
RM-S	RM-System
SRM	Single Resolution Mechanism
SC	state contribution
SSM	Single Supervisory Mechanism
STGF	Securities Traders' Guarantee Fund
TD II	Transparency Directive
TF	transformed fund
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
USA	United States of America
USD	international currency code for the United States dollar
VAT	value added tax
WPPP	Working Party on Private Pensions
WGFE	Working Group on Financial Education

APPENDIX 1: FINANCIAL MARKET LEGISLATION

The following changes were made to the financial market legislation of the Czech Republic and of European Union in 2014:

P1.1. Cross-Sectoral Financial Market Regulations

1) European legislation and other initiatives published in 2014:

- Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing Framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 82/891/EEC and 2001/24/EC, Directives 2002/47/EC, 2202/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU and Regulation (EU) No 1093/2010 and 648/2012 (referred to as BRRD);
- Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs);
- Delegated Regulation of Commission (EU) of 21 October 2014, supplementing Directive 2014/59/EU of the European Parliament and of the Council, as regard to ex ante contributions to resolution financing arrangements.

2) Pending European legislation (including legislation published after 31 December 2014) and other initiatives of the European Commission:

- Proposal for a regulation of the European Parliament and of the Council of 29 January 2014 on structural measures improving the resilience of EU credit institutions (referred to as BSR);
- EBA Proposal of 18 July 2014 complementing Commission Delegated Regulation in connection with regulatory technical standards and amending directive 2014/59/EU of European Parliament and Council on the content of recovery plans;
- EBA Proposal of 18 July 2014 complementing Commission Delegated Regulation amending in connection with regulatory technical standard directive 2014/59/EU of European Parliament and Council on the assessment of recovery plans;
- EBA Proposal of 19 December 2014 complementing Commission Delegated Regulation amending in connection with regulatory technical standard directive 2014/59/EU of European Parliament and Council on the resolution plans.

3) Acts that took effect in 2014:

- Act No 261/2014 Coll. amending some acts in the financial market (amendment to Act No 284/2009 Coll. on payments, Act No 254/2004 Coll. on restriction of cash payments and Act No 38/2004 Coll. on insurance intermediaries and individual loss adjusters (in effect as of 1 December 2014, some provisions as of 31 January 2015).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2014):

- Draft Bill amending Act No 256/2004 Coll. on the Business Activities on the Capital Market and certain related legislation (in effect as of 1 November 2015), (referred to as transparency amendment);
- Draft Bill amending Act No 256/2004 Coll. on the Business Activities on the Capital Market and certain related legislation (effective as of 1 July 2016) (referred to as MiFID II amendment);
- Draft bill on a framework for the recovery and resolution of credit institutions and investment firms (expected to take effect since January 2015);
- Draft bill amending certain legislation in connection with the adoption of the Act on a framework for the recovery and resolution of credit institutions and investment firms (expected to take effect during 2015).

5) Secondary legislation:

- Decree No 163/2014 Coll., on the performance of the activity of banks, credit unions and investment firms (in effect as of 30 July 2014);
- Decree No 164/2014 Coll., on keeping records of the coverage of mortgage bonds and information duties of a mortgage bond issuer (in effect as of 1 January 2015);

- Decree No 171/2014 Coll., amending decree No 233/2009 on Applications, Approval of Persons and the Manner of Proving Professional Qualifications, Trustworthiness and Experience of Persons, as amended (in effect as of 1 September 2014).

