

BANKING SUPERVISION

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BANKING SUPERVISION 2005

CONTENTS

A. BANKING SUPERVISION IN 2005	1
INTRODUCTION	1
1. BANKING SUPERVISION STRATEGY FOR 2005–2010	3
2. LEGISLATIVE CHANGES IN THE BANKING SECTOR IN 2005	4
3. PERFORMANCE OF BANKING SUPERVISION	7
3.1 OFF-SITE SURVEILLANCE	7
3.2 LICENSING AND AUTHORISATION ACTIVITIES	9
3.3 ON-SITE EXAMINATIONS	10
4. NEW BASEL CAPITAL ACCORD	14
5. CO-OPERATION WITH OTHER FINANCIAL MARKET REGULATORS IN THE CZECH REPUBLIC	17
6. INTEGRATION OF FINANCIAL MARKET SUPERVISION	18
7. CENTRAL REGISTER OF CREDITS	20
8. ACTIVITY OF THE FINANCIAL ARBITER	22
9. INTERNATIONAL CO-OPERATION	24
9.1 CO-OPERATION WITHIN THE STRUCTURES OF THE EUROPEAN COMMISSION	24
9.2 CO-OPERATION WITHIN THE STRUCTURES OF THE EUROPEAN CENTRAL BANK	27
9.3 CO-OPERATION WITHIN THE BASEL COMMITTEE ON BANKING SUPERVISION	28
9.4 CO-OPERATION WITH PARTNER SUPERVISORY AUTHORITIES	28
9.5 CO-OPERATION WITHIN THE GROUP OF BANKING SUPERVISORS FROM CENTRAL AND EASTERN EUROPE	29!*
29	
B. THE BANKING SECTOR IN 2005	30
METHODOLOGICAL NOTE	30
SUMMARY	31
1. THE ECONOMIC ENVIRONMENT IN 2005	33
2. THE STRUCTURE OF THE CZECH BANKING SECTOR	35
2.1 NUMBER OF BANKS	35
2.2 OWNERSHIP STRUCTURE	36
2.3 EMPLOYEES AND BANKING UNITS	37
2.4 NEW TECHNOLOGY	39
2.5 CONCENTRATION	41
2.6 COMPETITIVENESS	42
2.7 ASSETS AND LIABILITIES	44
3. RISKS IN BANKING	48
3.1 CREDIT RISK	48
3.1.1 Credit structure and credit trends	48
3.1.2 Classified and non-performing loans and their coverage	51
3.2 LIQUIDITY RISK	53
3.2.1 Primary funds	53
3.2.2 Secondary funds	55
3.2.3 Quick assets	56
3.2.4 Matching of asset and liability maturities	56
3.3 MARKET RISK	57
3.3.1 Foreign exchange risk	57
3.3.2 Equity risk	60
3.3.3 Derivatives risks	60
3.4 COUNTRY RISK	61
3.4.1 Activities vis-à-vis non-residents	61
3.4.2 Activities vis-à-vis individual regions and countries	63
4. CAPITAL ADEQUACY	64
5. BANKING SECTOR PERFORMANCE	66
5.1 PROFIT FROM FINANCIAL ACTIVITIES AND PROFIT FROM OTHER OPERATING ACTIVITIES	66

5.2 ADMINISTRATIVE EXPENSES, WRITE-OFFS, CREATION AND USE OF PROVISIONS	67
5.3 NET PROFIT	68
5.4 PROFITABILITY, EFFICIENCY AND PRODUCTIVITY	68
ABBREVIATIONS	70
C. ANNEXES	71
SURVEY OF BANKS AND FOREIGN BANK BRANCHES AS OF 31 DECEMBER 2005	73
ORGANISATIONAL STRUCTURE OF CNB BANKING SUPERVISION AS OF 31 DECEMBER 2005	75
BREAKDOWN OF BANKS INTO GROUPS	76
MAIN INDICATORS OF MONETARY AND ECONOMIC DEVELOPMENTS IN THE CZECH REPUBLIC	76
ASSETS	77
LIABILITIES	78
OFF-BALANCE-SHEET ASSETS	80
OFF-BALANCE-SHEET LIABILITIES	81
INCOME AND EXPENSES	82
PROFITABILITY AND EFFICIENCY	82
LOANS	83
DEPOSITS	83
CLASSIFIED AND NON-PERFORMING LOANS	84
QUICK ASSETS	84
ASSETS AND LIABILITIES BY RESIDUAL MATURITY	85
CAPITAL, CAPITAL REQUIREMENT AND CAPITAL ADEQUACY	86
FOREIGN EXCHANGE ACTIVITIES	86
ACTIVITIES VIS-À-VIS NON-RESIDENTS	88
SELECTED BANK GROUP INDICATORS	90
CONCENTRATION	92
BOX 1 ACTIVE PARTICIPATION OF CNB BANKING SUPERVISION STAFF IN EU COMMITTEES AND WORKING GROUPS (AS OF 31 MAY 2006)	94
BOX 2 LAMFALUSSY PROCESS	96

A. BANKING SUPERVISION IN 2005

INTRODUCTION

2005 was the last year in which the Czech National Bank (CNB) performed solely banking supervision and other authorities were responsible for supervising the remaining segments of the Czech financial market. On 1 April 2006, the Czech National Bank assumed responsibility for supervision of the entire Czech financial market. Since then, the CNB has been the sole authority supervising the entities operating in the financial market, analysing developments in the financial system, seeing to the safe and sound operation and development of the financial market in the Czech Republic, and contributing to the stability of the Czech financial system as a whole.

"Banking Supervision 2005" acquaints readers with the supervision performed by the CNB and with developments in the Czech banking sector in 2005.

The Czech National Bank developed its banking supervision activities in 2005 in line with the newly approved CNB Medium-term Banking Supervision Strategy for 2005–2010, focusing on performing the tasks set for the first year of the relevant period. The key strategic objectives in the regulatory area now are to systematically elaborate and prepare for the introduction of the new capital adequacy framework (Basel II) and to enhance the comprehensive regulatory framework for banks and consolidated groups in compliance with the regulatory principles applied in the European Union so as to ensure prudential banking business yet allow healthy competition. The performance of banking supervision was focused mostly on improving both off-site and on-site supervision and on establishing close co-operation with foreign supervisors and with the other regulators and supervisors of the Czech financial market. In addition to regulatory changes, oversight of the financial market was integrated in 2006 under a government decision.

The priorities for 2005 were defined on the basis of the CNB Medium-term Banking Supervision Strategy, the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, the recommendations of the FSAP (Financial Sector Assessment Program) mission¹ and the approved financial market supervision integration process. The main priorities were:

- to improve supervision in both off-site surveillance and on-site inspections;
- to prepare legal rules in the area of primary legislation in connection with the integration of financial market supervision;
- to prepare for the implementation of the new capital adequacy framework (Basel II);
- to prepare for accelerated integration of financial market supervision into the central bank;
- to enhance co-operation with foreign and domestic regulators, particularly as regards continuing harmonisation of standards and procedures;
- to be actively involved in international co-operation, especially within the ECB;
- to enhance the transparency of supervisory activities both to banks and to the public, and to publish regular reports and information on the banking sector.

Main supervisory tasks in 2005

¹ The Financial Sector Assessment Program was conducted jointly by the International Monetary Fund and the World Bank. It was based on the identification of the financial sector's strengths and weaknesses and system problems, and also areas which need to be improved for the financial sector to develop further and be stable. An integral part of the FSAP was an assessment of compliance with relevant international standards. The assessment for the Czech Republic was carried out in 2000 and updated in 2004.

In order to improve banking supervision, responsibilities and powers were clearly defined within a new organisational structure for banking supervision and regulation at the CNB. Laws and other rules and regulations establishing a necessary set of prudential standards were adopted. More and better information on the financial strength and results of the banking sector is now publicly available. The independence of CNB Banking Supervision and its funding is enshrined in law. CNB Banking Supervision's authority is founded on the professionalism and credibility of its staff. The exchange and protection of information between financial market supervisors in the Czech Republic was ensured in 2005 by means of a trilateral Memorandum of Understanding between the CNB, the Czech Securities Commission (CSC) and the Czech Ministry of Finance. There is increasing co-operation between the regulators of the domestic banking sector and regulators in other countries. An in-depth report on compliance with the principles of banking regulation and supervision, together with up-to-date information on the soundness, strength and development of the banking sector, is published at regular intervals on the CNB website (<http://www.cnb.cz>).

1. BANKING SUPERVISION STRATEGY FOR 2005–2010

In the forthcoming five-year period, CNB Banking Supervision will focus on the tasks specified in its medium-term banking supervision strategy, which is based, in turn, on the CNB's Strategy for 2005–2010. The main tasks are as follows:

- to implement the new capital adequacy framework (Basel II), which substantially changes banking regulation, introduces better regulation of the risks that banks face, allows banks to use their own models for regulatory purposes to measure not only market risks, but also credit and operational risk, and moreover strengthens the role of the home supervisor in relation to subsidiaries of internationally active banks;
- to use the integration of supervision of the Czech financial market into the Czech National Bank to improve the quality of banking supervision and to cut the costs of financial market supervision through more efficient joint operation of supervisory departments within the CNB, and to draw on the accumulated experience of supervisors and the common information base for oversight of the financial market as a whole;
- to harmonise standards and procedures with those of foreign and domestic regulators, a high priority given the ownership structure of the Czech banking sector; the need to reach a consensus is reinforced by the role of the home regulator in internationally active banks in conditions of effective co-operation with foreign regulators, particularly when approving internal risk management models;
- to emphasise intelligibility and clarity when drafting new regulations, to work with the Czech Banking Association and the Chamber of Auditors of the Czech Republic when discussing drafts, and to ensure ongoing publication of changes and broad communication with banks and the public;
- to continue to base supervisory practice on a combination of off-site surveillance, on-site inspections and the use of auditors' reports to verify risk management systems and financial statements. As part of the implementation of the new capital adequacy framework, the formation of a comprehensive bank risk profile assessment system will continue, based on a combination of quantitative and qualitative information on banks, allowing risk to be evaluated at a qualitatively higher level. Risk profile assessment will also serve as the basis for communication with banks during the appraisal of their internal risk assessment systems and their capital coverage of risks, for streamlining the regulation of consolidated groups and for addressing formal aspects of supervision in this area;
- to enhance the transparency of CNB Banking Supervision and the measures it adopts by publishing supervisory procedures and principles; a system for assessing the quality and effectiveness of banking supervision, including feedback to banks, is under preparation;
- to continue preparing and publishing regular reports on the banking/financial sector and aggregate documents for the ECB and other international organisations (IMF, WB, OECD, BIS, EC, etc.); in the licensing area, a simplified procedure based on information from the relevant domestic regulator will be applied consistently; preventive measures will be a matter of priority; CNB Banking Supervision will continue to work to limit the risks associated with money laundering and terrorist financing;
- the strategy can only be implemented if substantial changes are made to the primary and secondary legislation and if the existing methodological procedures are revised or new ones created; priority will be given to reducing the number of regulations, even at the cost of expanding their content.

2. LEGISLATIVE CHANGES IN THE BANKING SECTOR IN 2005

The Act on Financial Conglomerates was adopted in 2005. Throughout the year, banks and the CNB worked hard to prepare for the implementation of the new regulatory framework.² In addition, the CNB devoted a large part of its resources to the legislative and material preparations for the institutional integration of financial market supervision in the Czech Republic.³

Act on Financial Conglomerates

Act No. 377/2005 Coll., on Supplementary Supervision of Banks, Credit Unions, Electronic Money Institutions, Insurance Corporations and Investment Firms in Financial Conglomerates and on the Amendment of Certain Other Acts (Act on Financial Conglomerates), the major part of which took effect on 29 September 2005, represented a substantial legislative change in banking regulation and numerous other areas. This Act is important primarily because it implements "supplementary supervision" of some regulated entities (including banks) in financial conglomerates into Czech law in compliance with Directive 2002/87/EC. Moreover, it transposes Directives 2001/17/EC and 2001/24/EC, regarding the reorganisation and winding up of insurance companies and credit institutions, and also Directive 2002/47/EC on financial collateral arrangements.

Supplementary supervision is to some extent analogous to banking supervision on a consolidated basis in cases where a financial conglomerate subject to such supervision is heterogeneous in terms of the financial activities it performs. Specifically, it relates to groups in which insurance corporations and banks, and potentially investment firms, have a significant share in all the financial activities carried on by the members of such a group (the significance criteria are stipulated by law). However, unlike banking supervision on a consolidated basis, which is applied to the relevant banks and their consolidated groups by law, subject to criteria stipulated in legal rules, supplementary supervision applies to entities within a financial conglomerate only if a co-ordinator decides to define the financial group as a financial conglomerate. The Act lays down procedures and criteria for defining a financial conglomerate and for determining which supervisor of the members of such a group is to perform the function of co-ordinator as the institution primarily responsible for exercising supplementary supervision. On the Czech financial market, this issue has been resolved by creating a single regulator through the integration of financial market supervision into the CNB.

As indicated above, in addition to supplementary supervision of financial conglomerates, rules were adopted covering the bankruptcy/conservatorship of banks having branches in other Member States of the European Union (and the European Economic Area), and, conversely, covering analogous procedures conducted against foreign banks having their registered office in a Member State and a branch in the Czech Republic. These regulations essentially anchor the single procedure principle, the territoriality principle, under which the deciding jurisdiction is the law of the state where the bank concerned has its registered office (with exceptions stipulated by law in the form of conflict rules), and the principle of equal treatment of creditors from different states.

The Bankruptcy and Composition Act also introduces a rule under which this law cannot be applied to a bank that has a valid licence (nor to a credit union, an insurance company or a re-insurance company with a relevant licence). This means

² Basel II - for details, see section 4 *The New Basel Capital Accord*.

³ For details, see section 6 *Integration of financial market supervision*.

that responsibility for dealing with a bank experiencing financial difficulties lies with the banking supervisory authority until the CNB revokes the bank's licence and with the courts after the licence is revoked (provided that the bank is in bankruptcy). The CNB also now has the power to file a bankruptcy petition against a bank whose licence it has revoked without being a creditor of that bank with an unsatisfied claim.

In the context of the Act on Financial Conglomerates, an amendment was adopted to the Act on Banks specifying certain harmonisation provisions of the Act (relating primarily to supervision on a consolidated basis and co-operation between supervisory authorities) and reflecting changes in the Bankruptcy and Composition Act linked with the transposition of Directive 2001/24/EC. Finally, owing to the adoption of the legislation on supplementary supervision of financial conglomerates, it exempts from banking supervision on a consolidated basis groups headed by a mixed financial holding company which constitute a financial conglomerate. The Act introduces a requirement to check the trustworthiness and experience of natural persons in executive managerial positions of a financial holding company controlling the bank, and the power of the CNB to insist that the financial holding company replace a natural person in an executive managerial position of such a company if such person is not sufficiently experienced or trustworthy (for details, see Decree No. 14/2006 Coll.).

Besides the Act on Financial Conglomerates, the only other legislation to change the Act on Banks in 2005 was Act No. 413/2005 on the Amendment of Laws in Connection with the Adoption of the Act on Protection of Classified Information and on Security Clearance, with effect from 1 January 2006. This Act includes among the persons and authorities entitled to ask banks to provide information subject to banking secrecy without the consent of the client, the National Security Authority, the intelligence services and the Ministry of Interior when conducting security proceedings under the Act on Protection of Classified Information and on Security Clearance.

Further to the Act on Banks, as amended by the Act on Financial Conglomerates, the CNB issued Decree No. 14/2006 Coll. of 29 December 2005 regulating the supporting documents proving the trustworthiness and experience of persons in executive managerial positions of a financial holding entity. The Decree took effect on 16 January 2006.

Decree on the trustworthiness and experience of persons in executive managerial positions of a financial holding entity

Under the Act, a financial holding entity must ensure that its statutory body, a member thereof or any other natural person that manages the business of the financial holding entity or of a legal entity that is its statutory body or a member thereof (hereinafter a "person in an executive managerial position"), either alone or together with other natural persons, is a trustworthy person having enough experience to discharge the office and to meet the requirements applying to the financial holding entity under this Act. A financial holding entity must inform the Czech National Bank in advance of planned personnel changes in executive managerial positions and, at the same time, submit supporting documents proving the trustworthiness and experience of the natural persons nominated. An entity that has become a new financial holding entity cannot fulfil this obligation in advance, since the nature of the matter does not allow this, but it is obliged to meet this requirement within two months of becoming a financial holding entity, otherwise the persons in executive managerial positions will be deemed not to have complied with the set conditions. Natural persons in executive managerial positions (or persons nominated for such positions) must submit the necessary supporting documents and give assistance to the financial holding entity. The Act authorises the CNB to stipulate in a decree the supporting documents proving the trustworthiness and experience of persons in executive managerial positions of a financial holding entity.

The Decree stipulates that the key documents proving the trustworthiness and experience of natural persons in executive managerial positions of a financial holding entity are: an extract from the Criminal Register, a curriculum vitae, and documents proving the qualifications attained by the proposed natural person and also the questionnaire given in the Annex to the Decree completed by this person, a job description for the position which the natural person is to hold and a brief description of the strategy the person intends to apply in this position.

CNB provisions regulating the reporting obligation of banks

Provisions regulating only the methodology and technology for reporting by banks and foreign bank branches to the Czech National Bank were issued in 2005:

- CNB Provision No. 1 of 17 May 2005, stipulating the manner of transmitting and accepting automated statement data submitted by banks and foreign bank branches to the Czech National Bank;
- CNB Provision No. 2 of 19 December 2005, stipulating the submitting of statements by banks and foreign bank branches to the Czech National Bank;
- CNB Provision No. 1 of 13 January 2006, amending CNB Provision No. 1 of 17 May 2006, stipulating the manner of transmitting and accepting automated statement data submitted by banks and foreign bank branches to the Czech National Bank.

Official information in the area of banking regulation and supervision

In 2005, the CNB issued in its Bulletin:

- Official information of the CNB of 14 January 2005 regarding the provisions of Article 3(1) of Provision of the Czech National Bank No. 1 of 30 December 2003, stipulating the minimum requirements for disclosure of information by banks, as amended by Provision of the Czech National Bank No. 9 of 22 December 2004;
- Official information of the CNB of 1 December 2005 regarding the provisions of Article 41(6) of Act No. 21/1992 Coll. on Banks, as amended.

Official information documents are explanatory opinions or recommendations of the CNB; they do not constitute legal rules.

A full and up-to-date list of the CNB's prudential provisions, decrees and official information currently in force can be found on the CNB website (<http://www.cnb.cz> - *Legislation - Banking*).

3. PERFORMANCE OF BANKING SUPERVISION

In 2005, the Czech National Bank performed the role of regulator and supervisor of the banking sector.⁴ The powers of home and host supervisors were redefined after the country's accession to the EU. The CNB's banking supervisory competencies were partially limited. A change occurred in the case of foreign bank branches from EU countries, which the Czech National Bank continues to supervise primarily in the liquidity area and also monitors their compliance with the obligations set forth in the Act on Banks. Conversely, monitoring of notifications by foreign banks offering banking products and services on the Czech market has become part of the CNB's supervisory work. Owing to the high share of foreign owners in Czech banks and their prevailing orientation towards EU countries, the emphasis is on closer co-operation and communication with partner supervisory authorities in EU countries.

Even after EU accession, banking supervision in the Czech Republic continues to take the form of off-site surveillance and on-site examinations. Off-site surveillance is based on ongoing monitoring of banks' activities and on the regular conducting and assessment of financial analyses. In this area, the CNB is responsible for licensing and authorisation activities under the Act on Banks. A new activity is the registration of entities interested in operating in the Czech Republic under the single licence, including the scope of such activity. On-site supervision, consisting of examinations in banks, is becoming the basic tool for assessing, in particular, the qualitative aspects of banks' activities, including their management and control mechanisms.

The organisational structure of CNB Banking Supervision is consistent with its competencies. Regulatory and supervisory activities are covered by just one Banking Regulation and Supervision Department performing the main tasks of the approved medium-term strategy. Since February 2005 this department has consisted of five divisions. The Regulation Division deals with legislative and methodological activities. Off-site surveillance (monitoring, analyses of banks and the banking sector, relationships with banks, notifications) is performed by the Off-site Banking Supervision Division, whose activities are focused on the entire banking sector and on profile bank groups. The On-site Banking Supervision Division specialises in particular risk areas. It is responsible for credit risk and internal control systems (including money laundering prevention) and market and operational risks, including bank information system risks. The issue of administrative proceedings in the area of licensing and penalties is concentrated in the Licensing and Enforcement Division, which also covers activities relating to banks whose licences have been revoked. The fifth division provides support to all the executive units and is also responsible for the management and development of the credit register.

3.1 OFF-SITE SURVEILLANCE

Off-site supervision consists chiefly of regularly monitoring the activities of individual banks, groups of banks and the sector as whole, reviewing compliance

Principal off-site supervisory activities

⁴ Four regulators were active in the domestic financial sector in 2005. In addition to the CNB as the regulator of the banking sector, there was the Czech Securities Commission, the Ministry of Finance and the Office for Supervision of Credit Unions. All supervisory activities and supervisory authorities were merged into the CNB on 1 April 2006, meaning that the CNB is now the sole supervisory authority for all segments of the financial market. The Securities Commission and the Office for Supervision of Credit Unions ceased to exist as of the same date. For details, see section 6 *Integration of financial market supervision*.

with the prudential rules and limits, and imposing remedial measures when problems are identified. It is based on continuous appraisal of all available information on banks' activities, taken from various sources, in particular the statements and reports regularly submitted by banks on a solo and consolidated basis, banks' financial statements and annual reports, auditors' reports, banks' presentations, the results of on-site examinations and information-gathering visits and other sources, including publicly available reports. Meetings with banks' representatives also help supervisors to obtain additional information on banks' activities and performance.

The main analytical instrument employed in off-site surveillance is regular comprehensive analysis of the financial condition of banks in relation to the risks they face. To identify potential negative tendencies in time, the monthly early warning information on each bank is regularly appraised for the management of CNB Banking Supervision. Proposals are made for further supervisory action in banks showing negative trends. The development of the banking sector as a whole, and, where appropriate, individual segments of the sector, is also subject to analysis. Information on the sector is regularly disclosed on the CNB website (<http://www.cnb.cz> - *Financial market supervision - Banking supervision*).

Staff involved in off-site surveillance use an automated Banking Supervision Information Centre, which pools the data from all the supervisory reports and statements and generates standard outputs. It also enables the creation of specific outputs for analytical assessment of individual banks and the banking sector as a whole. This informational support provides a quick overview of the main indicators of the financial condition of each bank and the banking sector and of compliance with the prudential rules.

In addition to regular assessment of banks' financial condition, off-site surveillance also focuses on some other aspects of bank activities. In 2005, a total of 122 decisions were issued relating to the assessment of the competence and trustworthiness of persons nominated for executive managerial position in banks, the approval of external auditors, lists of shareholders prior to general meetings, the inclusion of subordinated debt in a bank's capital, etc.

Auditors' reports as a source of information

The assessment of auditors' reports continued in 2005. These reports are an important source of information on control systems and risk management systems in individual banks in periods when no on-site examination covering the given area is conducted. In 2005, CNB Banking Supervision obtained auditors' reports on a total of seven control system areas in seven banks, evaluating these banks' condition as of 31 December 2004. The area most frequently examined by auditors was, as in the previous year, credit risk management systems. Trilateral discussions with individual banks and auditing companies were subsequently held to assess the results of these examinations. The CNB's requests for examinations as of 31 December 2005 were commissioned in the same way. These examinations concern seven banks, and the results from them will be appraised in 2006.

Remedial measures

On the strength of the findings from off-site supervision and on-site inspections, remedial measures were imposed on a total of 13 banks. These measures required the banks concerned to eliminate shortcomings in their activities within a set timeframe. Banks' progress in eliminating shortcomings is always subsequently monitored. In 2005, CNB Banking Supervision opened no penalty proceedings to revoke licences or impose fines for violations of the Act on Banks. To eliminate shortcomings detected in banks during on-site inspections or off-site surveillance, the supervisor used alternative and equally effective instruments available to it under the law. These led to the required corrections as regards compliance with the prudential rules.

The co-operation between the CNB, the Ministry of Finance (MoF) and the Czech Securities Commission (CSC) under a trilateral Memorandum of Understanding amended in February 2003, continued into 2005. Under this memorandum, working groups composed of CNB, CSC and MoF representatives had been set up in 2003 for the individual consolidated groups, consisting of entities supervised by different regulatory institutions. Regular meetings of these working groups for the individual consolidated groups, whose members are subject to supervision by the CNB and also by the MoF or the CSC, were again organised in 2005. Where necessary, the working groups' members exchange up-to-date information throughout the year.

Consolidated supervision and co-operation with regulators

The Committee on the Co-ordination of Financial Market Supervision, which dealt with co-operation between the CNB, the MoF and the CSC, met three times in 2005. In addition to exchanging information and opinions on current banking regulation and supervision issues, the Committee focused primarily on the integration of financial market supervision and the merger of all the supervisory authorities into the CNB.

2005 saw deepening bilateral co-operation – based on memoranda of understanding – between CNB banking supervisors and foreign regulators responsible for supervising parent banks that have subsidiaries in the Czech Republic. By the end of 2005, the CNB had signed eight bilateral memoranda of understanding. Besides exchanging information on the financial position of banks of mutual interest, the meetings with foreign regulators in 2005 focused more on practical issues related to preparations for the implementation of the new capital adequacy framework.

3.2 LICENSING AND AUTHORISATION ACTIVITIES

In the licensing and authorisation area, 2005 was an average year as regards the number of administrative proceedings opened. The Czech National Bank obtained a total of 12 motions for the opening of administrative proceedings.

In all, 14 administrative decisions were issued. The Czech National Bank issued four prior consents to the acquisition a qualifying holding in a bank; five administrative proceedings involved changes to banking licences (licence extensions at banks' request); one merger of two banks was approved; one bank was converted into a branch under the single licence (sale of the business to the parent company approved, the bank wound up and the sold business transferred to a new branch with a single licence); and one banking institution was allowed to open a branch under the single licence principle in Slovakia.

One application for a licence was submitted to the CNB as the banking regulator by an applicant based in a country outside the EU. The administrative proceedings have not yet been completed.

CNB Banking Supervision obtained three notifications of the establishment of branches under the single banking licence principle – from Belgium's Fortis Bank SA/NV, Japan's Bank of Tokyo–Mitsubishi UFJ (Holland) N.V. and France's CALYON S.A. The CNB received these notifications from home regulators supervising the foreign banks, i.e. the head offices of branches with a single banking licence. Fortis Bank SA/NV opened for business in August 2005 and CALYON S.A. in November 2005, and Bank of Tokyo–Mitsubishi (Holland) N.V. opened its branch in the Czech Republic in April 2006.⁵

⁵ The opening of this branch is mentioned for information only. This branch is not included in the analysis, as the banking sector analysed here consists solely of banks with licences as of 31 December 2005.

EU accession also opened up the Czech banking market to other banking institutions entitled to benefit from the free movement of services. In 2005, a total of 45 other institutions from EU Member States announced their intention to offer and carry on the mutually recognised activities in the Czech Republic (43 of which being banks, one a financial institution and one an institution authorised to issue electronic money instruments). By 31 December 2005, the total number of these institutions had risen to 108. Provision of cross-border banking services is not subject to a reporting duty to the CNB, but should not have the character of permanent economic activity. These institutions are supervised by the home country regulator.

3.3 ON-SITE EXAMINATIONS

The on-site examinations conducted in 2005 concentrated on the areas of credit, market and operational risk management, money laundering prevention and overall assessment of internal control systems. In 2005, the CNB carried out ten examinations in ten banks. In-depth examinations of all the aforementioned areas took place in five banks, and inspections of the management of selected risks were conducted in the remaining five.

In 2005, the Czech National Bank continued incorporating the documents and conclusions of the European Commission and other relevant working groups of the European Union and the Basel Committee on Banking Supervision into its on-site examination procedures. In 2005, the CNB started performing inspections focusing on operational risk management in banks (until then it had examined information systems risk management). In connection with the preparations for approving advanced methods for determining capital requirements for credit risk (the IRB approach) and operational risk (the AMA approach), the CNB worked and communicated closely with banks, foreign regulators and the Czech Banking Association.

During on-site examinations, assessments were made of the methods used by banks to identify, measure, evaluate, monitor and limit the risks that they face. Attention was given to the methods applied by banks to measure, evaluate and monitor risks, to whether the information used in risk management is complete, reliable and up-to-date, and also to clear definition and assignment of responsibilities to competent departments and staff members.

For the first time, the CNB provided banks with an assessment of each examined area together with its on-site examination report.

Examinations of credit risk management systems

Credit risk is still the largest risk faced by banks. On-site supervision was therefore focused mainly on the assessment of credit risk management systems. After examining the organisation structure, credit strategy and risk management methods of the bank under inspection, the supervisors always selected a sample of non-bank clients in such a way as to cover, as far as possible, all the types of credit products provided and collateral accepted by the bank and its receivables of all categories. Other selection criteria include receivable size (volume) and whether a client belongs to a group of connected clients. The examiners studied in detail all the documents submitted by the bank relating to the receivables of the selected sample and identified control elements in the bank's loan provision, administration, evaluation and recovery processes. The supervisors examined whether these control elements were functional and ensured that the bank has a suitable approach to risk. Also assessed were the bank's systems for evaluating client creditworthiness, identifying and monitoring groups of connected entities, assessing credit transaction quality, creating provisions, and assessing and valuing collateral. The supervisors also examined whether the bank's information systems

provided sufficient information for decision-making to the bank's management and, last but not least, whether the bank provided consistent and accurate information about itself in its reports to CNB Banking Supervision.

Five credit risk examinations were conducted in five banks in 2005, focusing on credit risk management systems for transactions with non-bank clients.

In its on-site examinations, the CNB also focused on systems for managing market risks, liquidity risk and credit risk associated with trading on the financial market and also on operational risks associated with striking, processing and settling deals on the money, capital and foreign exchange markets.

The on-site examinations were targeted above all on assessing the methods used to measure and monitor risks, including verification of whether the data in banks' information systems are correct, reliable and up-to-date. Special attention was paid to banks' internal limit systems, which reduce the magnitude of the risks undertaken, and to the measures taken by banks to eliminate potential highly unfavourable market conditions for banks (stress scenarios, liquidity scenarios and contingency plans).

Under an agreement with the Czech Securities Commission, CNB Banking Supervision in 2005 ceased to inspect the management of risks faced by banks from acting as a depository. The CNB's planned depository examinations were fully covered by the CSC.

As regards the adjustment and expansion of the value-at-risk model, CNB Banking Supervision continued working in partnership with the bank that was granted consent in 2003 to use this model for calculating capital requirements for market risks.

Seven on-site examinations aimed at verifying systems for managing market risks, liquidity risk, and risks associated with trading on the financial market were carried out in 2005.

In 2005, the CNB started performing inspections focused on operational risk management systems in banks. On-site examinations were directed at systems for identifying, assessing, monitoring, adopting and implementing measures to mitigate risks which may result in bank losses due to shortcomings or failures in internal processes, the human factor or systems, or to external events and infringements of, or non-compliance with, legal rules. The examinations of information systems and information technology concentrated on the appraisal of IS/IT management systems, security and operability. Owing to the dynamic development of electronic banking, CNB Banking Supervision paid increasing attention to electronic banking security. An analysis of the present state of electronic banking was conducted at the end of 2005. The results will be used in the supervision of this area. Inspections focusing on the management of operational risk, information systems and information technology were performed in five banks in 2005.

The information obtained from the operational risk examinations conducted in 2005 showed that banks had established principles for managing this risk. To co-ordinate operational risk management and security, banks have set up committees or assigned this activity to the board of directors. Banks' procedures for monitoring, assessing and reducing the occurrence of operational risk events are in the development phase. Some differences were identified in the standard of management of individual areas in operational risk management systems. The situation was better in the area of monitoring and assessing "traditional" operational risk events such as damage events, fraud and client complaints. Banks are gradually refining the integration of operational risk management in individual areas into a system of operational risk management as a whole.

Examinations of management of market risks, liquidity risk and risks associated with trading on financial markets

Examinations of operational risk management systems

Verifying the operation and effectiveness of internal control systems

Examinations in this area are conducted as part of the examinations of particular risk management systems (assessing in particular the operation and effectiveness of the internal control system for the relevant business area of the bank, including the overall control environment) and also as a separate area of comprehensive inspection. In the latter case, the following components of the bank's internal control system are verified: application of corporate governance principles, the compliance function (based on the international standards and recommendations, in particular the BIS's April 2005 document entitled "Compliance and the Compliance Function in Banks", where compliance risk is defined as the risk of legal or regulatory sanctions, material financial loss or loss of reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards and codes of conduct applicable to its banking activities) and the internal audit function. Such examinations were conducted in five banks in 2005.

In the area of corporate governance, the inspections focus on evaluating the organisational structure of the bank as a whole, the functioning of the supervisory board and its advisory bodies, the board of directors and other management and advisory bodies, and the links between those bodies. The inspections also involve checks of the efficiency and effectiveness of the control environment, including the individual control mechanisms built into the bank's routine activities.

In the area of compliance, the inspections focus on the bank's system for monitoring legislative developments and for incorporating legislative changes into its internal regulations. Also verified is whether the bank's regulations and procedures are complete, intelligible and consistent, and whether its staff abide by them. In this context, an assessment is also made of whether the bank complies with the legislation and generally recommended procedures (best practices) and whether and how it applies "soft standards", in particular the principles of the general code of ethics.

In the area of internal auditing, the examinations focus on the organisation, methodology and staffing of the internal audit department. The creation of prerequisites for ensuring the independence of the internal audit department and its links to each of the company's bodies are evaluated. Also examined is the method whereby the bank's risks are assessed by the internal audit department, the internal audit planning process, the actual orientation of the internal audit department's work, and the quality of the outputs generated by each audit. An assessment is made of whether the bank has a functional and effective system for eliminating problems identified by the internal audit department or other entities (internal and external) and whether the managers of the bank pay sufficient heed to corrective measures.

Prevention of money laundering

The operation and effectiveness of the anti-money laundering system used by banks is examined. Supervisors concentrate on the following areas: the strategy and internal control system in this area; compliance of the bank's system with the legislative requirements; observance of the relevant provisions of the legislation; practical application of an appropriate "know-your-customer" policy; and the bank's ability to detect and evaluate suspicious transactions and to notify the Ministry of Finance's Financial Analytical Unit within the statutory time limits. Three such examinations were conducted in banks in 2005.

The Czech National Bank works closely with the Financial Analytical Unit in this area.

In 2005, the Czech National Bank took part in the assessment conducted by Moneyval (an expert group at the Council of Europe for the issue of money laundering prevention) of the money laundering prevention area in the Czech

Republic from the point of view of the banking sector. Moneyval's recommendations will be applied to future banking supervisory activities.

Under the revised capital adequacy framework (Basel II, or the revised EU directives 2001/12/EC and 93/6/EEC), banks will be allowed to use special approaches based on advanced mathematical models for calculating the capital requirements for credit risk and the newly introduced operational risk - the IRB approach for credit risk and the AMA approach for operational risk. The preparation for the approval of these approaches was one of the most complex tasks faced by the Banking Regulation and Supervision Department in 2005. At the end of 2004, two working groups were established within the Department to work with banks in implementing these special methods. In 2005, the two groups opened bilateral consultations with banks that had shown an interest in using the IRB or AMA approach in 2007 or 2008. This process included "pre-validations" of the implementation of these approaches in banks. Intensive pre-validation of the IRB approach was conducted in four banks, while the AMA approach was addressed by CNB staff in three banks.

Another task faced by the two teams was to communicate on an ongoing basis with foreign banking supervisory authorities in order to establish a common approach to verifying these special approaches in multinational banking groups. Several meetings were held on this issue in 2005, and more have been scheduled for the first half of 2006.

The CNB was also active in providing technical assistance to foreign regulators. In special projects co-ordinated by the US non-profit organisation Financial Services Volunteers Corps (focused on strengthening banking and financial systems), the CNB's Banking Regulation and Supervision Department provided technical assistance targeted at the implementation of banking regulation and supervision in the liquidity risk area to the central banks of Croatia and Bosnia and Herzegovina.

Preparations for Basel II implementation as regards advanced methods for determining capital requirements

Foreign technical assistance

4. NEW BASEL CAPITAL ACCORD

In 2005, the Czech National Bank continued its work relating to the preparation for, and implementation of, the new capital framework – usually referred to as Basel II. The first draft of the new framework was prepared by the Basel Committee on Banking Supervision (BCBS) in 1999. The most recent revised version, entitled "International Convergence of Capital Measurement and Capital Standards", was published by the BCBS in November 2005.

The aim of the new capital framework is to support the stability of the financial system and the competitive environment on the financial services market and also to strengthen management responsibility. The new framework concentrates on more accurate risk measurement and on promoting enhanced risk management in banks. By applying more risk-sensitive approaches, banks can make better and more efficient use of capital to cover the risks that they face. Innovations include a capital requirement for operational risk and rules allowing for more accurate determination of the capital requirement for credit risk. The new rules for determining capital requirements are more comprehensive, offer a wider range of options for measuring the risks faced and allow banks to align their risk measurement and management systems with the regulatory rules. Very importantly, they cover not only the risk of the bank alone (on a solo basis), but also the risk of the whole banking group. The new framework recognises that each country has its own specific conditions and so allows the competent national supervisory authority to opt for one of two or more admissible alternative procedures in a number of areas (national discretion). For the same reason, some provisions also contain admissible alternatives that banks may choose themselves (bank discretion).

The newly proposed framework is based on three pillars. Pillar 1 contains methods for risk management and for setting capital requirements for credit, market and operational risk. Pillar 2 deals mainly with all the significant risks and with capital adequacy. The basic principle consists in the bank putting appropriate internal processes in place to assess the adequacy of its capital in relation to its risk profile. The supervisory authority examines these processes and their outputs. It is entitled to set the capital requirement higher than that calculated by the bank if it considers the capital requirement set by the bank to be insufficient in relation to its overall risk profile. A capital ratio of 8% of the value of risk-weighted assets will be still considered the absolute minimum. Pillar 3 deals primarily with the issues of bolstering market discipline and attaining market transparency by means of reporting and comprehensive disclosure of relevant information by banks.

Transformation of Basel II into draft EC directives

Given the Czech Republic's accession to the EU, Basel II – in the form resulting from its transformation into Community law, i.e. into amendments to European directives 2000/12/EC⁶ and 93/6/EEC⁷ (hereinafter referred to as the Directives), regulating the activities and capital adequacy of credit institutions and investment firms – is and will continue to be crucial for the Czech Republic. The core of the framework remains unchanged in these Directives. However, it differs to a greater or lesser extent from the BCBS source document in some minor respects and takes into account the specifics of the European market. The European Parliament and the EU Council approved the Directives in autumn 2005, but they are not expected to be published in the EU's Official Journal until mid-2006 (after legal and linguistic checking) with effect from 2007. The approved version of the Directives is based on the comprehensive draft Directives published in July 2004, but also contains some material changes in line with the updated Basel document mentioned above

⁶ Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions.

⁷ Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions.

and has taken on board a number of parliamentary motions to amend, most of which reflected comments from the banking community. However, one of the crucial differences between the Directives and Basel II is that the Directives will apply to all credit institutions and investment companies, i.e. to all banks, credit unions and investment firms, while the BCBS document primarily relates to internationally active banks.

At home, the CNB stepped up the work on implementing the new capital framework in partnership with banks. Co-operation with the banking sector continued under a joint trilateral project of the CNB, the Czech Banking Association and the Chamber of Auditors of the Czech Republic. The joint project is aimed at ensuring effective implementation of the framework in the Czech Republic, establishing a uniform interpretation of the framework's rules and requirements, and at informing all parties involved of the implementation measures. It is also serving to upgrade the skills of the project participants with regard to the new rules and to stimulate debate of the impacts of the new framework and the CNB's approach in the areas of national discretion. Implementation of the joint project was launched in September 2002. In 2005, the project entered the legislative phase, focused on the incorporation of Basel II into Czech law. The CNB prepared a draft amendment to the Act on Banks and a proposed structure and working version of a related CNB Decree. At the end of 2005 it organised a series of presentations to inform the banking community about these documents. The CNB also worked closely with the Ministry of Finance on the preparation of amendments to other legal rules implementing Basel II, specifically an amendment to the Credit Unions Act and an amendment to the Capital Market Undertakings Act.

In 2005, CNB Banking Supervision geared up for the practical application of this fundamental change in banking sector regulation. CNB staff continued to upgrade their skills relating to the requirements of the new capital framework. The CNB's progress with, and approach to, implementing the new capital framework is published and regularly updated on its website at <http://www.cnb.cz> – *Financial market supervision – Banking supervision*.

The directive newly regulates relations between home and host supervisory authorities in the exercise of supervision of subsidiary banks whose parent bank or financial holding company has its registered office in another EC Member State. Much closer co-operation will be required than under the existing legislation. CNB Banking Supervision therefore held face-to-face meetings or communicated in other ways with selected foreign supervisory authorities on the issue of implementing the new framework, on relations between home and host supervisory authorities and on the related division of labour between them in the case of individual consolidated groups. Under the new conditions, the CNB will in most cases be in the position of host authority. Therefore, it supports a uniform interpretation of the rules and co-ordination of procedures.

These objectives can only be achieved through active co-operation at international level. The CNB is involved in the preparation of Basel II through its representatives in the Core Principles Liaison Group (CPLG) and in the CPLG's Working Group on Capital, which guarantees good access to the latest information and enables the CNB to voice its opinion on certain issues and, at least to some extent, to shape the new rules.

The CNB is also involved in the work of relevant committees and working groups operating within other European structures.⁸

Implementation of the framework in the Czech banking sector

International co-operation

⁸ For details, see section 9 *International co-operation*.

In December 2004, the BCBS decided to undertake another – and probably the last – Quantitative Impact Study (QIS 5), aimed at potential recalibration of Basel II. The strategic objective of the BCBS is to maintain the global capital volume roughly at the current level, while ensuring that the setting of capital requirements more sensitively reflects real risk exposures and encouraging banks to apply more advanced approaches. The capital charge for operational risk should create roughly 10% of the total minimum required capital and the capital charge for credit risk should on average decrease by the same amount. As a result of this study, recalibration of the parameters used to set capital requirements will be considered in order to best achieve the strategic goal declared by the Basel Committee.

Six banks from the Czech Republic – together accounting for more than 60% of banking sector assets – participated in this study. The CNB forwarded data to the Basel Committee for processing, except where they were part of consolidated QIS 5 data reported by the parent company. The CNB used the individual banks' data to analyse the impacts of Basel II in the Czech Republic. The results of the internal analysis indicate that the implementation of the new capital adequacy methodology is likely to cause a modest decrease in capital adequacy in the Czech banking sector as a whole as compared to the current situation, primarily due to the incorporation of the new capital requirements for operational risk, which will not be fully offset by a decrease in the credit risk area. By conducting this impact study, the CNB assured itself of the banks' progress in preparing for the new framework and their interest in introducing more advanced, model-based risk measurement approaches. The CNB greatly appreciated the co-operative approach shown by all the participating banks.

5. CO-OPERATION WITH OTHER FINANCIAL MARKET REGULATORS IN THE CZECH REPUBLIC

Until 31 March 2006, financial market participants were regulated and supervised by four different institutions in the Czech Republic. The Czech National Bank was responsible for the regulation and supervision of banks and consolidated groups containing banks; the Czech Securities Commission regulated and oversaw capital market participants; and the Czech Ministry of Finance was responsible for the regulation and surveillance of insurance companies and pension funds and partly for capital market regulation. The credit unions sector was supervised by the Office for Supervision of Credit Unions and regulated by the Czech Ministry of Finance. This diversified regulatory and supervisory structure required close co-operation.

A Memorandum of Understanding between the Czech National Bank, the Securities Commission and the Ministry of Finance of 28 February 2003, which replaced the original agreement dating from 1998, provided the formal basis for this co-operation. The primary aim of the Memorandum was to ensure the application of uniform criteria and procedures in the supervision of the financial market, including supervision of entry to, and exit from, the sector. This included co-operation in the areas of licensing and granting approvals, inspections, imposing remedial measures and regulation of the financial market and also co-operation with foreign supervisory authorities and international institutions. Exchange of information between these supervisory bodies was the main tool of co-operation. The Memorandum envisaged the signing of individual agreements on consolidated supervision of specific consolidated groups and laid down the basic elements thereof. The fulfilment of the commitments arising from the Memorandum and co-operation on a consolidated basis were ensured, among others, by working groups. The creation of general policies, concepts and strategies for future supervision of the financial market and addressing serious systemic problems was delegated to a Committee consisting of two representatives from each participating institution.

The Committee met three times in 2005. It dealt with the following issues in particular:

- exchange of information and opinions on current issues being addressed in the Level 3 committees under the Lamfalussy process (CEBS, CEIOPS and CESR),
- exchange of information on the implementation of Basel II in the banking sector and on the preparation of the Solvency II directive for insurance undertakings,
- the activities of working groups under the Memorandum,
- the integration of financial market supervision.

The most active of the five working groups (on supervision, collection of data on sectors, accounting harmonisation and information disclosure, conglomerates and licensing) in 2005 was the working group on supervision, consisting of five sub-groups responsible for individual regulated consolidated groups (eBanka and PPF banka, Česká spořitelna, Československá obchodní banka, J&T BANKA, Komerční banka). Within the group, information is exchanged on the financial condition of consolidated group members, compliance with regulatory limits and rules, results of inspections, planned inspections, imposition of remedial measures etc. The working group on accounting harmonisation and information disclosure discussed the Ministry of Finance's draft decree on the accounting rules for financial institutions and the processing of comments. The working group on conglomerates focused on the implementation of the financial conglomerates directive into the national legislation.

In mid-2005, the plan to integrate supervision was changed in favour of faster integration and merger of all the supervisory authorities into the CNB. The Committee discussed the progress being made with changes to the competency laws and related sector laws and the steps which had to be taken in order to ensure smooth approval of the legislation. The legislative changes necessary for integration of all the supervisory functions into the CNB were approved by the Czech Parliament at the beginning of 2006.

6. INTEGRATION OF FINANCIAL MARKET SUPERVISION

In May 2004, the Czech Government decided on a plan to gradually integrate financial market supervision in the Czech Republic into a single institution. On 24 August 2005, the Government approved a proposal of the Czech Ministry of Finance and the Czech National Bank to accelerate the integration process and decided that instead of a gradual merger, supervision would be integrated into the Czech National Bank as of 1 April 2006. The integration involved the Czech National Bank, which has been responsible for performing banking supervision since its establishment, taking over as of this date supervision of credit unions from the Office for Supervision of Credit Unions, supervision of the capital market and collective investment from the Czech Securities Commission and supervision of insurance companies and private pension schemes from the Czech Ministry of Finance.

As an integrated regulator, the CNB is responsible for the financial regulation and supervision of the business activities of regulated financial institutions. The first mentioned competency (regulation) consists mainly in the CNB, under the relevant laws, issuing subordinate legal rules and thereby setting detailed prudential rules for regulated financial institutions, and the latter competency (supervision) involves licensing, off-site supervision, on-site supervision and imposition of remedial measures. Primary legislation falls within the field of competence of the Finance Ministry.

The integration of supervision into the Czech National Bank will create the necessary conditions for unifying the regulatory rules and the demands placed by the supervisory authority on the activities of bank and non-bank financial institutions. It will have the positive effect of enhancing competition. It will also be welcomed by financial institutions, as significant cost savings are expected to ensue.