P1.2. Capital Market Legislation

1) European legislation and other initiatives published in 2014:

- Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (referred to as CSMAD);
- Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending directives 2002/92/EC and 2011/61/ EU (referred to as MiFID II);
- Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (SKIPCP) as regards depositary functions, remuneration policies and sanctions (referred to as UCITS 5);
- Commission Implementing Regulation (EU) No 593/2014 of 3 June 2014 laying down implementing technical standards with regard to the format of the notification according to Article 16(1) of Regulation (EU) No 345/2013 of the European Parliament and of the Council on European venture capital funds;
- Commission Implementing Regulation (EU) No 594/2014 of 3 June 2014 laying down implementing technical standards with regard to the format of the notification according to Article 17(1) of Regulation (EU) No 346/2013 of the European Parliament and of the Council on European social entrepreneurship funds;
- Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (referred to as MAR);
- Commission Delegated Regulation (EU) No 694/2014 of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers ("open-ended and closed-ended funds").

2) Pending European legislation (including legislation published after 31 December 2014) and other initiatives of the European Commission:

- Proposal for a regulation of the European Parliament and of the Council of 26 June 2013 on European long-term Investment Funds (referred to as ELTIF);
- Proposal for a regulation of the European Parliament and of the Council of 4 September 2013 Money Market Funds;
- Proposal for a regulation of the European Parliament and of the Council of 18 September 2013 on indices used as benchmarks in financial instruments and financial contracts;
- Commission Recommendation 2014/208/EU of 9 April 2014 on the quality of corporate governance reporting ("comply or explain");
- Green Paper: Building a Capital Markets Union of 18 February 2015 (referred to as CMU).

3) Acts that took effect in 2014:

- Act No 137/2014 Coll. amending Act No 190/2014 Coll. on Bonds as results from amendments (in effect as of 1 August 2014);
- Act No 336/2014 Coll. amending Act No 240/2013 Coll. on management companies and investment funds and certain other acts in the field of capital markets (in effect as of 1 January 2015).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2014):

- None.

5) Secondary legislation:

- Decree No 344/2014 Coll., amending Decree 247/2013 Coll., on applications according to the Act on Management Companies and Investment Funds (in effect as of 1 January 2015);

- Decree No. 129/2014 Coll., amending decree No 281/2008 Coll., on certain requirements for the system of internal principles, procedures and control measures against money laundering and terrorist financing.

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

1) European legislation and other initiatives published in 2014:

- Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (referred to as MCD);
- Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (referred to as DGSD, revised version);
- Commission Delegated Regulations supplementing Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (referred to as CRDIV);
- Commission Delegated and Implementing Acts amending Regulation (EU) No 575/2013 of European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (referred to as CRR);
- Regulation of the European Parliament and of the Council (EU) No 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council (referred to as SRM);
- Commission Delegated Regulation (EU) No 1125/2014 of 19 September 2014 supplementing Directive 2014/17/EU of the European Parliament and of the Council with regard to regulatory technical standards on the minimum monetary amount of the professional indemnity insurance or comparable guarantee to be held by credit intermediaries.

2) Pending European legislation (including legislation published after 31 December 2014) and other initiatives of the European Commission:

- Proposal for a regulation of the European Parliament and of the Council of 29 January 2014 on reporting and transparency of securities financing transactions (referred to as SFTR);
- Proposal for a regulation of the European Parliament and of the Council of 29 January 2014 on structural measures improving the resilience of EU credit institutions (referred to as BSR);
- Proposal for a directive of the European Parliament and of the Council of 24 July 2013 on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC (referred to as PSD).

3) Acts that took effect in 2014:

- Act No 135/2014 Coll. amending certain acts in connection with defining access to the activities of banks, credit unions and investment firms and supervision on these activities (in effect as of 22 July 2014);
- Act No 333/2014 Coll. amending Act No 87/1995 Coll. on credit unions and some related measures and the Act of the Czech National Council No 586/1992 Coll. on the income tax, as amended (in effect as of 1 January 2015).

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2014):

- Draft bill amending Act No 21/1992 Coll. on banks, as amended, and Act No 87/1995 Coll. on credit unions and some related measures and the Act of the Czech National Council No 586/1992 Coll. the income tax, as amended. The act will transpose into national legislation the Directive of the European Parliament and of the Council on deposit guarantee schemes. The aim of the bill is harmonization of the functioning of deposit guarantee schemes regarding the secured limit, the payment periods, the scope of secured products and depositors, information provided to depositors and cross-border cooperation at the level of EU. (expected to take effect since October 2015);

- Draft bill amending Act No 96/1993 Coll. on building savings and other related legislation. The aim of the bill is to correct some legislatively technical mistakes and ensure more effective check if the conditions for providing of state support to building savings are observed (expected to take effect as of 1 January 2016).

5) **Secondary legislation:**
   - Decree of the Czech National Bank No 163/2014 Coll. on the performance of the activity of banks, credit unions and investment firms (in effect as of 7 August 2014);
   - Decree of the Czech National Bank No 216/2014 Coll. amending Decree No 346/2013 Coll. on reporting of banks and foreign bank branches to the Czech National Bank (in effect as of 1 January 2015);
   - Decree of the Czech National Bank No 273/2014 Coll. on compiling and submitting information for the Czech National Bank database – the Central Credit Register by banks and foreign bank branches (in effect as of 1 January 2015);
   - Decree of the Czech National Bank No 310/2014 Coll. amending Decree No 426/2014 Coll. on reporting of credit unions to the Czech National Bank (in effect as of 1 January 2015).

P1.4. Payment Services and Market Infrastructure Legislation

1) **European legislation and other initiatives published in 2014:**
   - Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 (referred to as CSDR);
   - Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (referred to as PAD).

2) **Pending European legislation (including legislation published after 31 December 2014) and other initiatives of the European Commission:**
   - Proposal for a regulation of the European Parliament and of the Council of 29 January 2014 on reporting and transparency of securities financing transactions (referred to as SFTR);
   - Proposal for a directive of the European Parliament and of the Council of 24 July 2013 on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC (referred to as PSD);
   - Proposal for a regulation of the European Parliament and of the Council of 24 July 2013 on interchange fees for card-based payment transactions (referred to as MIFR).

3) **Acts that took effect in 2014:**
   - None.

4) **Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2014):**
   - Draft bill amending Act No 136/2011 Coll. on notes and coins circulation and on amendment to Act No 6/1993 Coll. on the Czech National Bank, as amended, as amended, and Act No 240/2000 Coll. on crisis management and on amendment to some acts (the Crisis Act), as amended, and cancelling Act No 219/1995 Coll., the Foreign Exchange Act, as amended (expected to take effect on 1 January 2016).

5) **Secondary legislation:**
   - Decree No 31/2014 Coll. amending Decree No 141/2011 Coll. on the performance of activities of payment institutions, electronic money institutions, small-scale payment service providers and small-scale electronic money issuers.

P1.5. Insurance and Private Pension Systems Legislation

1) **European legislation and other initiatives published in 2014:**
   - Directive 2014/51/EU of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC and Regulation (EC) 1060/2009, (EU) 1094/2010 and (EU) 1095/2010 in respect

of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (referred to as Omnibus II);
- Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

2) Pending European legislation (including legislation published after 31 December 2014) and other initiatives of the European Commission:
- Proposal for a Directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision (recast) (referred to as IORP II);
- Preparation of technical standards (Level 3) with regard to Directive 2009/138/ES (referred to as Solvency II);
- Proposal for a Directive of the European Parliament and of the Council of 7 July 2012 amending Directive 2002/92/EC on the insurance mediation (recast) (referred to as IMD II/IDD).

3) Acts that took effect in 2014:
- None.

4) Pending legislation (including acts already adopted that have taken effect or will take effect after 31 December 2014):
- Draft Bill amending Act No 277/2009 Coll., the Insurance Act, as amended, and certain other related legislation;
- Draft Bill amending Act No 426/2011 Coll., on retirement savings, as amended (in effect as of January 2016);
- Draft Bill on termination of retirement savings;
- Draft Bill amending certain legislation with regard to the adoption of the Act on termination of retirement savings;
- Draft Bill amending Act No 168/1999 Coll., Motor Third-Party Liability Insurance Act, as amended;
- Draft Bill amending Act No 38/2004 Coll., on insurance intermediaries and independent loss adjusters and the Trade Licensing Act (Insurance Intermediaries and Loss Adjusters Act), as amended, and certain other related legislation.