The integration of supervision necessitated changes to the legislation, which were implemented through the Act on Integration of Financial Market Supervision.⁹ This Act transfers powers in the area of financial regulation and supervision to the CNB and amends dozens of other laws, among them:

- the Act on the Czech National Bank, the Act on the Czech Securities Commission and the Commercial Code;
- the "sector acts" governing the activities of individual financial institutions, e.g. the Act on Capital Market Undertakings, the Act on Collective Investment, the Act on Bonds, the Act on Private Pension Insurance, the Act on Banks and the Act on Credit Unions;
- other acts governing the powers of the supervisory authorities, in particular the Act on Certain Measures Against Money Laundering, the Act on Income Taxes, the Act on Vehicle Liability Insurance, the Act on Insurance Intermediaries and Independent Loss Adjusters, the Act on Insurance Agreements, the Act on Some Conditions of Business in Travel, the Act on Offences, the Act on the Financial Arbiter, the Accounting Act, the Act on Bankruptcy and Composition and the Securities Act

After confirming the plan to integrate supervision into the Czech National Bank and acquiring political support, the CNB began implementing a carefully prepared project, the main objective of which was to maintain continuity in the supervision of financial institutions. Starting on 1 April 2006, most of the employees of the

⁹ Act No. 57/2006 of Coll., on the Amendment of Acts in Connection with the Integration of Financial Market Supervision.

original supervisory authorities joined the Czech National Bank, which guaranteed them good working conditions. Numerous internal rules of the Czech National Bank were amended, the information system was adapted to the needs of integrated supervision and, last but not least, hundreds of employees were relocated to new offices in the CNB building.

In the interests of continuity of supervision, the CNB retained the existing sectoral supervisory set-up. In 2007, the CNB will conduct an analysis of this organisational set-up and then consider making organisational changes in order to improve the conditions for achieving synergies from the integration of supervision.

Since 1 April 2006, the Czech National Bank has been ensuring fulfilment of all existing and new tasks in the area of financial regulation and supervision by means of three departments.

- The Banking Regulation and Supervision Department is responsible for supervision of the banking sector and the credit union sector.
- The Insurance Companies Regulation and Supervision Department is responsible for supervision of the insurance companies sector and the insurance intermediaries sector.
- The Capital Market Regulation and Supervision Department is responsible for supervision of investment firms, investment companies, open-end mutual funds, pension funds and regulated market organisers.

In its internal rules the Czech National Bank has defined the areas of competence, staffing levels and job descriptions for these departments and the relevant divisions.

7. CENTRAL REGISTER OF CREDITS

The Central Register of Credits (CRC) administered by the Czech National Bank has been in operation since 2002. Up to now it has only been used for its primary purpose, i.e. the sharing of information on client credit commitments and payment discipline between banks.

Key statistics on the CRC in 2005

No. of users as of 31 December 2005	1,927
No. of clients registered as of 31 December 2005	302,799
of which: individual entrepreneurs	184,062 (61%)
legal entities	118,737 (39%)
No. of active claims as of 31 December 2005	329,123
No. of enquiries on clients registered for 2005	256,425
No. of enquiries on total credit commitments of client (including credit commitments of own clients obtained via batch reports made available to bank after each update) for 2005	2,214,371
No. of extracts made for clients for 2005	133

The extent to which the register is used by banks is conditional on the usability of the data contained therein, knowledge of how the database operates, reliability and ease of access. Bank users are therefore trained as required and have all the necessary information available to them in a clear form in the CRC section of the CNB website, which contains full methodological documentation, a user manual and contact details for the application administrators at the CNB. In an effort to accommodate the banks' needs, the data processing options have been set so that banks can choose the most suitable method for preparing data or reports depending on their size or specialisation. Banks can choose interactive access to database and input data via application forms directly from the keyboard or prepare data in their own information systems and send them in batches via a transfer form.

Information on the CRC, i.e. basic information on the CRC, information on providing extracts to clients and an application form for the provision of an extract from the CRC, is available to the public on the CNB's website (<http://www.cnb.cz> – *Financial market supervision – Banking supervision*). Banks are responsible for the correctness of the information sent to the CRC, so if clients disagree with information kept on them in the register, they should contact directly the bank that entered that information into the CRC. If an error has indeed been made, the bank is obliged to correct the database without delay. On the other hand, banks can ask the CRC administrator to verify client data entered into the register by other banks. The experience with dealing with bank data verification applications has revealed that in the overwhelming majority of cases the information stored in the CRC is correct.

In the event of a data correction that affects the information on a client's credit commitments, all the users who have enquired about this client are informed about the changes and are asked to make a new enquiry.

2005 saw the implementation of Phase II of the CRC's development, targeted mainly at extending the functionality of the current system, making it more user friendly and broadening the scope of information available. Phase II will end in 2006.

Under Phase II, new tools are being prepared for analysts from the CNB and participating banks which will, among other things, facilitate dynamic creation of statistical reports using optional parameters. These will generate aggregate data separately and in mutual combinations based on the current scope of the data record, for example aggregation by sector, by client type, legal form and economic activity, by amount outstanding and overdue liabilities, etc. and by Business Register parameters (particularly number of employees and turnover). It will also be possible to select aggregation for the sector as a whole, for a selected group of banks or for an individual bank (with access limited to that particular bank only) and to calculate indicators based on the scope of the data record, for example average liability size, the ratio of outstanding liabilities to total liabilities, and combinations thereof broken down by sector or economic activity, etc.

A further extension of the CRC's functionality will enable banks to monitor client credit commitments and soundness not only on a solo basis, but also within groups of connected persons in the context of the obligations arising from the prudential rules. The proposed solution will allow banks to store a created group of clients for future use and to calculate the credit commitments of a particular group of clients in the same structure as for individual enquiries.

Several other registers have recently been established on a commercial basis in the Czech Republic. However, these specialise in other entities or products than the CRC. CBCB (Czech Banking Credit Bureau, a.s.) operates the Banking Register of Client Information, which specialises in natural persons (private citizens and sole traders). CBCB is owned by five founding banks and processes data under contracts with individual banks. Unlike the CRC, this is not a complete register, as it contains data from only 18 participating banks, giving them an overview of a client's current debt situation and historical records for the last four years. It has been in operation since June 2002.

SOLUS (Association for the Protection of Leasing and Loans to Consumers) is an association of legal entities. Its joint database, containing data on natural persons and, more recently, also on sole traders and legal entities that do not meet their obligations *vis-à-vis* the financial activities of at least of one SOLUS member (i.e. negative information only), is designed exclusively for the needs of the 12 members of the association. This register began operating in mid-1999. The members of the Association include two banks – HVB Bank Czech Republic and Raiffeisenbank.

Another register operating in the Czech Republic since June 2005 is the Non-banking Register of Client Information run by LLCB (Leasing Loan Credit Bureau, z.s.p.o.), an association of legal persons. The aim of this register is to enable eight leasing and hire-purchase credit providers operating in the Czech Republic to exchange information on issues relating to the soundness, creditworthiness and payment discipline of their clients (natural persons and legal entities). As in CBCB's case, CCB (Czech Credit Bureau) and CRIF are involved in processing the data.

8. ACTIVITY OF THE FINANCIAL ARBITER

The Financial Arbiter has been operating in the Czech Republic since 1 January 2003 under Act No. 229/2002 Coll., on the Financial Arbiter. The Financial Arbiter Act was amended in connection with the integration of financial market supervision into the CNB as from 1 April 2006. The Czech National Bank provides the Financial Arbiter, his deputy and five members of staff with premises, material resources and information technology. However, the Arbiter is independent of the CNB and is not a part of CNB Banking Supervision.

Information on the powers of the Arbiter, including conditions for opening proceedings before the financial Arbiter and the option of filing a petition to open proceedings, is published on the Financial Arbiter's website (www.finarbitr.cz). The site also lists the Arbiter's awards and adjudications, including examples of the disputes that do and do not fall within his jurisdiction. Information on similar institutions in member states of the European Union, the states constituting the European Economic Area, and European Union candidate countries is also available.

Any client of an institution may request the Arbiter's assistance, provided that the dispute falls within his jurisdiction. A transfer institution or an issuer of electronic payment instruments may not be a plaintiff for the opening of proceedings before the Financial Arbiter.

The Financial Arbiter adjudicates on disputes arising between institutions and their clients during the execution of transfers and the issuing and holding of electronic payment instruments pursuant to the Payment System Act (Act No. 124/2002 Coll.). These include disputes arising in particular during the execution of domestic and cross-border payments and the clearing of payment card transactions charged to cardholders' accounts and potentially of other electronic payments. With effect from 1 January 2005 the applicability of the Act was extended to cover corrective settlement and direct debits in the Czech Republic. This essentially concerns compliance with the statutory time limits and conditions for clearing individual payment transactions. With effect from 1 April 2006, the amendment to the Financial Arbiter Act specifies the powers of the Financial Arbiter for resolving disputes arising from transfers not initiated by the account holder or by a person authorised by the account holder. The Financial Arbiter is legally entitled to settle disputes concerning executed cross-border credit transfers of up to the equivalent of EUR 50,000.

The Financial Arbiter deals with corrective settlement pursuant to the Act on Banks (Act No. 21/1992 Coll.), while direct debits in the Czech Republic are also treated in compliance with Decree No. 62/2004 Coll., stipulating the manner of execution of payments between banks, settlement on accounts at banks and the technical procedures to be used by banks for corrective settlement. To the extent laid down in the law, such disputes can also be settled by the Deputy Financial Arbiter, who also deputises for the Arbiter in his absence to the full extent of his powers and responsibilities. In other cases a competent court must adjudicate.

Proceedings are opened upon the petition of the plaintiff. Petitions may be filed either in writing by letter or on a form issued by the Arbiter. Such forms can be downloaded from the Arbiter's website. Petitions may also be filed by fax. Petitions must contain all the information prescribed by law. The petitioner must precisely identify himself and the relevant institution with which he has unsuccessfully made a complaint falling under the terms of reference of the Payment Systems Act. This means giving his name and surname, birth certificate number or date of birth, and permanent address. In the case of an institution, its full name, identification number and registered address of the firm must be given. The petitioning client must give a clear and complete description of all the significant facts of the case and provide evidence, or at least a specification or description of the evidence. Another

important part of the petition is a description of what the plaintiff is seeking. An integral part of the petition is a declaration that the case has not been settled before a court of law or by an arbiter. The client must also furnish proof that he has unsuccessfully sought redress with the relevant institution (usually a bank).

The Arbiter, the Deputy Arbiter or an authorised member of staff will study the petition to see whether or not it has all the information prescribed by law. If any such information is missing, the Arbiter will call upon the petitioner to provide it. If the petition contains all the required elements, proceedings will be opened before the Arbiter. The plaintiff will be notified of this fact in writing and the transfer institution will be called upon in writing to comment on the case within the statutory time limit. Since 1 January 2005, the time limit has been 15 days and may be extended by further 15 days if the institution so requests. The Arbiter need not be bound by the petition in the course of proceedings, but may himself acquire other evidence and order a hearing on the merits of the case attended by both parties to the dispute. He is authorised to solicit from the transfer institution all the evidence he requires, as well as to search the institution's systems.

The Financial Arbiter Act requires the Arbiter to co-operate with analogous authorities in the Member States of the European Union and the European Economic Area. In 2005, the Financial Arbiter and persons authorised by him attended meetings with the ombudsmen in Germany (Bundesverband deutscher Banken and Bundesverband öffentlicher Banken Deutschlands). Contacts were initiated in Finland (Advisory Office for Bank Customers – The Finnish Securities Complaint Board) and with the Austrian ombudsman (Gemeinsame Schlichtungsstelle Wien).

On 6 October 2005, at the instigation of the Financial Arbiter, one of the regular meetings of the European network FIN-NET (Cross-border Out-of-Court Complaints Network for Financial Services), an association of financial ombudsmen and organisations dealing with out-of-court settlement of client disputes in banking, was held in Prague. The event was supported by, and took place at, the CNB.

In 2005, the Financial Arbiter dealt with a total of 537 cases. Of this total, 160 were petitions for the opening of proceedings before the Financial Arbiter, which means an increase of 23% in comparison with 2004 and 116% in comparison with 2003. The growing number of petitions and enquiries, including personal visits, suggests that the public, which is making more use of out-of-court settlements than in previous years, is becoming increasingly aware of the Financial Arbiter.

The Financial Arbiter issued 65 awards, of which 21, i.e. 32%, were in favour of the plaintiff. In 2004, the figure had been 44.8%. Of all the legitimate cases dealt with by the Financial Arbiter in 2005, 67% involved problems arising from the use of electronic payment instruments (mostly payment cards).

The Financial Arbiter imposed 31 fines (totalling CZK 943,457), of which seven were for failure to comply with the statutory reporting obligation by institutions and the rest were associated with the issuing of an award in which the institution received a sentence.

The Financial Arbiter Act imposes an information duty on institutions (i.e. transfer institutions and issuers of electronic payment instruments). A regularly updated list of these institutions is maintained on the Arbiter's website. The website also contains a specimen information-duty compliance form.

The Financial Arbiter held a press conference in 2005 connected with the publication of his annual report and the amendment of the Financial Arbiter Act. The Arbiter continued publishing information in daily newspapers and specialised magazines and appearing in the media in order to raise public awareness of the Financial Arbiter's activities in the Czech Republic.

9. INTERNATIONAL CO-OPERATION

Bilateral co-operation between CNB Banking Supervision representatives and partner banking supervision institutions and co-operation within international, mostly European, structures strengthened in 2005. This was due to the need to co-operate closely in preparation for the implementation of Basel II and the CNB's active involvement in the work of the Committee of European Banking Supervisors (CEBS) and the European Banking Committee (EBC)¹⁰ and in the activities of the working groups established by these committees. Now that the single banking licence principle has entered into force, the CNB is in most cases in the position of host authority, so it strongly supports a uniform interpretation of the rules and co-ordination of procedures.

Around one-third of the staff of CNB Banking Supervision are currently involved in the work of the 20 committees and working groups of the European Commission, the European Central Bank and the Bank for International Settlements.

9.1 CO-OPERATION WITHIN THE STRUCTURES OF THE EUROPEAN COMMISSION

The Committee of European Banking Supervisors (CEBS), on which the CNB has a representative, worked intensively in 2005 on recommendations relating to the implementation of the new capital adequacy framework in connection with the amendment of directives 2000/12/EC and 93/6/EEC. Efforts were concentrated on finalising consultation papers on common reporting of capital adequacy (COREP), financial reporting (FINREP), performance of supervision under the new capital framework (Pillar 2), assessment of external credit assessment institutions (ECAIs) and cross-border co-operation between home and host supervisors.

CNB Banking Supervision is represented in the following key working groups preparing the aforementioned documents:

- a) the Groupe de Contact,
- b) the Expert Group on Accounting and Auditing,
- c) the Expert Group on Common Reporting, and
- d) the Sponsor Group on Home/Host Issues.

CNB Banking Supervision employees also helped to prepare the recommendations and standards of other expert groups which the CNB does not have direct membership of, for example a recommendation to validate the advanced approaches to credit and operational risks and other issues.

At the beginning of 2005, the CEBS published consultation papers used in the preparations for the implementation of the new capital adequacy rules into the Czech legislation, and in particular into a new CNB decree.

The main topics addressed by the CEBS Committee and its working groups in 2005 were as follows:

- the completion of a basic set of recommendations for the implementation of Pillar II of the new capital framework, particularly risk assessment of banks by the supervisor, assessment of internal capital by banks, assessment of banks by the supervisor, and bank governance;
- the completion of a common framework for reporting on capital adequacy, the financial situation of banks and other regulatory requirements;
- the completion of recommendations for the assessment of external credit assessment institutions;

¹⁰ For more details, see Box 1 and Box 2

- the preparation of outsourcing standards and harmonisation of those standards across financial sectors in co-operation with the CESR and CEIOPS committees;
- the preparation of recommendations for validation of the advanced approaches to credit and operational risk management;
- the preparation of rules for monitoring and managing concentration risk, interest rate risk in the banking book and stress testing;
- the creation of requirements for uniform content and form of information disclosure by the supervisor under the new capital framework.

The CNB is interested in being an equal partner to home supervisory authorities; in having the opportunity to obtain necessary information about parent banks; in having its say in the approval of banks' models under the new capital framework, taking into account local market conditions; and in effectively supervising banks operating on the Czech market in accordance with Czech laws and regulations.

Through a technical expert, CNB Banking Supervision also worked in partnership with the Czech Ministry of Finance in preparing for and participating in the meetings of the European Banking Committee, a Lamfalussy process Level 2 committee created from the former Banking Advisory Committee (BAC). This co-operation took place primarily in the following areas:

- Cross-border mergers and acquisitions (cross-border consolidation) – preparation and discussion of a draft revision of the parts of Directive 2000/12/EC relating to the conditions for approving holdings in banks, especially the "fit and proper"¹¹ criteria, the shortening of the time limit for assessing a holding by the supervisor, joint assessment by home and host supervisors and other conditions.
- Large exposures – commencement of an examination of the part of Directive 2000/12/EC concerning the rules for large credit exposures, especially as regards clearness of definitions, reporting, the application of limits and the approach to banks of different sizes. A report on the functioning of this part of Directive, complete with proposed changes, is to be submitted to the European Parliament and the Council by 31 December 2007.
- Deposit-guarantee schemes – commencement of an examination of deposit-guarantee schemes in EU countries with the aim of ascertaining progress with the implementation of the EC Directive and the harmonisation of rules.
- Electronic money institutions – commencement of an examination of the rules for electronic money issuers and their suitability for mobile operators. This should result in a proposal to revise Directive 2000/46/EC.
- Mortgage loans – commencement of an examination of the systems of operation of rules for mortgage loans with the aim of integrating these rules within the EU.
- Own funds – commencement of an examination of the composition of own funds in individual countries for the purposes of calculating the basic prudential indicator of banks (capital adequacy). This should result in a proposal to revise Directive 93/6/EEC by 31 December 2008.

These specific projects are continuing in 2006. They are implementing the European Commission's financial services strategy for 2005–2010, which builds on the completed FSAP programme. CNB Banking Supervision, along with the other Czech financial market regulators, made comments on the European Commission's strategic document "Green Paper on Financial Services Policy (2005–2010)", which was submitted for public consultation in May 2005. The Ministry of Finance prepared the common position of the Czech Republic.

In this position, the Czech Republic expressed its support for the general objectives and main political orientation of the European Commission in the financial services area, stating that these may contribute significantly to market integration. In

11 Professional ability, experience and integrity.

particular, it supports the priorities in the area of better regulation, transposition, enforcement and evaluation, which the Commission has proposed with the objective of creating the same (comparable) legislative requirements across the financial sectors in areas where this can be achieved. However, the Czech Republic warned against over-zealous bureaucracy in evaluating the transposition of directives. It drew attention to the need for effective co-operation with the ECB, which formulates a range of analyses and reports which the Commission could make use of. It also expressed its support for the existing regulatory framework, which should remain, where possible, at a high level of generality. The tools available to the supervisory authorities are considered to be sufficient. Better use of the existing tools is preferred to the introduction of new instruments. The Czech Republic stated that control by a home supervisory authority should not be proclaimed as the main concept of supervision, given that significant barriers preventing the extension of this concept are known (the central bank's function as lender of last resort, legal responsibility for undertaking supervision and the deposit-guarantee scheme at national level and other issues).

After the end of the consultation period, the European Commission in November 2005 issued a "White Paper on Financial Services Policy (2005–2010)", setting out the following four objectives:

- in the area of financial services to move further towards an integrated and economically efficient EU financial market;
- to remove the remaining economic barriers so financial services can be provided throughout the EU at the lowest possible cost – with effective levels of prudential and conduct of business regulation, resulting in high levels of financial stability and consumer protection;
- to implement, enforce and continuously evaluate the existing legislation and to apply rigorously the better regulation agenda to all future initiatives;
- to enhance supervisory co-operation and convergence in the EU, deepen relations with other global financial marketplaces and strengthen European influence globally.

The EC states that the new policy is not focused primarily on new legislative measures, but is oriented towards strengthening regulatory and supervisory mechanisms and making them more effective and creating conditions to facilitate cross-border consolidation in the EU. It is expected that the new policy will involve only a limited number of well-targeted legislative initiatives.

These legislative initiatives concern, among other things, integration of the EU mortgage credit market; the creation of a single market for consumer credit and the improvement of consumer protection; the creation of a single European payment area; new solvency rules for insurance companies and consolidation with other rules for insurance companies; a review of qualifying holdings to support cross-border mergers and acquisitions; cross-border securities clearing and settlement; and an evaluation of the E-money Directive.

The future initiatives under consideration consist in ensuring consistent implementation of securities trading law and in taking action to integrate the retail services market.¹²

CNB Banking Supervision gained highly valuable experience in the discussions on the draft amendments to the relevant EC directives on the new capital framework in the working groups of the European Commission and ECOFIN. These discussions continued up until the completion of the work on the amended Directives 2000/12/EC and 93/6/EEC in July 2005.

¹² For details, see the White Paper.

At the beginning of 2006, CNB Banking Supervision nominated its representative for the European Commission's new "Capital Requirements Transposition Group". This group deals with the interpretation of the aforementioned directives through which the new capital framework is being introduced in the EU.

9.2 CO-OPERATION WITHIN THE STRUCTURES OF THE EUROPEAN CENTRAL BANK

The CNB has two representatives on the ECB's Banking Supervision Committee (BSC). One of them represents CNB Banking Supervision and the other represents the Financial Stability Section. The CNB is similarly represented in working groups established by and reporting to the BSC, namely the Working Group on Macro-Prudential Analyses (WGMA) and the Working Group on Developments in Banking (WGDB). The CNB also expects to participate in the Working Group on Credit Registers (WGCR). Such co-operation in the credit register area would be beneficial to the CNB as a supervisor and also to Czech banks, since the CNB operates a register of loans of legal entities and sole traders which has comparable parameters to those in other Member States. Active involvement in the exchange of information contained in credit registers depends on the support of the Czech banks represented in the Czech Banking Association. Negotiations have been opened in this respect.

In 2005, the BSC's activities focused on three basic areas: analysis and monitoring of financial stability and the cyclical and structural development of the European banking system, analyses of the effect of regulatory requirements on financial stability, the structure of the banking sector and the economy, and the promotion of co-operation between central banks and supervisors. The CNB helped to prepare documents on these topics within the two aforementioned working groups.

The documents prepared by the WGMA included:

- a financial stability report for the EU banking sector;
- a study of stress testing methods and the use of stress testing;
- a review of large banks' exposures to large enterprises and a study of the effect of changes in bank-loan corporate financing on the condition of banks;
- an analysis of the impacts of IFRS on banks' financial reporting and behaviour;
- an analysis of hedge funds;
- a review of the methods and possibilities for providing data on banks' interest rate risk and the use of the data in banking/financial stability analyses;
- the issue of the collection and use of data for stress testing at the micro-level.

The documents prepared by the WGDB included:

- projects relating to banking business risks;
- partial studies focused on banks' liquidity risk management, consumer credit, syndicated loans and corporate financing and a survey for an aggregate study on bank risks and expected developments in the banking sector over the next five years;
- the issue of competition on the mortgage credit market;
- an annual report on structural developments in the EU banking sector.

These objectives can only be achieved through active co-operation at international level. The CNB was involved in the preparation of the revised "Core Principles for Effective Banking Supervision" and the principles for implementing the new capital framework (Basel II) through the participation of its representatives in the Core Principles Liaison Group (CPLG) and in the CPLG's Working Group on Capital. This gave the CNB access to the latest information and enabled it to voice its opinion on issues of interest to it and, at least to some extent, to shape the new rules.

9.3 CO-OPERATION WITHIN THE BASEL COMMITTEE ON BANKING SUPERVISION (BCBS)

The main role of the BCBS is to provide a platform for regular discussion of banking supervisory issues in the G10 countries. Recently, however, it has been dealing ever more with the development of regulation. The CNB Banking Supervision has representatives in the Core Principles Liaison Group and the Core Principles Working Group. Two meetings of these groups were held in 2005, focused primarily on key aspects of the new capital adequacy framework (e.g. national discretion, principles of co-operation between home and host supervisors) and on the creation of the revised Core Principles for Effective Banking Supervision, which should be in line with best international practices. The draft revised Core Principles are intended to:

- reflect the development of services in the banking sector;
- eliminate duplications;
- align the principles with international standards;
- make some of the principles more specific;
- maintain continuity, simplicity, flexibility and universal applicability and to keep the same number of principles.

The revised principles are expected to be approved in the second half of 2006 and officially announced at an international conference of regulators in Mexico in October 2006.

9.4 CO-OPERATION WITH PARTNER SUPERVISORY AUTHORITIES

Co-operation with partner banking supervisors continued in 2005. This concentrated on the exchange of information on banks of mutual interest and procedures for the implementation of the new capital adequacy framework (Basel II).

The area of memoranda of understanding (MoU) remains unchanged. The CNB has so far signed eight memoranda of understanding (the same figure as in 2004): with the Netherlands, Italy, Slovakia, Austria, Germany, the USA (or, more precisely, the State of New York), Belgium and France. An MoU with the Russian Federation is still under negotiation and is conditional on agreement being reached on the terms and conditions for co-operation with Russia at the EU level. The negotiations organised under an agreement between Groupe de Contact members and the representatives of the Russian central bank continued in 2005.

Practical co-operation between supervisors also continued in 2005 both in written form and in the form of working meetings. Meetings were held primarily with partners from the countries whose banks have a major share of the Czech banking market (Austria, Germany and Belgium). The meetings always dealt with two basic topics: exchange of information on the financial position of parent banks and subsidiaries, and exchange of information on, and experience with, the procedures used by supervisors in the preparations for Basel II implementation.

The CNB emphasised the issue of Basel II implementation to its partner supervisory authorities at various forums. For CNB Banking Supervision, which is in the position of host supervisor, it is highly desirable that the content and forms of specific co-operation in the approval of applications, the validation of models and the continuous oversight of banks that apply for approval of advanced risk management methods under Basel II are set in such a way that they provide the banks concerned with clear information on treatment within the group.

9.5 CO-OPERATION WITHIN THE GROUP OF BANKING SUPERVISORS FROM CENTRAL AND EASTERN EUROPE

Although involvement in the structures of the European Commission and the ECB is the CNB's priority, it has not been neglecting its membership of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE).

This group, established 15 years ago, has 19 members, 9 of which are non-EU members. A two-day conference of the heads of these banking supervisory authorities is held every year to discuss current practical issues of banking regulation and supervision. The statutes of the BSCEE were amended in 2005. The main change occurred in the system of operation of the group's secretariat, which will change country every five years. At present, the secretariat is located at the Polish supervisory authority.

9.6 CO-OPERATION WITH THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK

Two World Bank pilot projects – on Corporate Governance and Insolvency of Banks – were completed at the CNB in 2005.

For CNB Banking Supervision, the application of corporate governance principles in banks is one of the key preconditions for prudent behaviour and sound operation of banks. However, the CNB does not agree with some of the recommendations of the World Bank. It is necessary to strike a balance between the benefits stemming from the proposed requirements and the negative impacts on the banking sector from inappropriate requirements leading to over-regulation. This area must always be assessed in terms of the national environment, the existing legislation and the legislation being prepared in the EU, which has to be implemented. The recommendations should also take into account current practice. The project has been a good experience for CNB Banking Supervision and has provided a platform for debate and exchange of views on specific topics in the bank governance area. The CNB has informed all interested parties about the results and recommendations of the project.

Corporate Governance

CNB Banking Supervision started addressing the issue of the legal framework for dealing with problem banks in the late 1990s. It has initiated a series of proposed legislative changes which would improve the overall framework for banks' exit from the sector, following problems that have arisen in connection with the closure of individual banks. A major complication is the lengthy and unclear reform of the bankruptcy law (prepared by the Czech Ministry of Justice). Some basic problems have been successfully resolved with the transposition of the EU directive on the reorganisation and winding up of credit institutions together with the adoption of the Act on Financial Conglomerates.

Bank insolvency

The CNB has succeeded in pushing through a number of statutory provisions which strengthen the framework for dealing with problem banks, but many questions remain open and are under discussion. These issues include in particular the concept and operation of conservatorship in banks. The issue of the legislative framework for any future efforts to economically rescue a bank or banks in difficulties with the intervention of the regulator is under discussion. The discussions are focused on a safety principle – analogous to the preliminary bankruptcy trustee – preventing any unwanted reduction in value of the assets of problem banks.

From the point of view of banks as major creditors, the reform of bankruptcy law remains unresolved. After several years of technical debate and legislative initiatives at the level of the Czech Government and Parliament, an insolvency act was passed with effect from 1 July 2007.

B. THE BANKING SECTOR IN 2005

METHODOLOGICAL NOTE

Implementation of International Financial Reporting Standards and changes thereto

Several changes to bank accounting methods were introduced on 1 January 2005, partly complicating the analytical work and reducing the information content of some time series. On that date, Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards started to be applied in the Czech Republic. Under this Regulation, issuers of listed securities must compile their consolidated financial statements for accounting periods starting 1 January 2005 or later in accordance with the International Financial Reporting Standards (IAS/IFRS) approved by the European Commission. The Czech Republic made use of the option provided for in the Regulation and extended the application of IAS/IFRS to individual financial statements. Thus, seven banks¹³ active in the Czech banking sector that are issuers of listed securities compile their financial statements in accordance with IAS/IFRS as from 1 January 2005. Their reporting to the CNB is also based on these standards. However, this change in itself is not an important complication, as the accounting procedures of the domestic banks have been broadly in line with the IFRS procedures since 1 January 2002.

The changes to the international accounting standards as such, especially IAS 39, also effective from 1 January 2005, have a more significant impact on the comparability of time series for some indicators. These changes have also been incorporated into the Czech accounting rules. Above all, the revised IAS 39 newly defined the categories of financial instruments, their content and manner of reporting.

The comparability of the 2005 and 2004 data was most affected by the new IAS/IFRS in the area of the volume and breakdown of client loans and securities. This was due to a new definition of "loans and receivables", which as from 2005 do not include bonds acquired on the primary market and quoted in an active market. The breakdown of profit from financial activities was affected by a change in the reporting of securities measured at fair value against expenses or income accounts, where accrued interest no longer needs to be presented separately. Thus, interest income from such securities does not have to be included in interest profit, but can be a part of profit from trading securities (in the area of profit from financial operations).

The most important aspects of the new rules are described in more detail in Part B of this publication, usually in the form of footnotes. In some cases the impact of these changes on the figures reported is also estimated.

Data used

All data used in this publication are for banks with a licence as of 31 December 2005, unless stated otherwise in the section heading or relevant passage. Data are always taken for the bank as a whole, i.e. including its foreign branches, with the exception of the data on the structure of loans and deposits by sector, economic activity and time, which cover bank transactions in the Czech Republic only. The data for 2005 partly reflect the results of external audits, so they may differ from data previously published by the CNB. There may be additional partial changes to the data given in this publication. However, these should not significantly affect the trends indicated.

¹³ The number of these banks increased by three during 2005.

SUMMARY

The Czech banking sector did not undergo any fundamental changes in 2005. In terms of the number of banks and their ownership, the sector has been stable in structure for several years now. More than 96% of the sector's total assets remain under direct or indirect control by foreign owners. The breakdown of ownership by country is diverse, limiting the potential adverse effects of cross-border contagion risk. Two new foreign bank branches (which, however, focus on selected groups of clients) commenced operation in the Czech Republic under the single banking licence. Two banks were merged and one was converted into a foreign bank branch.

The banking sector generated unconsolidated net profit of CZK 39.1 billion in 2005. This is an increase of CZK 6.3 billion (19.1%) in year-on-year comparison. The increase in net profit was due mainly to a significant rise in the main components of profit from financial activities (interest profit in particular), continuing control of operating expenses and low costs from the creation of provisions. A reduction in the contribution to the Deposit Insurance Fund also had a positive effect. Interest income is being driven primarily by a growing volume of loans provided, while income from fees and commissions is being aided chiefly by an increasing number of transactions and by growth in the number of loans provided and the number of clients investing in alternative products. However, the level of fees paid by clients for the individual services was broadly flat in 2005 due to competitive pressures and strong interest of the media in this issue. Some banks slightly reduced or cancelled some of their fees to make their price lists simpler and more transparent. As in previous years, profit was positively affected by a number of specific one-off transactions (results of legal disputes, extraordinary dividends, sales of interests and real estate, release of reserves).

Banks were interested most of all in lending to households. Loans to this sector rose by CZK 96.2 billion (34%) year on year to CZK 379.5 billion, owing mainly to mortgage loans. This significant increase was due mainly to the favourable environment of low interest rates, strong demand from the baby-boomers of the 1970s, who are now addressing their housing needs, and the still high volumes of liquid assets held by banks. Loans to non-financial corporations rose by CZK 66 billion (14.4%). Banks' interest in co-financing corporate projects subsidised from EU funds increased.

Banks continued to strengthen their focus on the expanding area of alternative investment and saving products, especially the sale of pension and mutual funds, life insurance, etc. These products are often managed by subsidiaries of the bank's financial group or the parent company's financial group. Many banks are seeking to achieve a competitive edge by improving and updating their services. This applies, for instance, to direct banking services, the expansion of the ATM network (including new features enabling the intermediation of other transactions, e.g. payment orders, and enhancing their user-friendliness, e.g. ATMs for blind people) and the increasing number of chip payment cards.

The risks undertaken did not change much in 2005. Credit risk remains the most important risk, with its importance still growing due to the increasing volume of loans provided. The volume of non-performing loans increased slightly. However, their share in total loans remains low (at 4.3%) as a result of the strong growth in the loan portfolio. Domestic banks remain more or less local, as reflected in the relatively low shares of transactions with non-residents and foreign currency activities. As regards securities, banks invest most in government bonds and, to a lesser extent, in corporate bonds. The volumes of shares or units held by banks are negligible. Despite the significant expansion of the loan portfolio, banks continue to report relatively large volumes of quick assets in their balance sheets.

Together with the continuing confidence in the banking sector, this minimises liquidity risk.

The capital adequacy ratio of the banking sector was 11.86% as of 31 December 2005. As a result of the strong expansion of the loan portfolio, the increase in capital requirements was higher than the rise in regulatory capital. Consequently, the capital adequacy ratio decreased by 0.69 percentage point year on year. Nevertheless, this still safely exceeds the minimum requirement of 8%, which was met by all banks in 2005. Some of them, however, may run into capital constraints while developing their activities further.

We do not anticipate any major stimuli that might adversely affect the current trends in the banking sector in 2006. We expect the structure of the sector to remain broadly unchanged. Interest in lending to the corporate sector and above all to households will remain strong. Alternative distribution channels, especially electronic banking, will continue to gain ground. The relatively favourable economic situation will again have a positive impact on the financial results of the banking sector.

1. THE ECONOMIC ENVIRONMENT IN 2005

The macroeconomic developments in the Czech Republic in 2005 were favourable, with economic growth picking up significantly and inflation remaining low. As in previous years, economic growth in the Czech Republic was faster than in the old EU Member States and also than in Germany, which has long been the Czech Republic's biggest trading partner. Economic growth was driven primarily by exports, with exports of goods and services growing considerably faster than imports in this time period. The effect of investment and both household and government consumption, which had previously been the main factors underlying economic growth, gradually weakened at the beginning of 2005. GDP totalled CZK 2,931.1 billion at current prices in 2005. The growth rate of real GDP was 6.0%, an increase of 1.3 percentage points on a year earlier.

The positive economic developments and the pick-up in economic growth were reflected in a stronger international economic position of the Czech Republic. The factors affecting total GDP growth changed in 2005 compared to a year earlier. Favourable net exports were the most important factor. The export growth was linked with a recovery in investment and export activity in the European Union. Production facilities created by foreign direct investment are beginning to have a positive effect. Household consumption also contributed slightly to the GDP growth, as did gross capital formation in 2005 H2. Unlike in 2004, government consumption did not contribute to the GDP growth. The positive economic developments were reflected in a 9.4% rise in lending in 2005. Export growth was more than twice as fast as import growth. The improved export performance is becoming a factor significantly supporting economic growth. For a small open economy, this is an exceptionally favourable phenomenon. As a result of the favourable macroeconomic developments, the current account deficit as a percentage of GDP fell by 3.9 percentage points to 2.1% in 2005. The financial account also developed favourably, ending in a surplus of CZK 137.9 billion despite a rising volume of repatriated earnings of foreign investors operating in the Czech Republic following the massive inflow of foreign investment into the country. The good trade results had a positive effect on the external balance. Exporters managed to adapt to the market conditions in the European Union and made perfect use of the economic recovery in their trading partners' countries. The efficient use of the production capacity of the domestic economy resulted in an increase in the annual growth rate of industrial production of 6.7% in 2005. The improvement in the balance of payments continued, with the current account deficit of CZK 61.7 billion (much lower than a year earlier) being offset by the capital and financial accounts despite a rising outflow of income abroad, especially in the form of dividends. The surplus on the financial account of CZK 137.9 billion was roughly one quarter lower than in 2004. Portfolio and other investment saw a reversal in trend in 2005. Unlike in the previous year, they recorded an overall outflow from the Czech Republic.

Inflation was 1.9% on average in 2005, which is 0.9 percentage point lower than a year earlier. During the year, inflation was affected mainly by movements in food and energy prices. Falling agricultural producer prices and food commodity importer prices were reflected in the decrease in inflation. Prices were also influenced by some changes to regulated prices and indirect taxes. Consumer price inflation was below the inflation level in the EU countries in the first three quarters of 2005 and only slightly higher in the final quarter.

The koruna's appreciation trend vis-à-vis the main currencies stabilised in 2005 compared to the previous periods and became one of the factors underlying the low inflation level. This was due to the strengthening of the dollar against the euro for most of the year. The koruna appreciated against both these currencies, in which the bulk of exports and imports are traded. From an annual average of

CZK 31.90 to the euro in 2004, the koruna strengthened to CZK 29.78 to the euro in 2005. The koruna's average exchange rate against the dollar firmed from CZK 25.70 to CZK 23.95 in year-on-year terms.

Despite the favourable position of the economy in an upward phase of the business cycle, the labour market improved only slowly amid the low inflation. Long-term unemployment was flat for the second year running, at 4.3% on average. The labour market was very volatile in the individual months of the year. As usual, seasonal factors had particularly adverse effects. The registered unemployment rate was 8.9% on average under the existing methodology. The ratio between productivity and real wages further improved amid tough competition in 2005. The average monthly nominal wage of employees increased by 5.4% year on year, 1.2 percentage points less than a year earlier. At 5.0%, aggregate labour productivity growth lagged slightly behind the growth in nominal wages. Unit wage costs fell by 1.3%. At 3.4%, average real wage growth was 0.3 percentage point lower than in 2004.

The public budgets have regularly recorded deficits in recent years. One positive phenomenon in 2005 was the fact that the state budget deficit was considerably lower than expected. At CZK 56.3 billion, it was the lowest deficit in three years. This relatively favourable result was due both to higher revenues and to lower expenditure. To improve the public finance position it will be necessary to implement, together with a public finance reform, fundamental reforms of the pension and health care systems.

In line with its primary objective of maintaining price stability, the central bank cut its key interest rates three times in 2005. There was one upward correction in Q4. These monetary policy decisions were based on findings regarding the key indicator of economic growth, with headline and net annual inflation also being taken into account. The rate changes also reflected the external economic environment and the level of interest rates in the euro area. The key domestic interest rates were cut as follows: the two-week repo rate from an initial level of 2.5% to 2.0%, the discount rate from 1.5% to 1.0%, and the Lombard rate from 3.5% to 3.0%.

2. THE STRUCTURE OF THE CZECH BANKING SECTOR

2.1 NUMBER OF BANKS

(for banks with licences as of the given date)

As of 31 December 2005, the Czech banking sector consisted of 36 banks and foreign bank branches. Their number was up by one bank compared to the end of the previous year. The structure of the banking sector underwent partial changes. Two entities operating on the domestic banking market merged in 2005. Following the merger of BAWAG Bank CZ and BAWAG International Bank CZ, only one entity, called BAWAG Bank CZ, is now active in the Czech Republic. As from 1 November 2005, the former medium-sized bank CALYON BANK CZECH REPUBLIC, a.s., was converted into a foreign bank branch called CALYON S.A, organizační složka, under the single licence. Two foreign bank branches started operation in 2005, namely Austria's PRIVAT BANK AG der Raiffeisenlandesbank Oberösterreich, pobočka Česká republika, in January, and Belgium's Fortis Bank SA/NV, pobočka Česká republika, in August.

Changes in the names of some banking entities did not affect the structure of the sector. On 1 January 2005, Všeobecná stavební spořitelna Komerční banky changed its name to Modrá pyramida stavební spořitelna and GE Capital Bank was renamed GE Money Bank in mid-January 2005.

The breakdown of banking entities into bank groups, known as "peer groups"¹⁴, remained virtually unchanged in 2005. The group of four large universal banks providing a broad range of banking products and services still accounts for the majority of the banking sector's total assets. Their banking activities are geared mainly towards the domestic banking market. Corporations and retail customers remain their target clients. These segments have growth potential on both the demand and supply side and account for an ever-increasing share of the funds provided to finance the business activities of small and medium-sized enterprises. Foreign ownership predominates in all large banks, three of which have undergone privatisation. The entry of strategic partners has led to a strengthening of their banking activities and an expansion in new products, and the transfer of know-how has had a positive effect on their banking business.

The consolidation trend visible in international and European banking is affecting the domestic banking sector primarily as a result of mergers and acquisitions of foreign parent banks through their subsidiaries operating on the Czech market. The process of formation of financial groups is continuing in the Czech banking sector. This process is going on broadly across the financial sector, with banking entities heavily involved. The most important bank-led banking financial groups in the Czech Republic are those of Československá obchodní banka, a.s., Česká spořitelna, a.s., and Komerční banka, a.s., which are members of their foreign parent banks' financial groups. These financial groups market a diverse range of financial services. Banking products and services are the mainstay of banking financial groups, complemented by a range of investment opportunities in investment funds, pension funds and products of insurance, factoring, leasing and consulting companies. Financial groups usually include a building society. The structure of financial groups is being optimised, *inter alia*, with regard to the parent company's financial group and its plans for the domestic market and further expansion, especially in Central and Eastern Europe.

¹⁴ For the purposes of the analysis, we use the traditional breakdown into five groups: large banks, medium-sized banks, small banks, building societies and foreign bank branches. A list of the banks assigned to each group is given in Part C – Annexes.

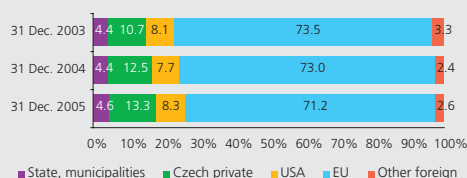
Following the Czech Republic's accession to the EU in 2004, banks from EU countries may enter the liberalised banking market and offer their products and services under the single banking licence. By the end of 2005, a total of 106 foreign banks from EU countries had notified the Czech National Bank of their intention to provide some or all of the mutually recognised banking activities under cross-border banking in the Czech Republic pursuant to Article 21 of Directive 2000/12/EC.¹⁵ Two Czech banks had declared their interest in cross-border provision of services by the same date.

One Czech bank had opened a branch in the EU under the single licence by the end of 2005.

2.2 OWNERSHIP STRUCTURE

(for banks with licences as of the given date, excluding foreign bank branches)

CHART 1
BANK OWNERSHIP STRUCTURE
for banks with licences as of the given date

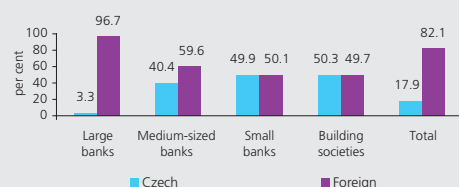


The ownership structure of the banking sector changed slightly in 2005 as a result of changes in the structure of the banking sector. The total capital of the banking sector decreased by CZK 0.6 billion due to the merger of two entities operating on the Czech market to form a new bank BAWAG Bank CZ. The conversion of CALYON BANK into a foreign bank branch also led to a decline in the sector's total capital. However, many banks operating on the domestic market increased their capital owing to a significant expansion of their business activities.

As of 31 December 2005, the banking sector had capital totalling CZK 69.8 billion. The share of foreign capital in total capital fell slightly to 82.1% at the end of 2005, down by 1 percentage point from a year earlier. Owners from European Union countries accounted for most of this decrease, owing to structural changes. Conversely, the 0.8 percentage point rise in the share of Czech private owners of banks based in the Czech Republic, as well as the increase in the share of the state and municipalities, was due to capital growth related to expansion of business. The share of US-based owners in total capital also recorded a moderate rise.

With a share of 96.7%, foreign capital dominates in the group of large banks. In medium-sized and small banks the share of foreign capital also exceeds 50%. Building societies were the only bank group where foreign capital accounted for less than one-half of capital (just below 50%) at the end of 2005. Building societies are usually members of the financial groups of large banks, which are subsidiaries of foreign banks.

CHART 2
CAPITAL ORIGIN AS OF 31 DECEMBER 2005
for banks with licences as of 31 December 2005



The prevailing trend of a high proportion of foreign capital was also visible in the individual banks. As of 31 December 2005, eight out of the total of 24 banks (excluding foreign bank branches) were exclusively owned by foreign capital, and in another seven foreign capital predominated. Conversely, domestic capital prevailed in eight banks, three of which, however, were subsidiaries of domestic banks that are foreign owned. One building society also continues to have equal shares of domestic and foreign capital. The state and municipalities have long-term stakes in two banks, which specialise in delivering state programmes of support to exporters and small and medium-sized enterprises.

¹⁵ In addition to banks, one financial institution and one institution authorised to issue electronic money instruments announced their intention to operate in the Czech Republic under the single licence. An up-to-date list of these institutions is available in the *Banking supervision* section of the CNB's website.

The strong position of foreign capital manifests itself even more markedly through direct and indirect control of total assets. At the end of 2005, foreign shareholders exercised direct control¹⁶ of 84.4% of the total assets of the banking sector. The share is much higher if indirect control is taken into account, i.e. if the subsidiaries of the large Czech banks that are owned by major foreign banks are included. From that perspective, 96.2% of total assets were controlled by foreign owners, a very slight increase of 0.1 percentage point compared to the end of 2004. This annual increase was due mainly to a decrease in the total assets of state-owned banks.¹⁷

2.3 EMPLOYEES AND BANKING UNITS

(for banks with licences as of the given date)

The number of employees in the banking sector continued decreasing in 2005, albeit at a much slower pace. At the end of 2005, the banking sector employed 37,540 people, a decrease of 1.6% from a year earlier. A total of 620 employees left the sector. As no bank closed down, the decrease was due to restructuring and cost-cutting. In 2005, the number of employees changed in all banks. The changes also reflected the altered structure of the banking sector. The reduction in the number of employees mainly affected the large bank group, whose structure remained unchanged. The 3% decrease in this group was in line with the strategic plan to increase the efficiency of banking business. Employment in the building society group was stable. The increase in the number of employees of the medium-sized bank group was due mainly to the changes in the structure of this group (compared to the end of 2004, two small banks entered this group and one bank was converted into a branch). However, the number of employees rose even taking into account this effect, by 1.7%. The 10% fall in the number of employees in small banks reflected the decrease in the number of such banks. The expansion of the foreign bank branch group was accompanied by an increase in the number of its employees of almost 20% and a rise in the number of entities in this group of 33%.