5) Secondary legislation:
- Draft Decree of the Czech National Bank on applications according to the Insurance Act;
- Draft Decree of the Czech National Bank implementing certain provisions of the Insurance Act;
- Decree No 145/2014 Coll., amending Decree No. 117/2012 Coll., on more detailed regulation of the activities of a pension management company, a retirement fund and a participation fund.

APPENDIX 2: SUPPLEMENTARY TABLES

Table P2.1: Loans by type

As at 31 Dec (CZK bn)	2012	2013	2014	Year-on-year change	
				abs.	(%)
Overdrafts and debit balances of current accounts	142.9	143.6	148.2	4.5	3.2
Consumer loans (excl. overdrafts and debit balances of current accounts)	185.3	187.0	186.1	-0.9	-0.5
Housing loans excl. mortgages	138.6	132.2	127.1	-5.1	-3.9
Mortgage loans for residential properties	747.6	789.5	844.3	54.8	6.9
Mortgage loans for non-residential properties	116.6	120.2	120.7	0.5	0.4
Other loans	415.8	515.2	545.3	30.1	5.8
Investment loans	577.5	585.4	619.6	34.1	5.8
Bridge loans	2.7	2.6	2.5	-0.1	-2.8
Trade receivables	33.0	39.1	41.4	2.3	5.8
Total	2,360.1	2,514.8	2,635.1	120.3	4.8

Source: CNB – ARAD

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

As at 31 Dec 2014	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
Česká spořitelna, a. s.	70.6	42.3	16.9
INVESTIČNÍ KAPITÁLOVÁ SPOLEČNOST KB, a. s.	33.8	20.2	22.0
ČP INVEST investiční společnost, a. s.	15.9	9.5	2.7
ČSOB Asset Management, a.s., investiční společnost	9.5	5.7	46.3
Raiffeisenbank a.s.	9.4	5.7	415.7
Pioneer investiční společnost, a. s.	8.5	5.1	63.0
Conseq Funds investiční společnost, a.s	7.8	4.7	44.1
AXA Investiční společnost, a. s.	5.4	3.2	-14.2
Other members of AKAT	6.1	3.7	229.7
Total	167.0	100.0	27.8

Source: AKAT CR

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

As at 31 Dec 2014	Net assets (CZK bn)	Share in total value (%)	Year-on-year change (%)
ČSOB Asset Management, a.s., investiční společnost	80.0	49.4	14.8
Česká spořitelna, a. s.	16.2	10.0	38.9
Pioneer Asset Management, a. s.	15.2	9.4	304.5
ING Investment Management (C.R.), a. s.	15.2	9.4	-1.2
Conseq Investment Management, a. s.	11.0	6.8	-18.7
Komerční banka, a. s. (group)	6.4	3.9	41.1
Raiffeisenbank a.s.	4.9	3.0	-43.9
ČP INVEST investiční společnost, a. s.	2.9	1.8	9.1
Other members of AKAT	10.3	6.4	-4.0
Total	161.9	100.0	15.2