The rationalisation of banking activities and rising efficiency are characterised by changes in the number of both employees and banking units. The highly competitive environment on the domestic banking market is forcing banks to expand the range of banking services they offer. In the expanding market, they are employing alternative distribution channels, direct banking and business network sharing within financial groups. They are also streamlining their existing branch networks. The branch network is going through a partial restructuring, with the distribution of banking units being tailored to changing client needs and current shifts in demand. The number of banking units rose by 3.2% in 2005. A total of 1,931 banking units served the clients of domestic banks in the Czech Republic and abroad, of which 106 were located outside the Czech Republic. The vast majority of those were in Slovakia. Besides the aforementioned changes in the structure of bank groups, the development of the branch network was affected by the different approaches of the individual banks and their groups. A different approach was adopted in particular by large banks, which had previously focused mainly on establishing networks of banking units. Their current aim is to achieve a rational distribution of units, make efficient use of those units and optimise their networks in terms of client service. Business network sharing fosters higher income

CHART 3
STRUCTURE OF TOTAL ASSETS BY OWNER AS OF 31 DECEMBER 2005

for banks with licences as of 31 December 2005

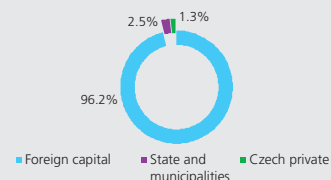


CHART 4
STRUCTURE OF BANKING UNITS AND EMPLOYEES BY BANK GROUP

for banks with licences as of the given date

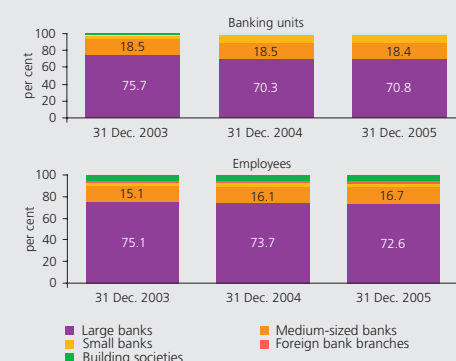


TABLE 1
NUMBER OF EMPLOYEES AND BANKING UNITS IN THE BANKING SECTOR

for banks with licences as of the given date

	31 Dec 99	31 Dec 00	31 Dec 01	31 Dec 02	31 Dec 03	31 Dec 04	31 Dec 05
Number of employees (thous.)	49.4	45.5	40.9	40.6	39.0	38.2	37.5
Number of banking units (thous.)	2.0	1.8	1.8	1.8	1.7	1.9	1.9
Number of employees per bank (thous.)	1.2	1.1	1.1	1.1	1.1	1.1	1.0
per banking unit	24.6	25.2	23.3	22.8	23.4	20.4	19.4
Number of citizens per bank (thous.)	244.7	256.7	270.3	275.0	291.7	292.0	284.8
per banking unit (thous.)	5.1	5.7	5.9	5.7	6.1	5.5	5.3
per employee	208.2	225.6	251.3	250.5	261.8	267.8	273.1

¹⁶ Direct control means a share in equity capital of more than 50% (including foreign bank branches).

¹⁷ Some aspects of the prevailing foreign ownership in the banking sector are also discussed in the publication *Financial Stability Report 2005* (section 4.8 *International aspects*).

per client through cross-selling of the financial group members' products. Banking activities still have growth potential. In this group of banks, such potential is visible in client service rationalisation and branch network expansion. In absolute terms, the number of banking units of large banks increased by 51 year on year. This reinforced the position of large banks in the banking sector. Building societies reduced their business network by one unit. They have the advantage of being able to use the core distribution network shared within the financial group they belong to, and they also use the services of independent distributors. The expansion of medium-sized banks, foreign bank branches and small banks is focused on retail clients. This strategy is linked with the expansion of their retail networks and the building of direct relationships between client and bank. Small banks, whose number decreased by one compared to 2004, account for 9.1% of the banking sector's retail network.

The growth potential of the banking business is based on ever-increasing use of banking products and services by clients. Banking transactions have become an integral part of people's professional and personal lives. Banks' clients include large corporations, medium-sized and small enterprises, an increasing number of institutions, self-employed people, residents and non-residents. Banks are offering their clients a wider range of innovative services provided in an increasingly convenient manner. In the environment of ever-growing competition, banks are trying to streamline their business activities and increase the efficiency of bank business. Banks are increasingly focusing on retail clients. The provision of services to this client segment involves the processing of large numbers of banking transactions. It is time-consuming and requires adaptation of banking processes. Banks usually achieve these goals by restructuring service provision in their branch networks, frequently by offering the services of personal bankers. In an endeavour to boost efficiency, banks are trying to encourage their clients to use alternative service channels. Electronic banking rationalises banking processes and transactions and gives clients 24-hour access to the bank.

In 2005, the banking sector in this way achieved higher productivity as measured in terms of the number of citizens per bank and per banking unit and the number of bank clients per bank employee. The upward trend in banking business efficiency is continuing. The number of potential bank clients in the Czech Republic grew slightly in 2005 in line with the increase in the total population to 10,251,100 and with the rise in the number of foreign visitors and non-residents. The number of citizens per bank fell by 7,264 to 284,800 as a result of the entry of one new entity into the banking sector. The number of citizens per banking unit also recorded a slight decrease, to 5,300, due to faster development of retail networks. Thanks to work process rationalisation and innovation, enhanced productivity and the continuing downward trend in the total number of employees in the banking sector, one bank employee is ready to serve a total of 273.1 citizens. Productivity measured in this way increased again in 2005, by 2.0%. The number of clients served by the banking sector is further increased by foreign visitors, while branch networks abroad serve banks' clients abroad as well as local people and companies.

Banks are striving for close contacts with their clients, who now have direct access to personal bankers at branches. In line with these aims, the structure of banking units has been gradually changing. Thanks to the employment of new technology and process rationalisation, the number of employees per banking unit fell to 19.4. The rationalisation of activities visible in retail branch networks is also taking place in back offices and usually across the entire financial group.

The volume of assets managed per banking unit is another indicator of the rationalisation of banking activities. The steady upward trend in assets managed also reflects the rising frequency of banking transactions and the ever wider use of

banking products. The extent and quality of banking services in the Czech Republic, which are becoming an integral part of people's lives, is continuing to converge towards that in the old member countries of the European Union. At the end of 2005, assets exceeding CZK 1.5 billion were being managed per banking unit, a year-on-year increase of 8.6%. Large banks and building societies were the biggest contributors to this increase, recording rises of 10.6% and almost 27%, respectively. Building societies establish their own networks to only a limited extent, as they share the networks of their financial groups. Assets managed per banking unit were as usual higher than average in foreign bank branches as well as building societies. Foreign bank branches also have specific clients. They focus chiefly on corporate clients, usually serving only certain regions or providing a limited range of banking products. They offer their services only through their own banking units and generally do not focus on retail clients. The indicators for the small and medium-sized bank groups are affected by the changes in their structure. The higher level of assets managed per banking unit in medium-sized banks was influenced by the merger of two entities into one medium-sized bank. Small banks remained at the usual level even though their number decreased.

The trends in productivity as measured by total assets per employee are identical with those in productivity as measured by total assets per banking unit. At the end of 2005, one employee managed balance-sheet assets amounting to CZK 78.7 million on average. This figure was up by CZK 9.6 million (or 13.9%) per employee compared to 2004. Given the low inflation, this increase was due chiefly to improved performance of the banking sector. The trend towards more intensive staff utilisation in the banking sector was visible in nearly all bank groups. Most important for the banking sector as a whole was the trend in the large bank group, whose structure was stable throughout 2005. Each employee in this group managed balance-sheet assets of CZK 66.3 million. Medium-sized banks recorded a similar trend and slightly higher figures, with each employee managing balance-sheet assets of CZK 71.2 billion in 2005. The indicators of assets managed for small banks increase every year as a result of the effort of these banks to expand their activities. Assets per employee in foreign bank branches decreased year on year due to the entry of new entities into the domestic market and a rise in the number of employees. The current quantitative increase may manifest itself in the qualitative measures in the years to come. By contrast, the expansion of the activities of building societies, their stabilised structure and their optimised processes for traditional building saving schemes are generating steady increases in productivity. At the end of 2005, balance-sheet assets managed by building society employees were up by 13.4% on a year earlier, a growth rate similar to that in large banks. In the case of building societies, however, this is indicator is influenced by the widespread use of external representatives to sell building saving schemes.

2.4 NEW TECHNOLOGY

Technological development influences both the global economy and everyday life and has a significant impact on dynamic sectors such as banking. In line with global banking trends, the domestic banking sector is making increasing use of new technology. Banks use it to offer their clients new sophisticated products, develop banking services and increase the convenience and availability of services. New technology is also applied in internal processes, optimisation of client service activities and client identification. It also plays an important role in enhancing the security of banking services, ensuring control functions and reducing risk. It can also help banks to cut costs, rationalise staff numbers and optimise business networks. New technology is crucial to the processing and evaluation of banking information and to fast data transfer. Various forms of electronic banking have emerged on the basis of new technology, leading to enhanced quality, range

CHART 5
TOTAL ASSETS MANAGED PER BANKING UNIT
for banks with licences as of the given date

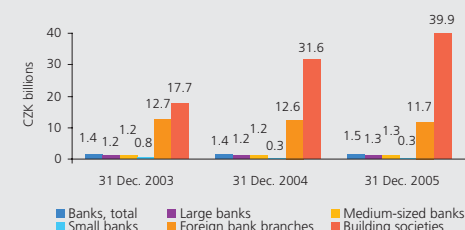


CHART 6
TOTAL ASSETS MANAGED PER EMPLOYEE
for banks with licences as of the given date

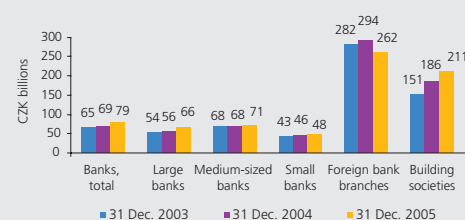


TABLE 2
SELECTED TYPES OF PAYMENT CARDS, ATMS AND ATM NETWORKS

for banks with licences as of the given date

	31 Dec. 99	31 Dec. 00	31 Dec. 01	31 Dec. 02	31 Dec. 03	31 Dec. 04	31 Dec. 05
Number of ATM networks	4	4	4	4	4	4	4
Number of ATMs	1,499	1,602	1,923	2,254	2,669	2,750	2,915
Annual number of ATM transactions (millions)	70.0	85.8	100.7	106.8	116.8	125.3	136.9
Annual ATM transaction turnover (CZK billions)	128.0	175.5	232.7	285.4	352.3	397.9	443.4
Cash withdrawal cards (thous.)	2,784.5	3,976.6	4,556.3	5,768.9	6,373.6	6,720.8	7,433.0
Debit cards (thous.)	2,790.0	3,960.4	4,516.3	5,658.3	5,803.1	6,174.0	6,555.5
Credit cards (thous.)	5.6	38.7	53.2	113.2	206.2	402.4	872.3
Number of terminals	8,962	13,187	17,931	25,358	31,678	44,404	52,683
Annual number of card payments (millions)	6.0	14.5	26.6	41.0	55.1	58.4	79.3
Annual card payment turnover (CZK billions)	14.0	27.0	44.7	52.5	61.3	65.9	88.0

Note: Cards issued by banks only, including for other companies

and availability of services. New technology has also become a weapon in the competitive struggle between banks.

The payment system is one of the areas that is fundamentally affected by new banking trends, especially with regard to new technology. Banks and other financial institutions offer a wide variety of payment instruments and methods. Non-cash payment for goods and services has become prevalent. In this area, banks are responding to client demand based on changing lifestyles. Now that having a bank account is a necessity and using ATMs to withdraw cash is commonplace, competition is focused on offering various types of payment and credit cards and enhancing the quality and security of card transactions.

The four ATM networks operating in the Czech Republic continue to provide the traditional range of services, fully covering clients' needs and creating a sufficiently competitive environment. At the end of 2005, a total of 2,915 ATMs were in service. At 6% year on year, the rate of introduction of new of ATMs was again faster than a year earlier. All existing ATMs were used ever more frequently, with the number of transactions growing by 9.3% year on year. Even faster growth (of 11.4%) was recorded for the volume of ATM transactions since the end of 2004, which may be due partly to the fee policies of banks, which are encouraging a lower transaction frequency and higher transaction volumes. Banks are enabling clients to optimise the fees charged for ATM use within their own ATM networks by offering special packages including a pre-set number of withdrawals free of charge. The factors underlying the increase in the average amount per ATM transaction to CZK 3,238.90 include moderate growth in prices due to inflation and regular growth in wages and other income remitted to bank accounts.

The use of payment cards has become part of everyday life. As a result, the card market is expanding. Cash withdrawal cards remain the largest group with 7,433,000 cards, an increase of 10.6% in 2005. Clients are demanding cards that can also be used for payments. A total of 6,555,500 of these had been issued by 31 December 2005, up by 6.2% on a year earlier. The expansion on the credit card market is being amplified by a still low base. The number of credit cards approximately doubled for the fourth consecutive year, reaching 872,300 at the end of 2005. Their share in the total number of cards issued also doubled, to almost 12%. Credit cards, which allow credit to be drawn under predefined conditions and up to a contractually determined limit, are one of the factors underlying the increase in household debt. The volume of card payments rose by a full one-third in 2005. Even these high growth rates in card payment volumes did not change the previous trends. Card payments still amounted to only 19.8% of the volume of ATM cash withdrawals. This can be attributed to the conservative behaviour of a part of the population and the still not fully developed network of retailers accepting payment cards. It is also affected by fee policies under which clients can save some money by paying in cash. The number of card payment terminals increased by 18.6% in 2005. Payment cards are offered by nearly all banks, although some banks specialise in these products to a larger extent. This depends on the bank's target client segment. Card payments outside the Czech Republic are becoming increasingly popular with bank clients. Payments amounting to 13.8% of the total annual card payment turnover were made outside the Czech Republic.

Banks regard these trends in banking as crucial and expect them to continue. They can be expected to optimise their ATM networks and extend the range of services provided. It can be predicted that domestic banks will expand the supply and enhance the security features of payment and credit cards. For example, banks are increasingly including chip cards in their product ranges.

2.5 CONCENTRATION

(for banks with licences as of the given date)

The Czech banking sector remains broadly stabilised with respect to structure. The changes that occurred in 2005 stemmed from a need to adapt to market conditions, from organic growth and from utilisation of the opportunities offered by the single banking licence to financial institutions licensed in EU countries. At the decision of the shareholder, a new medium-sized bank was established through the merger of one medium-sized and one small bank. And, on the basis of a strategic decision made by its parent bank, one medium-sized bank was converted into a foreign bank branch operating in the Czech Republic under the single banking licence. In addition, two new foreign bank branches whose parent banks are based in the EU entered the market under the single banking licence.

Compared to the end of 2004, the position of the domestic banking sector weakened slightly in terms of size of equity capital (excluding foreign bank branches). The total equity capital of the banking sector fell by CZK 0.6 billion year on year. One bank left each of the groups of banks with equity capital ranging from CZK 1.0 billion to CZK 2.4 billion and from CZK 0.5 billion to CZK 0.9 billion, owing to a merger and a conversion to a foreign bank branch. The structure of the two groups with the highest capitalisation remained stable in 2005. In the coming year, we can expect some banks to move to the higher capital categories in order to strengthen their market position following the expansion of their banking activities, especially in the area of lending to households. The preparation for, and implementation of, the new capital framework (Basel II) could be associated with an increase in capitalisation. Only three banks were at the minimum acceptable threshold of CZK 500 million as of 31 December 2005 as stipulated in the Act on Banks.

As regards the distribution of equity capital as of 31 December 2005, banks operating in the Czech Republic can be regarded as a heterogeneous group. As in previous years, the large banks can be divided into two pairs according to their equity capital. The capital strength of the large bank group was confirmed, with each pair having a similar level of capital which is much higher compared to the other entities operating on the Czech banking market. There is a marked difference in capital even between these two pairs. The four strongest banks as regards capital account for almost 63.6% of the equity capital of the banking sector. The remaining 20 banks form a relatively homogeneous group with similar equity capital which is far lower than that of the large bank group. Bank capital is often supplemented with other sources, reserve funds in particular. In recent years, retained earnings have become increasingly important in this respect thanks to the good performance of the banking sector.

The breakdown of the banking sector as regards total assets changed in 2005, primarily as a result of organic growth based on the expansion of banks' business activities, the entry of new branches into the sector and the merger of two banks. One building society and one foreign bank branch joined the traditional group of four large banks with total assets exceeding CZK 100 billion. The increase in the number of entities with total assets of less than CZK 10 billion was due to the entry of two new entities into the sector in 2005.

As in the case of equity capital, the distribution of the total assets of domestic banks reveals sizeable differences. These are even larger than the differences in equity capital between the four largest banks and the other banks, where the differences are limited by the minimum regulatory capital requirement of CZK 500 million necessary for the granting of a banking licence.

TABLE 3
BREAKDOWN OF BANKS BY SIZE OF EQUITY CAPITAL
for banks with licences as of the given date

CZK billions	31 Dec. 00	31 Dec. 01	31 Dec. 02	31 Dec. 03	31 Dec. 04	31 Dec. 05
over 5.0	6	5	3	3	4	4
2.5 to 4.9	0	0	2	3	3	3
1.0 to 2.4	12	12	10	8	7	6
0.5 to 0.9	6	6	9	9	9	8
0.5	6	5	4	3	3	3
under 0.5	0	0	0	0	0	0

CHART 7
EQUITY CAPITAL DISTRIBUTION OF BANKS AS OF 31 DECEMBER 2005
for banks with licences as of 31 December 2005

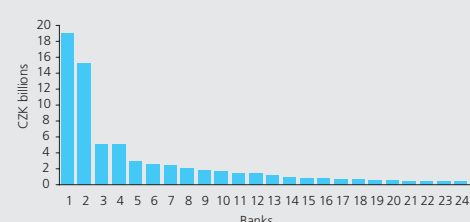


TABLE 4
BREAKDOWN OF BANKS BY SIZE OF TOTAL ASSETS
for banks with licences as of the given date

CZK billions	31 Dec. 00	31 Dec. 01	31 Dec. 02	31 Dec. 03	31 Dec. 04	31 Dec. 05
over 100	5	5	4	4	5	6
50 to 99	5	6	7	7	7	7
25 to 49	8	7	6	8	7	9
10 to 24	11	8	11	9	10	6
under 10	11	12	9	7	6	8

CHART 8
TOTAL ASSET DISTRIBUTION OF BANKS AS OF 31 DECEMBER 2005
for banks with licences as of 31 December 2005

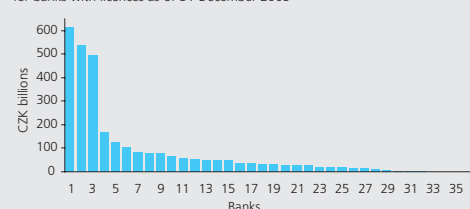


TABLE 5
PERCENTAGE SHARES OF INDIVIDUAL BANK GROUPS IN
TOTAL ASSETS

for banks with licences as of the given date

	31 Dec. 00	31 Dec. 01	31 Dec. 02	31 Dec. 03	31 Dec. 04	31 Dec. 05
Banks, total	100.0	100.0	100.0	100.0	100.0	100.0
of which:						
large banks	61.5	63.8	62.2	62.1	59.8	61.2
medium-sized banks	18.2	14.8	16.6	15.8	15.9	15.1
small banks	2.6	2.3	3.4	2.0	2.3	2.0
foreign bank branches	11.8	12.8	9.6	9.6	10.0	9.5
building societies	5.2	6.3	8.2	10.5	12.0	12.2

The total assets of the banking sector rose by 12.1% year on year, thanks mainly to an absolute increase in the business activities of large banks and building societies. Large banks strengthened their position in the banking sector, accounting for 61.2% of its total assets at the end of 2005, an increase of 1.4 percentage points on a year earlier. The share of building societies rose by 0.2 percentage point.

2.6 COMPETITIVENESS

(for banks with licences as of the given date)

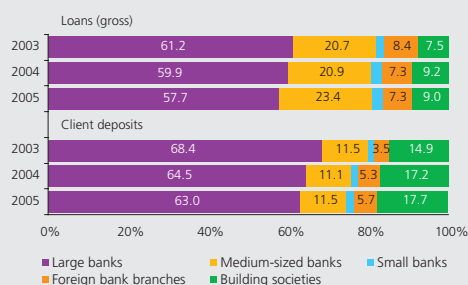
A functioning competitive environment based on diversified activities of banks is a key factor underlying the development of the banking sector. It is reflected in an expanding range of client services and new products using innovative client service processes and new distribution channels. Banks operating in a competitive environment are forced to constantly update their products and distribution channels. For clients, this means a diverse range of services, ever greater convenience and downward pressure on the prices of banking services.

The developments in the banking sector indicate a continuing strong position of the whole group of large banks, which consists of universal banks providing a full range of banking products and a considerable range of financial products of the subsidiaries of their financial groups. In some markets, specialised banks or specialised products are also enjoying success, creating healthy competition to the universal large banks. The expanding building societies, with their specialised building saving scheme product, have a unique position as a group. They benefit from state support for this product.

Competition was particularly visible on the credit market. All the bank groups contributed to the rise in lending in 2005, recording increases in the absolute volumes of loans that they provided. The position of large banks weakened slightly, by 2.2 percentage points. As of 31 December 2005 their market share was 57.7%. By contrast, medium-sized banks strengthened their market position. Medium-sized banks recorded the largest market share increase, of 2.5 percentage points to 23.4%. The share of small banks decreased by 0.2 percentage point to 2.6%. The business activities of banks were geared towards all client segments of the credit market. A strong preference for lending to households prevails. Loans to households again grew the fastest of all loan categories. This was due largely to the financing of housing needs using various types of credit such as mortgages or building saving loans combined with consumer credit or standard bank loans. The position of building societies on the credit market deteriorated slightly, by 0.2 percentage point. The share of foreign bank branches remained stable at 7.3% at the end of 2005.

CHART 9
MARKET SHARES OF BANK GROUPS IN SELECTED PRODUCTS
IN PER CENT

for banks with licences as of 31 December 2005



Similar trends were visible in the market shares of the individual bank groups on the deposit market, where banks are enjoying the fruits of branch network building and investments in additional banking units. The share of large banks is also decreasing gradually, although they still account for most of the total deposits accepted by the banking sector (63.0% at the end of 2005). However, their share in the client deposits accepted by the banking sector fell by 1.5 percentage points year on year. Other bank groups expanded their influence on the client deposit market. Client deposits in building societies continued to increase, with their share in total deposits rising by 0.5 percentage point to 17.7%. The share of medium-sized banks grew by 0.4 percentage point. Client deposits in foreign bank branches increased to 5.7% of all client deposits. Their share was lower in both relative and absolute terms than the share of foreign bank branches in the sector, owing to the generally lower level of activity of these branches on the Czech banking market and their orientation towards specific groups of clients. Client deposits are only a

complementary source of funding for foreign bank branches in addition to funds from other banks.

In 2005, the large banks lost some ground on both the credit and deposit markets, although their position measured as the share in the sector's total balance-sheet assets strengthened. Small banks increased their shares on deposit markets, but in absolute terms their position is not significant. The activities of building societies also expanded in 2005, particularly on the deposit market. Excess deposits are regularly traded on the interbank market. Medium-sized banks focused on developing their business activities in lending and in accepting deposits to finance lending. Foreign bank branches, which focus on specific transactions and clients, recorded a slightly strengthened position on the relevant markets.

The changes in the structure of the Czech banking sector and in market shares on the domestic banking market were reflected in the values of the Herfindahl index of market competition¹⁸ for selected groups of banking transactions. The Herfindahl index on the credit market decreased in 2005, which means that competition on this market grew slightly. Competition strengthened due to a decrease in the share of the large bank group, which consists of only a few banks, and the entry of a new entity into the sector. On the deposit market, the competition index remained unchanged. The Herfindahl index was also affected by the changes in the structure of the banking sector in 2005. In particular, the merger of two entities already participating in the market and the entry of two new foreign bank branches should encourage further growth in competition on the domestic credit and deposit markets. Competition on the rapidly expanding credit market remained stronger than on the deposit market. In an effort to succeed on the market, banks are forced to adapt their product ranges to the increasing competition. The weaker competition on the deposit market is affected by whether banks have a sufficiently developed branch network for the collection of deposits. The large banks and the state-supported building saving schemes have a competitive edge in this respect.

The market shares of the largest banks are falling only gradually, despite the increase in competition and the changes in the structure of the Czech banking sector. The ratio of the balance-sheet assets of the largest banks to the total assets of the banking sector rose slightly in 2005. However, the analogous ratios for the aforementioned market segments and for the performance and efficiency of the banking sector are gradually falling. The activities of the sector are usually concentrated in three leading banks,¹⁹ which usually account for more than 55% of the whole market (assets, deposits, profit from financial activities, administrative costs, net profit) but sometimes remain below this threshold (capital, credit). As a rule, however, the figures exceed one half of the total market. As of 31 December 2005, the three leading banks administered 55.6% of the total balance-sheet assets of the sector, had granted 49.7% of all client loans and had accepted 57.3% of all client deposits.

CHART 10
YEAR-ON-YEAR CHANGES IN MARKET SHARES IN INDIVIDUAL MARKET SEGMENTS AS OF 31 DECEMBER 2005
(IN PERCENTAGE POINTS)

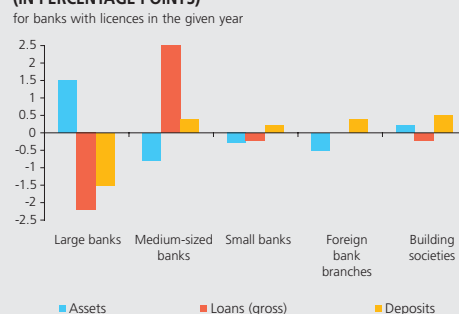
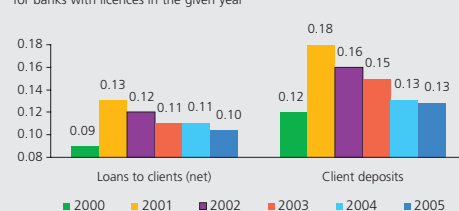


CHART 11
HERFINDAHL INDICES OF MARKET COMPETITION



¹⁸ The Herfindahl index of market competition can take values in the range of 0 to 1, where 1 indicates a totally uncompetitive environment. Competition on the market increases with decreasing Herfindahl index value.

¹⁹ These banks are not identical to the official large bank group. The composition of the group of three leading banks with the largest share in a type of transaction, balance sheet item or profit and loss account item may differ depending on the type of transaction or item.

CHART 12
SHARES OF GROUPS OF LARGEST BANKS IN BANKING SECTOR AS OF 31 DECEMBER 2005
 for banks with licences as of the given date

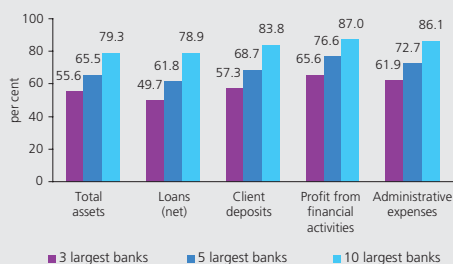
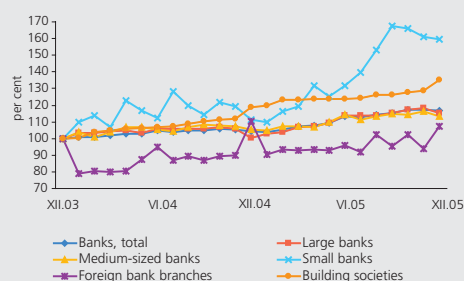


CHART 13
GROWTH OF TOTAL ASSETS
 for banks with licences as of 31 December 2005



The high concentration of banking activities is evident in the figures for the three banks with the largest shares in profit from financial activities (65.6%) and administrative expenses (61.9%). The relatively low differences in the above shares of the three, five and ten largest banks indicate that the four or five largest banks still enjoy a lead over the other banks making up the domestic banking sector.

2.7 ASSETS AND LIABILITIES

(for banks with licences as of 31 December 2005)

As of 31 December 2005, the total assets of the banking sector amounted to CZK 2.954.4 billion, up by 12.1% on 2004. This increase represents a rise in the growth rate of 7.8 percentage points year on year. The development of total assets in 2005 thus confirmed that potential still exists for growth of the domestic banking sector.

In 2005, total assets were again mainly affected by the group of large banks, whose total assets accounted for 61.2% of the assets of the entire banking sector at the end of this year. Deviations from this key trend can, however, be identified in the development of assets of other bank groups. The assets of all bank groups, with the exception of foreign bank branches, increased throughout 2005. Large banks focused on developing their business activities in 2005. The rise in their assets of 14.8% underlies the significant increase in the assets of the banking sector. The rise in the sector's total assets was also driven by the strong group of six building societies and by the dynamically developing small banks. The strength of growth in both these bank groups exceeds the average for the sector. The assets of building societies increased by 13.8% in 2005, which represents a decline in the growth rate compared to previous years. Despite that, building societies are growing faster than the overall banking sector, considerably affecting its development due to their 12.2% share. An absolute increase in their business is regularly recorded in the last quarter of the year, when contracts for the new six-year saving cycle are concluded. This is due to the nature of building saving schemes, which allow clients to defer depositing the total or residual part of the whole-year savings figure required to qualify for the maximum amount of state support on their accounts until the end of the year. The increased demand for housing financing products affected the activities of building societies. The number of applicants for loan products is rising and growth in client deposits in this bank group is ceasing to be the sole driving force behind the growth in their total assets. Although the dynamic group of small banks grew by an unusually high 43.3% year on year, they still account for less than 2% of the sector. The lower 7.6% growth rate of the total assets of the medium-sized banks was affected by internal structural changes within the group. The total assets of foreign bank branches declined by 2.5% in absolute terms. Some branches in the Czech Republic are still experiencing changes generated in their foreign parent banks, be it in the area of business activities or with regard to fundamental structural reforms associated with financial results.

The structure of the assets and liabilities of the banking sector remained essentially unchanged in year-on-year comparison. Some shifts were made in connection with a methodological change on the asset side in the reporting of part of the securities portfolio as from the start of 2005.²⁰ The total assets of the entire sector and key

²⁰ As of 1 January 2005, banks were given the option of transferring part of the non-trading securities acquired in primary issues which are traded on a regulated market from the receivables category to the securities category under an amendment to IAS 39. Banks had reclassified part of the securities of a value representing a change in structure of around 2.3% of the assets of the banking sector by the end of 2005.

balance-sheet items were broadly similar. The annual increase in banks' activities on the interbank market was at the growth level of the sector. The liabilities side saw a slight downward correction due to the methodological change. Liabilities to clients increased by 10.9%, owing to the persisting conservative behaviour of bank clients. Above all, deposits of building societies continued to grow, increasing the liabilities side of the banking sector. Total lending consistently accounts for the bulk of total assets. Demand for loans is increasing every year, being favourably affected by macroeconomic indicators, including positive expectations going forward. From the long-term perspective, this is largely attributable to the low interest rate environment. The ability to repay loans became a key factor underlying the rise in loans in 2005. However, due to the above-mentioned methodological change, the share of loans granted by banks to clients in the total volume of assets showed a slight decline (of 0.9 percentage point). In absolute terms, the volume of loans increased by 9.4% compared to the end of 2004, accounting for 39.8% of total assets. As regards the sectoral breakdown of receivables from clients, the key growth factor was loans granted to the household sector, which rose by 32.4% year on year. The intensity of lending differs across the bank groups. Medium-sized banks have the largest share of loans in balance-sheet assets (60.8%), well above the sector average of 39.8%. Foreign bank branches and building societies are the least active groups in lending in terms of share in total assets (with 31.1% and 30.0% respectively).

The second largest component of the banking sector's assets is the securities portfolio (including short-term government zero-coupon bonds and ownership interests), the share of which exceeded 22% of total assets at the end of 2005. The increase in the share in the structure of assets was partly to the detriment of receivables from clients and banks, which is associated with the above-mentioned methodological change. This effect is around 2.3% of the assets of the banking sector. On the other hand, deposits with the central bank were slightly below 20%, having decreased by 0.7 percentage point year on year. Deposits with other banks of the sector again occupied a stable position in the structure of assets. In 2005, an increase in absolute terms was recorded for deposits with the CNB and deposits with other banks, due to renewed activity on the interbank market. Banks' fixed assets, the predominant component of which is tangible assets, represented in large part by real estate (branch networks and headquarters), recorded a decrease of 0.3 percentage point in their share of total assets. This slight fall was due to restructuring and optimisation of the retail networks of banks, which are seeking ever more efficient utilisation of business units.

Client deposits are the main component of balance-sheet liabilities, owing to the persisting orientation of domestic banks towards traditional banking. Although their share in the total liabilities of the sector has recently been declining slightly, it stood at 65.0% at the end of 2005. The fact that both entrepreneurs and individuals now require accounts is another factor affecting the volumes of deposits. The balances on demand accounts are contributing to this trend. The growth in client deposits is largely due to demand deposits, which account for around half of total deposits. Deposits received from other banks saw another year-on-year decrease in their share in total liabilities, falling below 13%.

Banking business is characterised by a strong prevalence of external funds over own funds. The share of own funds in the total assets of the banking sector remained unchanged in 2005, again amounting to 7.2%. However, there are vast differences in the extent of financing by own funds across the individual banks and across the individual stages of development of banks' business activities. Although external funds generally predominate in the banking sector, some banks, especially those that have recently opened for business, are financed exclusively by their own funds. The key large bank group uses own funds representing 8.2% of its total balance-sheet liabilities to finance banking activities. The overall own

CHART 14

ASSETS STRUCTURE

for banks with licences as of 31 December 2005

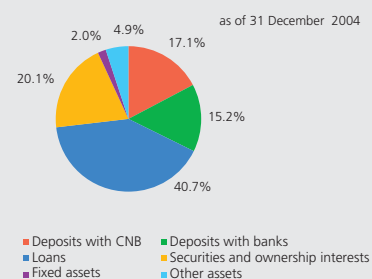
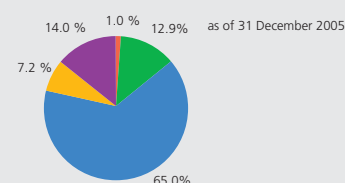
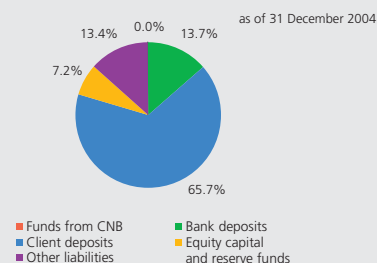


CHART 15

LIABILITIES STRUCTURE

for banks with licences as of 31 December 2005



funds of the banking sector were up by 9.9% year on year at the end of 2005. Banks recorded very good financial results and increased the own funds of the banking sector by keeping part of the profit in their balance sheets under retained earnings and increased reserve funds.

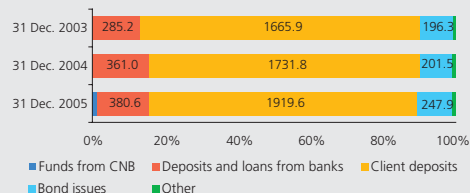
Equity capital is the largest component of own funds, although its share of own funds showed a slight year-on-year decrease to stand at 32.8% at the end of 2005. The aggregate value of the other components of own funds depends mainly on the banking sector's profits/losses in the current year and previous years. Reserve funds and retained earnings have been increasing steadily thanks to repeated generation of profits. Equity capital and reserves account for 7.2% of total liabilities, virtually the same figure as at the end of 2004. The share of subordinated liabilities, which display the characteristics of both external and own funds, is insignificant, being below 0.5% of total liabilities, despite the fact that some banks issued subordinated bonds or accepted subordinated debt in 2005.

Primary funds continued to dominate the external funds structure in 2005, although their share did decrease slightly. All bank groups recorded an increase in client deposits, with large banks and building societies recording the largest growth in absolute terms. Banks supplemented their funds on the interbank market and the absolute value of such funds increased again in 2005. The transactions of the banking sector are regularly financed by means of new bond issues. The share of debt securities in the external funds of the banking sector is close to 10%, mainly due to an increasing volume of mortgage bonds. These securities, serving as a source of financing of mortgage loans, almost doubled in volume year on year.

Client deposits (including deposits made by government institutions) still represent the main component of the external funds of banks carrying on business in the Czech Republic. This is entirely consistent with the domestic banks' persisting basic orientation towards traditional banking. Client deposits increased by 10.8% in 2005. This growth was lower than that of the total assets of the banking sector and the share of client deposits in the external funds of the sector declined slightly year on year, by 1 percentage point. The rise in client deposits in 2005 was chiefly due to large banks and building societies (which accounted for 70.7% of the total annual increase). By dint of its long-term nature (a six-year saving cycle applies at present to new contracts) a building saving scheme is a guarantee of stable deposit formation in the future, and unchangeable conditions upon signature of the contract mean that all the benefits to clients are preserved. The growth was also fostered by medium-sized banks. The fastest growth compared to the end of 2004 was recorded for deposits in small banks (37.5%). While client deposits accounted for 94.3% of the liabilities side of the balance sheet in the building societies group on 31 December 2005, the share was close to 70% in the groups of large banks and small banks, 50% in the group of medium-sized banks and just below 40% in the foreign bank branch group.

Deposits received from other banks remained the second largest component of external financing sources for the business activities of the banking sector in the Czech Republic in 2005. They increased again in absolute terms (by 5.4%), although their relative share in external funds decreased by 1 percentage point. The sufficient level of primary funds is not fostering any greater development of the interbank market. Issuance of debt securities, which increased by a full 23.0% year on year, occupied third position in terms of the share in external funds at the end of 2005, accounting for 9.5%. The only group for which, in the long term, funds obtained on the interbank market represent more than 50% of external funds (54.7% as of 31 December 2005) are branches of foreign banks. By contrast, this item is insignificant for building societies.

CHART 16
BANKS' EXTERNAL FUNDS
for banks with licences as of 31 December 2005



Note: The data in the chart are in CZK billions

Issuance of debt securities is still a less significant financing source for the business activities of the domestic banking sector. As of 31 December 2005, total bond issues amounted to CZK 247.9 billion. Debt securities constitute a kind of half-way house as regards the breakdown of banks' external funds into primary and secondary sources. The creditor can be either another bank or a non-bank. For the first time, debt securities were dominated by bonds with an agreed maturity of over one year (long-term bonds) in 2005, accounting for 57.4% of debt securities at the end of the year. The breakdown of bonds in terms of maturity changed in 2005 owing to a doubling of the issuance of mortgage bonds, which, with a share of 85.6%, make up the bulk of long-term bonds. Debt securities are not represented evenly across the bank groups in the financing of banks' business activities. While medium-sized banks focused exclusively on long-term securities (87.8% of their entire issuance of debt securities), foreign bank branches issued solely short-term debt securities. The issuance of mortgage bonds – debt securities covered by mortgage loan claims – developed apace in 2005, growing by 97.7%.²¹ The rising issuance of mortgage bonds by domestic banks is due to the large growth in mortgage loans granted, i.e. loans collateralised by real estate.

21 Another factor affecting the issuance of mortgage bonds was a proposed amendment to the Act on Income Taxes, which might have led to an increase in the price of funds obtained in this way. Ultimately, the exemption of mortgage bond interest income from income tax was maintained. However, the conditions under which it can be applied were tightened. The exemption is now restricted to cases of interest income on mortgage bonds which specify clearly in the terms and conditions of issuance that the issuer undertakes only to use receivables from mortgage loans granted solely to finance investment in real estate or to finance housing needs to duly cover the liabilities arising from such mortgage bonds. This exemption does not apply to the part of the issue related, for example, to American mortgages. The change in tax conditions applies to mortgage bonds issued from 1 January 2006 onwards.

3. RISKS IN BANKING

The banking sector as a whole and the individual banking institutions operating within it are generally exposed to many risks, some of which are typical of banking or other financial business. However, the risk profiles of individual banks can differ significantly, as they reflect the activities in which each bank engages. The real exposure of a bank to particular risks also reflects the quality of management of those risks. The risks undertaken also change over time.

Risks can result in banks suffering business losses, which means a reduction in a banking institution's capital or the assets of its shareholders. Where the bank's capital is insufficient to cover the losses, the bank's creditors – especially its depositors – are put at risk. The regulator pays close attention to the role of capital. Banks must maintain at least a minimum prescribed volume of capital in relation to the risks that they face.

Given the domestic banks' prevailing orientation towards traditional banking (i.e. the collection of deposits and the providing of loans), credit risk remains the most significant type of risk faced by the Czech banking sector. However, banking regulators and banking supervisors also pay equal attention to all other types of risk and to the way in which banks manage them.

3.1 CREDIT RISK

Credit risk is the risk faced most frequently by banks operating on the banking market in the Czech Republic. For many of these banks, the share of loans granted on the assets side remains significant, with a similarly significant share of client deposits on the liabilities side. Credit risk is largely associated with the provision of bank loans. It represents the inability of a debtor to comply with the conditions of a loan agreement. The potential risks to the Czech banking sector linked with credit derivatives currently account for only a small part of the overall credit risk.

Banks pay particular attention to credit risk management. The basis for credit risk management is an ever-improving lending system (objective assessment of a client's creditworthiness, monitoring of a client's risk profile, segregation of conflict duties, limiting subjectivity when assessing individual loan transactions and so on). Banks have established an efficient system for measuring and monitoring credit risk, have in place set limits relating to each type of loan transaction, and analyse and assess the quality of their loan portfolios on a regular basis. They regularly use advanced statistical methods for measuring credit risk, mathematical credit risk management models and so on. The use of data from the Central Register of Credits and other independent credit registers, which enable the participating banks to share credit information, has become a routine support tool for assessing a client's creditworthiness.

3.1.1 Credit structure and credit trends

(for banks with licences as of 31 December 2005)

At the end of 2005, the total volume of net loans (i.e. taking into account provisions) granted to clients by banks was CZK 1.174.4 billion, up by 9.4% on a year earlier.²² Gross loans amounted to CZK 1,204.7 billion on 31 December 2005; this represents growth of 9.5% over the same period. The upward trend in lending, established in 2003, is continuing.

²² Lending also includes loans provided to general government. The growth rate in 2005 is affected by a methodological change. For details, see footnote 20.

As in 2004, annual growth in lending was recorded by all the bank groups. However, the growth rates varied widely across the individual bank groups. The largest annual increase in loans, of CZK 43.3 billion (19%) in absolute terms, was recorded by the medium-sized banks. The large banks increased their lending by CZK 35.5 billion, up by 5.5% as in the previous year. Nevertheless, the rise in loans granted by large banks is still being affected by a continuing decline in receivables from general government, which accounts for the majority of the clients of this bank group – see also below. Loans granted by small banks and building societies increased by CZK 12.0 billion (63.8%) and CZK 8.3 billion (8.4%) respectively in 2005.

The rise in lending throughout 2005 was mainly associated with growth in loans granted to households, in most cases mortgage loans for housing financing purposes. Nevertheless, loans to the corporate sector remain the largest component of all loans granted in the Czech Republic. Their share declined slightly by 1.2 percentage points and their value was CZK 525.5 billion in absolute terms at the end of 2005, up by 14.4% on a year earlier. The improving economic situation of the corporate sector, growth in industrial production and investment, expansion in exports and the overall very good trend in macroeconomic indicators together with a stable low interest rate environment is enabling businesses to obtain bank loans to finance their activities or to further increase their existing debt. The rise in business loans is due to loans to corporations owned by domestic non-government entities and to loans to foreign-owned corporations.

As in previous years, the volume of claims on general government showed a decline of almost 30% in 2005, which was reflected in a further decrease in their share in total lending of 4.5 percentage points to 6.9%. This was mainly due to a winding down of activities at the Czech Consolidation Agency connected with its planned closure. The CCA is usually a client of the group of large banks.

In 2005, the main component of the dynamic growth in the loan portfolio was again loans granted to the household sector. Households had CZK 379.5 billion borrowed from banks as of 31 December 2005, an increase of 34.0% (almost the same as in the previous year). The continuing high rates of growth of loans to households are changing the structure of the loan portfolio. Households are now responsible for the repayment of 32.0% of total credit issued, up by 4.0 percentage points on a year earlier.

Mortgage loans dominated the growth in loans to households in 2005, rising by 48.4% year on year despite an ever increasing base. They totalled CZK 178.5 billion as of 31 December 2005. Their share in total loans received by households increased to 47.0% (up by 4.6 percentage points compared to the end of 2004). A slight decline in the growth rate of building society loans²³ and the increasing popularity of consumer credit for financing everyday necessities led to an equalisation of the shares of these two types of loans in loans to households at 25%.

CHART 17
STRUCTURE OF LOANS BY ECONOMIC SECTOR
for banks with licences as of 31 December 2005

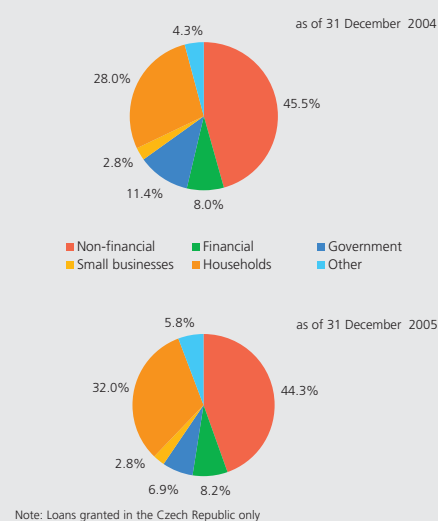
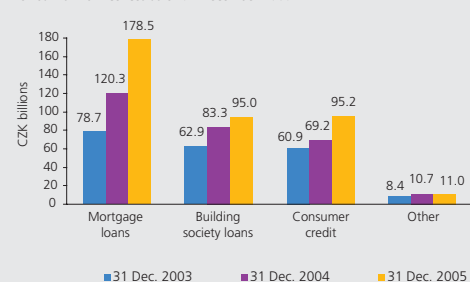


CHART 18
LOANS TO HOUSEHOLDS
for banks with licences as of 31 December 2005



²³ The dynamic growth in mortgage loans and the slower growth in building society loans are also due to a methodological change in the reporting of mortgage loans and building society loans implemented in 2005. Mortgage loans now include building society loans which are secured by real estate and meet the criteria for mortgage loans. Conversely, this reduced the volume of building society loans recorded at the end of 2005. Hypothetically, taking into account this methodological change, the increase in mortgage loans would be 10 percentage points lower and the rise in building society loans correspondingly higher.

The rate of growth of new mortgage loan agreements increased throughout 2005, peaking at the very end of the year. The Czech Republic is increasingly following a path similar to that in the European Union, where the financing of housing needs and real estate by means of mortgage loans is taken for granted. Mortgage loans traditionally have a central position in banking transactions. Mortgages rank among the most important banking transactions in the Czech Republic and have a better payment discipline than other types of loans. They involve long-term relationships between the client and the bank, generating a substantial proportion of banks' income from financial activities. Although the recipients of mortgage loans are mainly households, applicants also include commercial companies, co-operatives, property owners associations and others.