Source: AKAT CR

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

As at 31 Dec		2009	2010	2011	2012	2013	2014
New building savings contracts	number	575,292	532,765	410,461	433,093	449,588	481,439
	change (%)	-18.5	-7.4	-23.0	5.5	3.8	7.1
Average target value for new building savings contracts with private individuals	value (CZK th.)	308.7	300.5	346.2	366.1	370.8	336.0
	change (%)	1.9	-2.7	15.2	5.7	1.3	-9.4
Building savings contracts in savings phase	number	4,926,183	4,845,319	4,550,468	4,316,999	4,066,684	3,825,367
	change (%)	-2.8	-1.6	-6.1	-5.1	-5.8	-5.9
Paid state contribution	value (CZK bn)	13.3	11.7	10.7	5.3	5.0	4.8
	change (%)	-6.7	-11.5	-8.6	-50.7	-6.4	-3.9
Average state contribution paid per building savings contract for the relevant year	value (CZK)	2,776.0	2,631.0	1,324.0	1,312.0	1,316	---
	change (%)	-5.2	-5.2	-49.7	-0.9	0.3	---
Saved amount	value (CZK bn)	415.2	430.1	433.4	435.0	429.1	413.6
	change (%)	3.5	3.6	0.8	0.4	-1.4	-3.6
Loans in total	number	988,353	993,357	956,659	894,358	815,160	752,558
of which: building savings loans	number	565,485	564,633	552,999	521,312	471,441	425,508
bridging loans[77]	number	422,868	428,724	403,660	373,046	343,719	327,050
	change (%)	1.8	0.5	-3.7	-6.5	-8.9	-7.7
Loans in total	value (CZK bn)	267.5	293.4	293.1	282.2	261.4	249.6
of which: building savings loans	value (CZK bn)	48.9	53.1	55.8	55.7	51.7	48.0
bridging loans[77]	value (CZK bn)	218.6	240.3	237.3	226.5	209.7	201.6
	change (%)	17.6	9.7	-0.1	-3.7	-7.4	-4.5
Ratio of loans in total to saved amount	ratio (%)	64.4	68.2	67.6	64.9	60.9	60.4

Source: Building savings banks, MoF calculations

[77] Loans according to Section 5 (5) of Act No 96/1993 Coll. on building savings and state contribution for building savings, as amended.

Table P2.5: Allocation of pension fund assets

As at 31 Dec (market prices, CZK bn)	2008	2009	2010	2011	2012	2013	2014	Share in 2013 (%)
Bonds	144.8	171.6	195.3	214.2	235.9	256.9	300.3	88.5
Treasury bills	6.4	2.2	1.1	0.6	6.8	0.9	1.7	0.5
Shares	5.7	3.5	1.9	1.0	0.6	0.9	0.5	0.1
Unit certificates	6.2	6.9	8.7	5.7	3.1	3.8	5.0	1.5
Money and other assets	28.4	31.5	25.2	26.0	26.8	34.9	31.8	9.4
Total	191.5	215.7	232.1	247.5	273.2	297.4	339.2	100.0

Source: APS CZ, CNB – ARAD

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

As at 31 Dec		2008	2009	2010	2011	2012	2013	2014
Supplementary pension insurance contracts[78]	number	4,207,236	4,394,522	4,527,774	4,565,741	5,134,862	4,886,675	4,585,149
	change (%)	6.9	4.5	3.0	0.8	12.5	-4.8	-6.2
New supplementary pension insurance contracts	number	590,490	524,867	495,516	457,033	1,128,020	-	-
	change (%)	0.7	-11.1	-5.6	-7.8	146.8	-	-
Supplementary pension insurance policies with employer contribution	number	1,222,639	1,261,525	1,284,736	1,271,934	1,317,563	1,339,000	1,313,766
	change (%)	8.2	3.2	1.8	-1.0	3.6	1.6	-1.9
State contributions for a given period	value (CZK bn)	5.1	5.3	5.5	5.6	5.9	6.8	6.6
	change (%)	9.4	5.1	3.1	1.7	5.6	15.0	-3.3
Participant contributions[79]	value (CZK bn)	21.9	23.0	23.2	23.4	25.5	33.0	31.6
	change (%)	8.3	4.9	1.1	0.9	8.8	29.3	-4.3
Average monthly state contribution	value (CZK)	104.9	105.2	105.0	105.4	108.0	117.0	119.0
	change (%)	1.0	0.3	-0.2	0.4	2.5	8.2	2.1
Average monthly participant contribution	value (CZK bn)	450.5	443.9	439.6	441.7	465.0	568.0	574.0
	change (%)	0.2	-1.5	-1.0	0.5	5.3	22.2	1.0