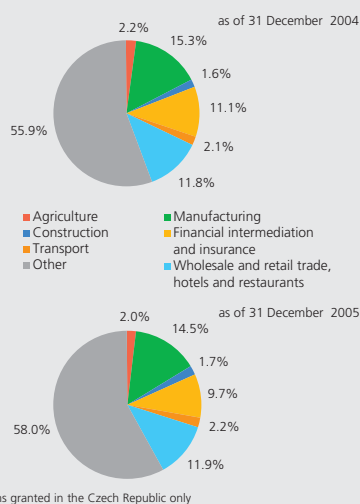
An important factor behind the growth in the mortgage market remains the low interest rate environment, including more favourable external economic conditions and expectations that they will persist, based, in turn, on the positive outlook for the economy. This is being reinforced by demand pressure from baby-boomers addressing their current housing needs. The possibility of increases in regulated rents means that a wider range of the population is opting for owner-occupied housing rather than rental of residential premises. The expected rise in VAT on construction work in 2008 is a specific factor. Low interest rates on deposit products are also fostering the use of mortgages in order to invest funds. On the supply side, banks are trying to attract clients and are using mortgage loans to establish a long-term relationship between themselves and clients for a wider range of banking services. They are developing new variants of the mortgage loan and offering complementary services. The highly competitive environment is exerting downward pressure on mortgage-related fees. The stable economic situation and the improving income situation of households are allowing them to take on long-term commitments. The average amount of a new mortgage loan is increasing slightly over time and now exceeds CZK 1.5 million.

In the Czech Republic, mortgage loans are provided by banks with universal licences. Of the total of 36 banks and foreign bank branches, 25 offer mortgage loans (under the new methodology; see footnote 21). Banks are increasingly issuing mortgage bonds to finance mortgage transactions. In 2005, a total of 10 banks contributed to the doubling of the total value of mortgage bonds, which amounted to CZK 121 billion as of 31 December 2005.

The mortgage market will be affected going forward mainly by economic developments and also by state housing support policy, the rent deregulation process, the entry of baby-boomers into the labour market and their decisions as regards working in the EU labour market, state tax policy in support of house-buying, immigration policy, investment opportunities and so on.

The stable economy is manifesting itself in balanced development across the individual economic activities. This is consistent with the continuation of the previous bank lending trends. There were no major impulses to constrain any activities in terms of credibility. The structure of loans by economic activity remained broadly unchanged in year-on-year comparison. The only slight change was a decline recorded by financial intermediation and insurance. The value of loans granted to this industry was almost flat, which, in the growing market, led to a decline in their share in total loans of 1.4 percentage points. This share fell below 10% for the first time in a long time. Repayment of loans by the Czech Consolidation Agency, which is winding down its activities and is included in this segment, had an effect. A specific feature of the regularly increasing "other loans" item is that it includes loans granted to households. This is a significant factor behind the year-on-year growth in its share, which was just below 60% in 2005.

CHART 19
STRUCTURE OF LOANS BY ECONOMIC ACTIVITY
for banks with licences as of 31 December 2005



The increasing demand for housing loans, the further growth in consumer credit and the methodological change²⁴ implemented in 2005 are affecting the maturity structure of loans. There was another sharp increase in long-term loans with a maturity of over 5 years, which essentially means mortgage loans and other housing loans, including building society loans. Their volume grew by 25% year on year, with their share in total lending rising by 3.2 percentage points. An almost 19% increase in the volume of short-term loans means stagnation in terms of their share in total loans. The growth in short-term loans is due mainly to a year-on-year rise in the volume of bank overdrafts, card credit and short-term loans granted to non-financial corporations.

3.1.2 Classified and non-performing loans and their coverage (for banks with licences as of 31 December 2005)

Credit risk has always been the most significant type of risk undertaken in the Czech banking sector. The attention paid to improvements in loan portfolio quality takes several forms. Virtually until 2003, banking assets were cleaned up by transferring bad loans outside the banking sector with effective assistance from the state connected with the sale of the state's interests in large Czech banks. Another factor is the now firmly established increase in banks' prudence when assessing credit transactions. A considerable improvement in economic performance has fundamentally affected the financial condition of the entire corporate sector. The stimulus for this was an improvement in the economic situation in countries where most domestic producers export their goods. And finally, there has been a shift in the loan portfolio structure towards loans provided to households, predominantly housing loans. Besides having high-quality collateral, this type of loan is associated with lower risk.

As of 31 December 2005, classified loans amounted to CZK 127.7 billion, up by 7.5% compared to the end of the previous year. The significant rise in lending had an effect, and there were also changes in the qualitative indicators during this period. The share of classified loans in the total loan volume for the banking sector showed a year-on-year increase of 0.9 percentage point to 11.7%.

The growth in classified loans was due to a 8.5% rise in the volume of watch loans (the lowest-risk category) and above all to increases in doubtful loans and loss loans (the highest-risk category) of 43.7% and 8.2% respectively. Substandard loans were the only category to record a decline in absolute terms in 2005, falling by 7.0%.

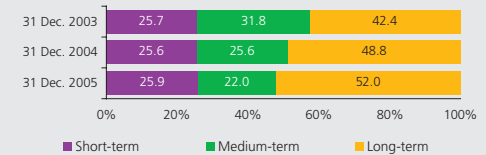
International comparative analyses of loan portfolio quality usually state the values of non-performing loans. According to the standard classification, this category includes substandard, doubtful and loss loans. As regards the quality of loan portfolio, the 5.8% increase in non-performing loans compared to the 9.4% year-on-year increase in the portfolio of receivables from clients is positive. Non-performing loans amounted to CZK 47.1 billion at the end of 2005, i.e. 4.3% of total client loans.

The growth in lending is particularly dynamic in the case of loans to the household sector. This is one of the factors affecting the quality of the banking sector's loan portfolio. Loans to households (excluding small businesses) recorded a rise of CZK 96.2 billion (34.0%) in 2005. Loans to non-financial corporations grew by CZK 66.0 billion (14.4%). However, the share of classified loans provided to

CHART 20

TIME STRUCTURE OF LOANS

for banks with licences as of 31 December 2005



Note: Loans granted in the Czech Republic only

24 See footnote 21.

households in the total volume of loans to this segment is 5.8%, which is significantly lower than in other sectors. The 3.2% share of non-performing loans in lending to households was also lower than that in the sector as a whole. The rising share of loans to households in total loans of the banking sector is thus positively affecting loan portfolio quality.

Mortgage loans and building society loans, i.e. loans related to the financing of housing needs, which are the driving force behind the marked increase in total receivables from clients, now account for 72.0% of total loans to households. This loan category includes 5.0% of classified loans. The share of such classified loans increased by 1 percentage point in 2005. These are long-term loans with maturities of up to 20 years. High-quality real estate collateral, improved loan approval processes and maximum efforts to comply with the conditions of loan agreements mean that such loans have a low level of risk. The lower quality of consumer credit is due to the nature of such credit. The process of providing consumer credit is as simple as possible, it involves lower amounts, and banks are trying to increase its availability. In the case of consumer credit, which accounts for 25% of loans to households, the share of classified loans declined from 10.8% to 9.7% year on year, owing to a rise in total volume of consumer credit.

Banks work on an ongoing basis with clients to deal with any problem loans, seeking ways and schedules of repayment of past-due receivables. In 2005, 64% of the total decrease in classified loans resulted from standard repayment of such loans and around one-third was due to reclassification to standard loans. Sales of classified loans to other entities, a frequently used way of cleaning up banks' loan portfolios in the past, were negligible for the second consecutive year. Write-offs of receivables against provisions were only applied to receivables with a total value of CZK 0.9 billion as of the end of 2005. Their share in the decrease in classified loans is also insignificant. Realisation of collateral was applied only minimally in 2005, accounting for 0.05% of the decrease in classified loans.

The quality of the banking sector's loan portfolio is monitored regularly and in detail by CNB Banking Supervision. It is becoming the basis for assessing banks, a part of banking analyses and, last but not least, a key element of on-site inspections. Such assessments pay particular attention to whether banks have sufficient provisions in place to cover the weighted classification, which enables loans with varying probabilities of default to be recalculated on a single base. The weighted classification thus allows us to evaluate and summarise truly non-performing classified loans with much greater precision than in the case of mere summation of the volumes in each classified loan category. The value of the weighted classification increased slightly in 2005, amounting to CZK 30.7 billion, or 2.6% of total loans granted. The weighted classification had long been falling, albeit at a declining rate, owing to the completed clean-up of the banking sector. In 2005, this factor was no longer influencing loan portfolio quality. By contrast, the gradually increasing rate of growth of lending is affecting the amounts of classified loans. The volume of weighted classified loans thus rose by almost 10% year on year in 2005.

Despite this rise, the banking sector's loan portfolio quality remained good in 2005. The provisions created by banks in 2005 and in previous years are consistent with the amount of weighted classified loans.²⁵ Although the provisions created in

TABLE 6
STRUCTURE OF CLASSIFIED AND NON-PERFORMING LOANS
for banks with licences as of 31 December 2005

	31 Dec. 03		31 Dec. 04		2005		
			31 Mar.	30 Jun.	30 Sep.	31 Dec.	
Classified loans in CZK millions	114,009	118,826	125,448	126,327	131,116	127,738	
as a percentage of total loans	11.2	10.8	12.8	12.3	12.3	11.7	
Non-performing loans in CZK millions	49,608	44,506	47,494	47,485	47,090	47,093	
as a percentage of total loans	4.9	4.1	4.8	4.6	4.4	4.3	
of which:	in CZK millions						
watch loans	64,400	74,320	77,954	78,842	84,027	80,657	
substandard loans	19,298	19,344	21,777	21,164	18,738	17,988	
doubtful loans	6,913	5,306	5,558	5,627	7,121	7,624	
loss loans	23,398	19,857	20,159	20,695	21,231	21,481	
of which:	in per cent						
watch loans	56.5	62.5	62.1	62.4	64.1	63.1	
substandard loans	16.9	16.3	17.4	16.8	14.3	14.1	
doubtful loans	6.1	4.5	4.4	4.5	5.4	6.0	
loss loans	20.5	16.7	16.1	16.4	16.2	16.8	

CHART 21
DECREASES IN WATCH AND NON-PERFORMING LOANS
for banks with licences as of 31 December 2005

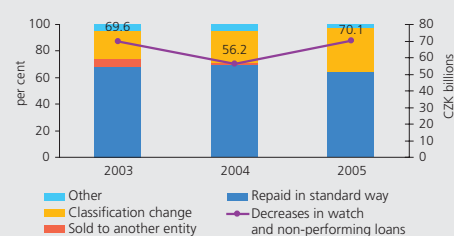
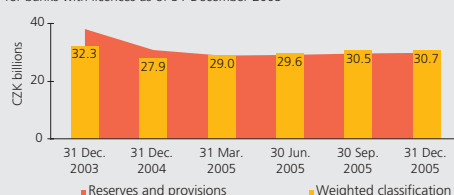


CHART 22
COVERAGE OF POTENTIAL LOSSES FROM LOAN PORTFOLIO
for banks with licences as of 31 December 2005



²⁵ Since the beginning of 2005, banks have determined their provisions in line with the method they use to keep their accounts and compile their financial statements. Banks that use the IFRS method determine their provisions for receivables on the basis of the expected future flows from these receivables (or their collateral). The method of determining provisions by means of coefficients for the relevant classified loan category continues to be used by banks that keep their accounts under Czech accounting standards (CAS).

2005 were slightly less than the weighted classification, banks can also use quality collateral as security for part of the loan portfolio.

3.2 LIQUIDITY RISK

The banking sector and individual banks are threatened with liquidity risk if they are unable to meet their financial liabilities when these become due. A lack of disposable liquid assets may thus result in losses connected with the extraordinary costs of securing such additional funds. Liquidity risk can also be looked at from the angle of banks' ability to procure sufficient liquid funds in the form of credit, through interbank transactions or in some other way in order to cover their due liabilities where necessary. In all such cases, the key factor is price at which a bank is able to acquire the necessary funds and eliminate the liquidity risk.

Holding quick assets is one of the tools for mitigating liquidity risk. Such assets are the safest investment of banks, but they are simultaneously associated with relatively low yields. Quick assets comprise cash, deposits with central banks, T-bills and similar bonds issued by the state and central banks, and items on current accounts with other banks and loans to other banks due within 24 hours. In the case of marketable securities, the liquidity of the capital market on which they are traded is also a factor. Any other costs derive from potential losses incurred in rapid trading on the secondary market under temporarily unfavourable conditions.

Matching the maturities of assets and liabilities is a basic prerequisite for managing this type of risk. For the purposes of liquidity risk management, banks must have suitable procedures in place for measuring and monitoring net cash flows and liquidity positions in each of the main currencies with which they work. When determining the maturities of many asset and liability items, banks must use assumptions based on historical experience.

In addition to standard liquidity scenarios, banks must have contingency procedures in place for emergencies that affect the bank alone or the financial market as a whole. Therefore, banks continuously monitor their options for accessing the market in order to acquire additional funds or to sell their assets.

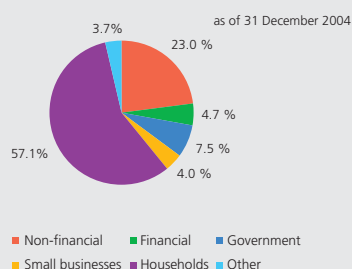
3.2.1 Primary funds

(for banks with licences as of 31 December 2005)

Deposits from clients, including deposits from general government, continue to represent a major component of the total disposable funds of the banking sector. Deposits received from clients amounted to CZK 1,919.6 billion on 31 December 2005. Client deposits increased by CZK 187.7 billion (10.8%) compared to the same period a year earlier. In this respect, 2005 was a successful year. The rate of growth of primary deposits used by banks to finance transactions increased by 6.8 percentage points. At the end of 2005, primary funds accounted for more than 70% of external funds in the domestic banking sector.

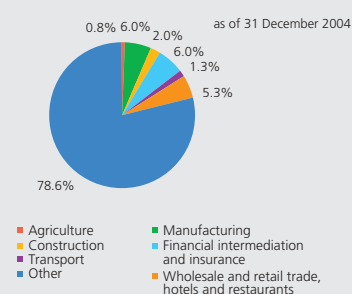
The continuing low interest rate environment, which is fostering growth in lending, did not reduce funds in the form of primary deposits. Their growth was mainly affected by the minimisation of the risks undertaken by means of increased limits for insurance of deposits in banks and also by the popularity of state-supported building savings and the persisting conservative behaviour of clients of banks, for whom bank deposit products still offer certainty and security, including the option of prompt access to cash when necessary.

CHART 23
DEPOSIT STRUCTURE BY ECONOMIC SECTOR
for banks with licences as of 31 December 2005



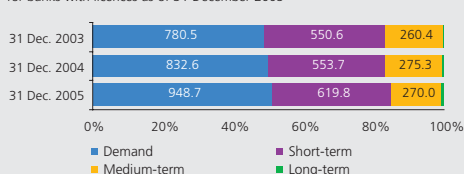
Note: Deposits accepted in the Czech Republic only

CHART 24
DEPOSIT STRUCTURE BY ECONOMIC ACTIVITY
for banks with licences as of 31 December 2005



Note: Deposits accepted in the Czech Republic only

CHART 25
TIME STRUCTURE OF DEPOSITS
for banks with licences as of 31 December 2005



Note: Deposits accepted in the Czech Republic only; the data in the chart are in CZK billions

Household deposits, which form the main part of total client deposits, also increased in 2005, but the 5.7% growth rate was rather more moderate. They totalled CZK 1,007.4 billion at the end of the year. Deposits of the non-financial sector, which, with a share of almost 25%, is the second largest banking sector depositor, increased by 16.5% in this time period. They amounted to CZK 447.8 billion as of 31 December 2005. As regards structure, all the economic sector categories recorded a slight strengthening, at the expense of a decline in the share of household deposits of 2.7 percentage points, which, however, still account for more than half of all client deposits.

The structure of the Czech economy was subject to no major changes in 2005. The domestic economy even became one of the factors positively affecting banking sector stability. This effect was indirectly reflected in a stable structure of deposits generated by economic activity. Financial intermediation and insurance remain the most important depositors in terms of economic activity at the end of 2005, accounting for about 6%, with wholesale and retail trade and hotels and restaurants newly featuring. Funds from households are thus also getting into banks' balance sheets indirectly through financial intermediaries. Other economic sectors are below 2% and their influence on the generation of primary bank funds is very small.

Interest rates are an important factor affecting demand for deposit products in terms of the time for which a bank is entitled to free use of the funds. The persisting low interest rate environment offered no incentive to deposit funds on time accounts in 2005. More than half (51.3%) of all client deposits consist of demand deposits. This largest group of deposits increased from an already high base by 13.9%, which is 3.0 percentage points faster than the growth in total client deposits in the same year. Banks thus received primary funds amounting to CZK 181.3 billion in 2005. Unlike in previous periods, total time deposits strengthened for the second consecutive year, increasing by CZK 65.3 billion (7.8%) in 2005. Client deposits accounted for 62.6% of total liabilities of the banking sector as of 31 December 2005 and have long been fluctuating around the 65% mark. The trend in primary deposits consisting in faster growth in demand deposits than in time deposits is linked to the preferences of banks' clients, which have been affected, in turn, by the low interest rate environment in recent years. Owing to the very low interest rates on time deposits, it is still advantageous to keep free funds on current accounts, which offer unrestricted access at only slightly lower yields.

More than 80% of all client deposits are deposited on demand accounts and short-term time accounts with maturities of up to one year. The increase in the volume of time deposits was mainly due to a rise of CZK 66.2 billion (11.9%) in such short-term deposits. On the other hand, an annual increase of 61.2% (CZK 4.5 billion) was recorded for long-term time deposits (greater than 5 years' maturity). Although their share in the total deposits of the banking sector grew by 0.2 percentage points, it is negligible overall at 0.6%. Long-term time deposit accounts are mainly used by building societies' clients. This fact is associated with a change to the building savings terms and conditions as of 1 January 2004, which, under an amendment to the legislation, prolonged the minimum saving time for qualifying for state support to 6 years. This effect emerged back in 2004. The sole product of building societies is based on a combination of a long-term deposit and the possibility of obtaining credit under conditions agreed in advance. However, the state-subsidised building saving schemes allow for irregular depositing – almost half the deposits are usually made during the final month of the year. Building societies recorded an increase in client deposits of CZK 41.5 billion in 2005, with a higher growth rate (13.9%) than the average growth rate for the banking sector as a whole. Building society deposits strengthened again, and now account for almost 18% of the deposits of the banking sector as a whole. Least popular among

clients were medium-term deposits with maturities of between one and five years, which declined in both absolute and relative terms.

The increasing share of demand deposits may, under certain circumstances, pose a liquidity risk to banks although a portion of the deposits remains permanently at banks' disposal in the form of regular outstanding current account balances. Conversely, the moderate rise in deposits with maturities of over five years means an increase in the funds available to banks in the long term.

3.2.2 Secondary funds

(for banks with licences as of 31 December 2005)

The financing of banks' business activities through the interbank market depends on the banks' need to top up their primary funds. The price of funds obtained in such manner is also a determining factor. Banks' activities on the interbank deposit market differ in this respect across the individual bank groups and across banks of the same group. In terms of time sequence, the volume of liabilities to other banks also varies considerably from month to month depending on what business activities are financed through them and also on their current need for additional funds. Liabilities to other banks²⁶ are the second largest component of external funds after client deposits. They amounted to CZK 380.6 billion for the banking sector as a whole on 31 December 2005. Banks received CZK 19.6 billion more in funds in this way than in the same period of 2004. The increase of 5.4% was considerably lower than the 26.6% rise recorded in 2004. At 12.9%, liabilities to other banks are the second largest component in the structure of liabilities of the banking sector. This share increases by 1 percentage point if liabilities to central banks are included.

The domestic banking sector, including the individual bank groups, continued to be a net creditor on the interbank market. Large banks had the largest positive position on the interbank market in absolute terms. The value of assets and liabilities changed in the course of the year, but the net creditor position at the sector and bank group level persisted throughout 2005. Foreign bank branches were the group with the highest volatility.

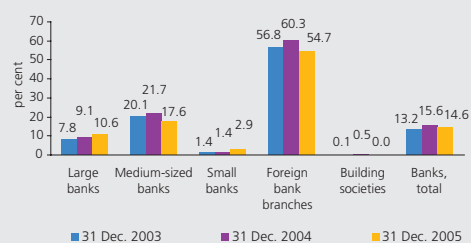
Large banks do not depend on obtaining additional funds through the interbank market. This group of banks is not among the key players financing themselves on the interbank market, as the group as a whole and the individual banks have extensive branch networks through which they obtain sufficient funds directly from their clients in the form of client deposits. Client confidence in the banking sector, underpinned by a functioning deposit-guarantee scheme, helps in raising funds. The share of secondary funds in external funds is even smaller in the building societies group, where client deposits cover the need for funds almost fully. Deposits with this group of banks are still favoured by clients owing to the overall higher returns on such deposits combined with the option of taking out a loan in the future. In the case of large banks, deposits received from other banks accounted for 10.6% of total external funds at the end of 2005, while in the case of building societies the share was less than 0.02%.

Foreign bank branches are very active in utilising funds obtained from other banks to finance their business activities. Their share of liabilities to banks in external funds has long fluctuated between 50% and 60% and stabilised at 55% at the end of 2005. Foreign bank branches are a type of banking institution which has a

CHART 26

SECONDARY FUNDS AS A PERCENTAGE OF EXTERNAL FUNDS

for banks with licences as of 31 December 2005



²⁶ Liabilities to central banks are not included.

minimal share of client deposits, owing due to their limited branch networks. They accounted for a mere 5.7% of total client deposits accepted by banks in the Czech Republic, despite their 9.5% share in the total assets of the sector. The domestic market contains branches of renowned banks which are able, where necessary, to obtain a loan on the interbank market under very advantageous conditions. Their business activities are in no way limited in this respect, as they have easy access to funds. The financing of small banks can be affected by the transactions of just one bank, given the weight of this bank group in the activities of the entire banking sector. A change in the internal structure of the group of small banks thus fundamentally changes its financing through the interbank market.

Financing by means of debt security issues is still the third largest source of financing of the domestic banking sector. Debt security liabilities accounted for 8.9% of the total liabilities of the banking sector, although their growth rate increased by a substantial 15.7 percentage points in 2005, reaching 22.1% year on year. For the first time, long-term securities predominated in the structure of the securities issued, amounting to CZK 142.3 billion (57.4%). Most of these are mortgage bonds, which are being used to finance the growing mortgage market, which almost doubled year on year, totalling CZK 121.8 billion at the end of 2005. Mortgage bonds now make up almost half of the debt securities issued. Large banks account for 57.8% of total mortgage bond liabilities. Medium-sized banks are the second most significant group. Of the other bank groups, small banks have a minimal share, while the other groups are not registered on this market.

3.2.3 Quick assets

(for banks with licences as of 31 December 2005)

The banking sector in the Czech Republic continues to have sufficient quick assets. In 2005, their rate of growth picked up to 9.7% and their total volume increased to CZK 948.3 billion. The volume of quick assets of the banking sector varies over the year, largely reflecting repurchase operations with government institutions, which deposit their short-term free funds with banks. Banks then allocate these funds to repos with the CNB. However, the volume of these operations always falls significantly at the year-end, and this is reflected in a decline in quick assets. The same trend was observed in 2005, when quick assets markedly exceeded their end-2004 level throughout the year and did not fall significantly until December.

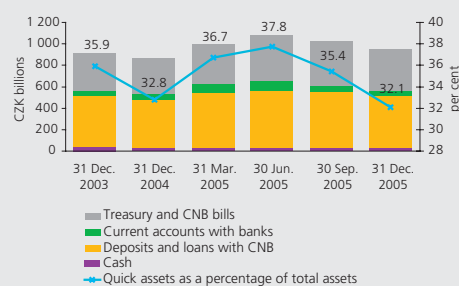
The share of quick assets in the total balance-sheet assets of the sector was almost constant in 2005, amounting to 32.1% at the end of the year. There were no substantial changes in their structure, either. Standing at 51% as of 31 December 2005, deposits and loans with the central bank remained the component playing the main role in total quick assets. Despite recording a year-on-year decline of 1.1 percentage points, deposits and loans with the CNB increased to CZK 483.8 billion in absolute terms at the end of 2005. T-bills and similar bonds issued by the state and central banks are the second largest component of quick assets, amounting to CZK 383.4 billion, or 40.4% of the total volume of quick assets. T-bills have shown an upward trend over the last few years. Conversely, current accounts with other banks and loans to other banks due within 24 hours are not significant in terms of volume. Their share in quick assets declined below 5% in December 2005.