Source: MoF

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

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

As at 31 Dec		2013	2014
Supplementary pension savings contracts[80]	number	76,669	217,985
	change (%)	-	184.3
New supplementary pension savings contracts	number	77,771	145,841
	change (%)	-	87.5
of which transfer from supplementary pension insurance[81]	number	1,284	14,221
Supplementary pension savings policies with employer's contribution	number	13,461	40,719
	change (%)	-	202.5
State contribution for a given period	value (CZK bn)	0.1	0.270
	change (%)	-	333.6
Participant contributions[82]	value (CZK bn)	0.3	1.341
	change (%)	-	291.8
Average monthly state contribution	value (CZK bn)	143.0	148
	change (%)	-	3.6
Average monthly participant contribution	value (CZK bn)	749.0	722
	change (%)	-	-3.5

Source: MoF

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

Table P2.8: Placement of insurance technical reserves

As at 31 Dec (CZK bn)	2013			2014			Abs. change			Year-on-year change (%)		
	LI	NLI	Total	LI	NLI	Total	LI	NLI	Total	LI	NLI	Total
Debt securities	193.2	71.8	285.8	199.8	75.7	303.8	6.6	3.8	18.0	3.4	5.3	6.3
Of which: Bonds issued by the member state or its national central bank	111.4	50.7	171.7	118.1	55.5	185.6	6.7	4.8	13.9	6.0	9.5	8.1
Bonds issued by banks of Member States	19.6	5.0	28.3	19.6	4.6	28.0	-0.1	-0.4	-0.3	-0.4	-7.7	-1.1
Listed bonds issued by corporations	15.9	5.9	26.9	18.3	6.2	31.1	2.4	0.3	4.1	15.0	5.0	15.4
Treasury bills	0.5	0.9	1.6	0.2	1.8	5.2	-0.3	0.9	3.6	-55.1	94.8	234.4
Listed municipal bonds	1.2	0.5	1.7	2.0	0.6	3.0	0.8	0.2	1.3	69.5	36.2	74.9
Mortgage bonds	22.7	6.7	30.3	20.0	4.3	25.8	-2.7	-2.4	-4.4	-11.9	-36.3	-14.7
Bonds issued by EIB, ECB, EBRD or IBRD	6.3	0.6	6.9	6.9	1.3	8.2	0.6	0.7	1.3	10.2	109.2	19.4
Foreign debt securities traded on any regulated market of OECD Member States	13.7	1.5	16.0	14.1	1.3	16.2	0.4	-0.2	0.2	3.2	-14.6	1.3
Equity securities	56.0	8.3	85.7	52.9	9.7	85.5	-3.2	1.3	-0.2	-5.6	16.0	-0.2
Of which: Listed shares	4.4	0.5	5.5	4.9	0.6	5.6	0.5	0.0	0.1	11.8	7.9	1.2
Securities by mutual funds complying with EC regulations	37.2	4.1	44.0	36.3	4.7	44.1	-0.9	0.6	0.1	-2.4	15.5	0.2
Real estate	0,3	2.4	5.1	0.3	2.2	5.1	0.0	-0.2	0.0	1.7	-8.1	-0.5
Deposits and certificates of deposits or depository bonds	5,8	4.7	24.3	5.2	6.2	16.3	-0.5	1.6	-8.0	-9.1	33.5	-33.0
Receivables from reinsurance companies	1,3	12.7	22.1	2.9	10.6	22.4	1.7	-2.2	0.3	129.5	-16.9	1.4
Financial placements total	255,5	101.2	424.1	259.0	105.5	431.3	3.6	4.2	7.2	1.4	4.2	1.7

Source: CNB

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