3.2.4 Matching of asset and liability maturities

(for banks with licences as of 31 December 2005)

Banks manage liquidity risk and reduce the possibility of incurring extraordinary expenses ensuing from a lack of liquid funds necessary to cover their current needs

CHART 27
QUICK ASSETS
for banks with licences as of 31 December 2005



by matching the maturities of assets and liabilities. The key factor for banks is to align the residual maturities of asset and liability items within each time band. Owing to the persisting low interest rates, the share of demand deposits in the total deposits of the banking sector is continuing to rise. The changes in the deposit structure are affecting banks' stability in terms of liquidity position assessment. On the other hand, both components of client deposits – demand as well as time deposits – are increasing regularly in absolute terms.

The liquidity risk of the banking sector as a whole as expressed by the cumulative net position to one month (including the off-balance sheet and net of 80% of demand deposits) in relation to total assets, at 0.74% indicated a balance situation between the most liquid assets and liabilities as of 31 December 2005, with only a slight excess of assets. Liquidity risk is negligible in this respect. The cumulative net position to three months as a percentage of total assets (net of 80% of demand deposits) was 3.42% in absolute terms at the end of 2005, which does not imply any risk to the liquidity position of the banking sector. The absolute value lies within a range that has no adverse effects on bank profitability. The negative value of the indicator denotes excess liabilities.

The values of the net balance-sheet position of the banking sector are strongly affected by the liabilities side of the balance sheet, where there is a high ratio of demand deposits. The liabilities component representing the residual maturity of this part of the balance sheet with a maturity of less than 1 week is 2.7 times higher. Assets exceed liabilities in the longer time bands, except for the 1–3 month maturity band. In this respect, the liabilities of banks are covered by equivalent income from the asset-side activities of the banking sector.

3.3 MARKET RISK

Market risk consists in the potential for a bank to incur losses due to changes in interest rates, exchange rates, share prices on the capital market or prices of other assets. All the components of market risk are dependent on the development of market prices of assets and the relevant derived instruments. Market risk also affects the liabilities side of the balance sheet, since it influences the total level of banks' liabilities. It is an umbrella term for interest rate risk, foreign exchange risk, equity risk and other risks associated with movements in market prices.

3.3.1 Foreign exchange risk

(for banks with licences as of 31 December 2005)

Foreign exchange risk is classed as a market risk. It represents the potential for incurring a loss due to movements in exchange rates. Banks are exposed to this risk if they have foreign currency assets or liabilities in their balance sheet or off-balance sheet. Banks report the values of their assets and liabilities in the domestic currency, and changes in exchange rates automatically also bring about changes in these values. The degree of foreign exchange risk is directly dependent on the proportion of foreign currency assets and liabilities in banks' balance sheets. Each bank is exposed to foreign exchange risk corresponding to the extent of its involvement in foreign currency activities.

The Czech banking sector as a whole remains exposed to only limited foreign currency risk. This ensues primarily from the local nature of domestic banks, whose business activities are largely geared towards the domestic market. The volumes of operations on foreign markets, be they direct (securities trading etc.) or via foreign branch networks and subsidiaries, are not large. The Czech Republic's accession to the European Union in 2004 has not changed these trends. The most important

TABLE 7

MATCHING OF ASSET AND LIABILITY MATURITIES

for banks with licences as of 31 December 2005; percentages

	31 Dec. 2004	31 Mar. 2005	30 Jun. 2005	30 Sep. 2005	31 Dec. 2005
Cumulative net position:					
to 3 months as a percentage of assets ¹⁾	-1.80	-2.41	-2.11	-4.25	-3.42
to 1 month, including off-balance sheet, as a percentage of assets ¹⁾	-0.01	0.22	0.80	-1.13	0.74
Assets/liabilities maturing:					
within 1 month	51.78	52.66	53.14	50.80	52.80
in more than 1 year	263.81	274.21	279.67	284.48	278.13
in more than 5 years	720.07	872.02	787.24	778.65	589.65

1) Minus 80% of demand deposits

CHART 28
FOREIGN EXCHANGE ASSETS AND LIABILITIES AS
A PERCENTAGE OF TOTAL ASSETS AND LIABILITIES
for banks with licences as of 31 December 2005

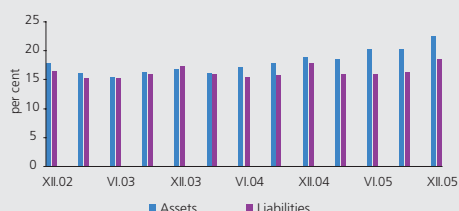


CHART 29
STRUCTURE OF FOREIGN EXCHANGE ASSETS AND
LIABILITIES AS OF 31 DECEMBER 2005
for banks with licences as of 31 December 2005

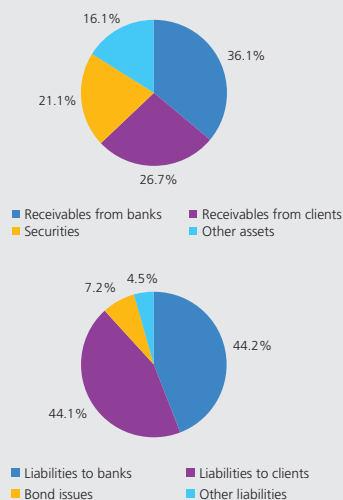
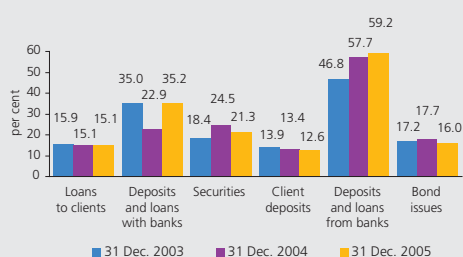


CHART 30
SHARE OF FOREIGN EXCHANGE IN SELECTED PRODUCTS
for banks with licences as of 31 December 2005



Note: For asset items, the percentages are calculated from net asset values

TABLE 8
PERCENTAGE SHARES OF FOREIGN EXCHANGE IN ASSETS,
LIABILITIES AND SELECTED TYPES OF BANKING
TRANSACTIONS AS OF 31 DECEMBER 2005; PERCENTAGES
for banks with licences as of 31 December 2005; in the case of asset items,
the percentages are calculated from their net values

	Large banks	Medium-sized banks	Small banks	Foreign bank branches	Banks, total
Assets	24.9	20.7	17.6	40.1	22.5
Liabilities	17.2	22.2	12.1	46.4	18.6
Receivables from banks	32.0	38.9	19.8	53.5	35.2
Receivables from clients	16.2	15.6	18.2	23.6	15.1
Securities	32.9	17.5	7.4	0.0	21.3
Liabilities to banks	58.0	51.1	92.8	64.1	59.2
Liabilities to clients	13.6	20.3	12.4	25.2	12.6
Bond issues	11.9	18.9	0.1	73.2	16.0
Receivables from derivatives transactions	26.7	33.3	46.4	42.9	31.2

currency used following EU accession is the euro, followed by the dollar. The indirect foreign currency risk to which banks are exposed via lending to their clients is not currently high either.

The difference in the shares of foreign exchange assets and liabilities in total assets and liabilities in the banking sector increased slightly in 2005. The shares of foreign currency assets in balance-sheet assets increased modestly, amounting to 22.5% as of 12 December 2005 compared to 19.0% a year earlier. The proportion of foreign currency liabilities in total liabilities fluctuated just above the 18% level (18.6% at the end of 2005). The value of foreign exchange assets totalled CZK 666.1 billion, up by CZK 166.0 billion, or 33.2%, year on year.

A large part of the year-on-year increase is due to receivables from banks. Their 36.1% share of foreign currency assets was 2.6 percentage points higher at the end of 2005. Conversely, the volume of foreign exchange client receivables moved in the opposite direction, with their share falling by 5.7 percentage points in the same period to 26.7% of total foreign exchange assets. The growth in foreign currency securities, which rose by almost CZK 10 billion, or 7.5%, year on year, continued into 2005. Foreign currency securities now make up 21.1% of all the securities of domestic banks.

The value of foreign exchange liabilities developed less dynamically. Both their rate of growth and their absolute increase were roughly half (15.6% and CZK 74.0 billion respectively) those recorded for foreign exchange assets. Their share of total liabilities again rose slightly, from 18.0% to 18.6%, amounting to CZK 548.6 billion in absolute terms. This increase was due to rising liabilities to banks (up by 0.3 percentage point) and an increasing share of foreign currency client deposits (up by 0.9 percentage point). Despite slight growth in the volume of foreign currency securities issued (of CZK 1.6 billion), their share of foreign currency liabilities declined by 0.8 percentage point year on year.

Turning to the off-balance sheet, the foreign exchange component of off-balance-sheet assets and liabilities increased in 2005. Off-balance-sheet foreign exchange assets increased to CZK 1,452.4 billion and accounted for 29.8% of off-balance-sheet assets. Off-balance-sheet foreign exchange liabilities amounted to CZK 1,567.6 billion and exceeded 30% of off-balance-sheet liabilities (34.2%). The shares of the foreign exchange parts of the off-balance sheet increased on both sides, by 3.0 percentage points in the case of assets and by 4.8 percentage points in the case of liabilities. In the case of both claims and liabilities, derivatives – specifically fixed-term transactions – are the largest component.

The share of foreign currency operations on the assets and liabilities sides differs very markedly between the individual bank groups, particularly with regard to the prevailing types of banking transactions. The representation of foreign currency operations is particularly high in foreign bank branches. Their high proportion of foreign currency reflects a high frequency of transactions with business partners in the countries where their head offices are located. The share of foreign exchange assets in total assets continues to be the highest by far in foreign bank branches, amounting to 40.1%. In the large banks the figure is 24.9%, in medium-sized banks it is 20.7% and in small banks it is 17.6%. Given the legally restricted range of transactions that building societies are allowed to carry on, this group registers only 0.1% of assets in foreign currencies.

The differences between balance-sheet and off-balance-sheet assets and liabilities – i.e. the foreign exchange positions – recorded very dramatic developments over the three years up to the end of 2005. Contrary movements in the balance-sheet and off-balance-sheet foreign exchange positions were a characteristic feature of this period. The short balance-sheet position of the banking sector

of CZK -12.9 billion in 2003 increased regularly to a long balance-sheet foreign-exchange position of CZK 117.5 billion at the end of 2005. Balance-sheet foreign currency assets went up by 56.4% over the three-year period, which is more than double the 25% growth in foreign currency liabilities over the same period. Specifically, there was a sharp rise in foreign currency receivables from banks, which make up a large part of all foreign currency assets (almost 40%). Another factor was a more than 40% increase in foreign currency securities in banks' balance sheets, particularly government foreign currency bonds.

The short off-balance-sheet foreign exchange position continued to widen, from CZK -2.6 billion at the start of the period in 2003 to more than CZK -115 billion by the end of 2005. This trend was due mainly to faster growth in liabilities from fixed-term transactions, especially transactions in currency instruments and partly also interest rate instruments in foreign currencies, which together rose by CZK 374.5 billion in this period. Fast rising volumes of transactions of the type of liabilities arising from swaps and option transactions dominate the foreign currency transactions in the off-balance sheet. Off-balance-sheet foreign exchange risk recorded a further marked decrease in 2005.

The overall foreign exchange position of the banking sector has been balancing out as a result of the contrary movements in balance-sheet and off-balance-sheet foreign currency assets and liabilities. The short foreign exchange position (of CZK -29.8 billion) at the end of 2004 changed into a long one during 2005 for the first time in three years. The foreign currency assets of the banking sector exceeded the liabilities part of balance sheet and off-balance sheet by CZK 2.3 billion. The overall exposure of the domestic banking sector to foreign exchange risk remains very limited.

The prevailing orientation of the domestic economy towards EU countries is also reflected in the Czech banking sector. The banking sector's largest open foreign exchange position is vis-à-vis the euro. As of 31 December 2005 this was a long position (i.e. the volume of assets exceeded the volume of liabilities) of CZK 2.2 billion, which represents 1.32% of the banking sector's capital. The second-largest open position is vis-à-vis the Slovak koruna (short position, CZK 1.9 billion, 1.16% of capital). The domestic banking sector again showed a short foreign exchange position vis-à-vis the dollar (CZK 0.6 billion, 0.34% of capital).

Just as the shares of foreign currencies in assets and liabilities differ considerably across the individual bank groups, so do the market shares of the bank groups in the individual foreign exchange items of the banking sector's balance sheet. These shares, expressing the representation of foreign currency, also differ from their shares in total balance-sheet items. More changes occurred during 2005. The large bank group is strengthening the position of foreign currency balance-sheet items in terms of market share. The share of the large banks in foreign currency assets was 67.6% at the close of 2005, an increase of 2.2 percentage points on a year earlier. Significant market shares in foreign exchange assets as of 31 December 2005 were held by foreign bank branches and medium-sized banks, with 16.9% and 13.9% respectively. Despite being almost double the end-2005 figure, the 1.5% share of the small banks in foreign exchange assets is in keeping with their overall share in the sector. The building societies' shares are negligible in this regard.

Foreign exchange client deposits are located most of all in large banks (67.9%), despite showing a slightly downward trend of less than 1.7 percentage point year on year. The most visible groups on the foreign exchange deposit market are the medium-sized banks and foreign bank branches, whose positions stabilised at 18.6% and 11.5% respectively at the end of 2005. The large bank group still dominates the foreign currency client loan market, with a share steadily

CHART 31
FOREIGN EXCHANGE POSITION OF THE BANKING SECTOR
for banks with licences as of 31 December 2005

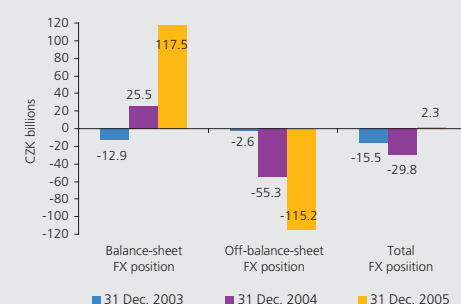


CHART 32
MARKET SHARES OF BANK GROUPS IN ASSETS AND SELECTED FOREIGN CURRENCY PRODUCTS IN PER CENT
for banks with licences as of 31 December 2005

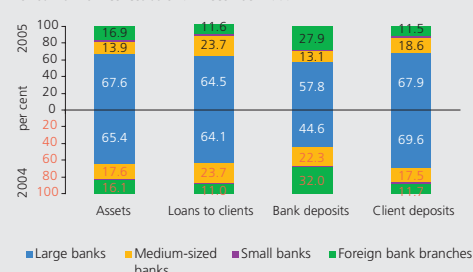


TABLE 9
STRUCTURE OF SECURITIES BY TYPE

for banks with licences as of 31 December 2005; CZK billions

	31 Dec. 03	31 Dec. 04	31 Dec. 05
Securities accepted by central banks for refinancing	304.5	291.6	334.6
Government bonds	291.3	272.6	330.8
Central bank bonds	13.2	19.0	3.8
Bonds	200.4	200.7	272.6
issued by government institutions	53.2	60.4	72.5
issued by other entities	147.2	140.3	200.0
Bills of exchange	1.9	2.1	1.5
Asset-backed securities	8.4	5.9	2.8
Shares	1.3	1.3	2.3
Units and other interests	6.4	9.1	9.2
Ownership interests	12.1	18.6	36.3
substantial	1.3	2.3	3.7
controlling	10.8	16.3	32.6
Securities, total	535.0	529.2	659.3

CHART 33
STRUCTURE OF SECURITIES PORTFOLIO BY PORTFOLIO TYPE
for banks with licences as of 31 December 2005

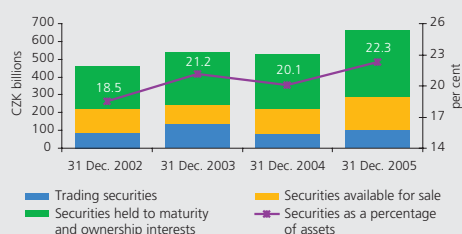
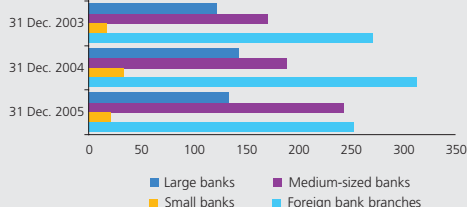


TABLE 10
STRUCTURE OF SECURITIES AS OF 31 DECEMBER 2005
for banks with licences as of 31 December 2005

	Large banks	Medium-sized banks	Small banks	Building societies	Foreign bank branches
Securities, total, in CZK billions	405.0	38.2	4.6	199.2	12.4
of which:					
trading securities	91.0	8.9	2.1	0.0	5.3
securities available for sale	106.1	22.3	1.1	44.5	7.0
securities held to maturity + ownership interests	208.0	7.0	1.4	154.7	0.0
of which:					
trading securities	22.5	23.2	46.9	0.0	43.3
securities available for sale	26.2	58.4	23.0	22.3	56.7
securities held to maturity + ownership interests	51.3	18.4	30.1	77.7	0.0

CHART 34
RECEIVABLES FROM DERIVATIVES TRANSACTIONS AS A PERCENTAGE OF TOTAL ASSETS
for banks with licences as of 31 December 2005



approaching 65%. The volatile foreign exchange bank deposit market recorded significant shifts again in 2005. The large banks again had the leading position on the market. By increasing its share by 13.2 percentage points it attained almost 60% on the foreign currency bank deposit market. The share of large banks rose at the expense of decreases in the shares in foreign exchange bank deposits in medium-sized banks (by 9.2 percentage points) and in foreign bank branches (by 4.1 percentage points).

3.3.2 Equity risk

(for banks with licences as of 31 December 2005)

The total volume of securities (including short-term government zero-coupon bonds and ownership interests) held by the domestic banking sector rose by CZK 130.1 billion (24.5%) to CZK 659.3 billion in 2005. The main reason for this increase was a change in IAS 39, under which part of bonds acquired in primary issues were reclassified from receivables (from clients and banks) to securities as of 1 January 2005. Without this methodological change, the total volume of securities would have increased by approximately CZK 37.1 billion (7.0%).

Securities issued by general government (government bonds and bonds of state institutions, e.g. the Czech Consolidation Agency, municipalities, etc.) and central bank bills account for around CZK 407.1 billion (61.7%) of the total volume of securities.

Corporate and banking bonds amount to CZK 200 billion (30.3%), of which more than CZK 156 billion is held by the large bank group. Building societies are a long way behind in second place, with CZK 29.8 billion. Under the Building Savings Schemes Act, building societies may only invest in bank bonds (particularly mortgage bonds issued by domestic banks).

The domestic banking sector does not engage significantly in transactions in shares, units or asset-backed securities. Their share of total securities is around 2%. Most are held by large banks.

The book value of the ownership interests of the banking sector increased by CZK 17.7 billion in 2005, to CZK 36.3 billion. The large bank group accounts for CZK 35.8 billion of this total.

As regards individual portfolios, around 56% of all securities are held to maturity, 27% are available for sale and the remaining 17% are trading securities. These figures recorded no major year-on-year changes.

3.3.3 Derivatives risks

(for banks with licences as of 31 December 2005)

Derivatives transactions are means of converting the risks of market participants. Hedging transactions account for the largest proportion of derivatives transactions. The vast majority of these transactions are OTC transactions. The upward trend in derivatives transactions continued into 2005, albeit at a slower pace. Receivables and liabilities from derivatives transactions rose by 6.7% and 7.0% year on year to CZK 4,236.6 billion and CZK 4,216.3 billion respectively as of the end of 2005. The total assets of the banking sector increased twice as fast as derivatives transactions during 2005. This meant that the value of derivatives transactions exceeded the total assets of the banking sector by 43%, a year-on-year decrease of 7.2 percentage points.

Despite the regular increases in the nominal value of derivatives transactions, the net nominal and real position of derivatives transactions remains very small. The net real value of fixed-term transactions was virtually unchanged year on year, amounting to around CZK 6 billion at the end of 2005. The net real value of option transactions remains negligible.

There are large differences between the individual banks and bank groups as regards their involvement in derivatives transactions. The banks that are active on the derivatives market have not changed substantially over time. At the end of 2005, 21 banks and foreign bank branches (excluding building societies) of the total of 36 banks had receivables from derivatives transactions in their balance sheets. Medium-sized banks and foreign bank branches, whose shares in total derivatives transactions exceed their shares in the banking sector's total assets by 10.6 percentage points and 7.4 percentage points respectively, are particularly active. The large bank group accounts for the largest, 57.2% share of derivatives transactions.

The structure of derivatives according to the underlying instruments used did not change significantly in 2005. Interest rate instruments are still very dominant. As of 31 December 2005 their share amounted to 67.2%, although this meant a year-on-year decline of 6.3 percentage points. Conversely, the share of currency instruments showed an upward tendency, stopping at 31.8% (up by 5.5 percentage points). Other underlying instruments did not fundamentally affect the structure.

The dynamic development of derivatives transactions in 2005 was visible mainly in the structure of such transactions as regards transaction type. The upward trend in receivables from forwards, which had started in 2002, halted in 2005. The total value of receivables from forwards declined by around 25% and their share fell just below the 30% level. By contrast, rapid growth in swaps (an increase of 23.5%) meant that they accounted for 61.0% all derivatives transactions. In this regard, the fast growth in options transactions (of 90% year on year) is of marginal significance, as this type of transaction accounted for 8.8% of total derivatives receivables.

3.4 COUNTRY RISK

Country risk is the risk of potential losses arising from the unwillingness or inability of entities from a particular country (or the country itself) to meet their external liabilities for reasons that are not related to any current credit risk. Unwillingness to fulfil obligations may arise, for instance, during a change in political regime in the country, while inability to fulfil obligations may be a consequence of an economic crisis, natural disaster or the introduction of regulatory measures. The level of country risk can be sometimes similar for several countries in a particular region where they display similar basic characteristics. Quantifying country risk is not easy, as it is related to economic and political developments in the country, which are often very difficult to predict. Banks manage this risk primarily by setting limits for their exposures to individual countries or regions and by differentiating the conditions under which commercial contracts are concluded.

3.4.1 Activities vis-à-vis non-residents

(for banks with licences as of 31 December 2005)

Activities vis-à-vis non-residents as a whole allow us to obtain a rough estimate of the overall level of risk towards clients and other banks having their registered offices or places of residence abroad. The most important factor in this respect is

CHART 35

DERIVATIVES STRUCTURE BY UNDERLYING ASSET

for banks with licences as of 31 December 2005

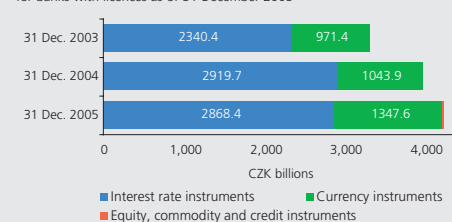


CHART 36

DERIVATIVES STRUCTURE BY CONTRACT TYPE

for banks with licences as of 31 December 2005

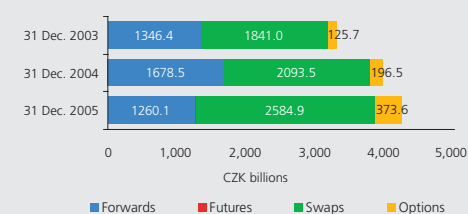


CHART 37

NON-RESIDENT ASSETS AND LIABILITIES AS A PERCENTAGE OF TOTAL ASSETS AND LIABILITIES

for banks with licences as of 31 December 2005

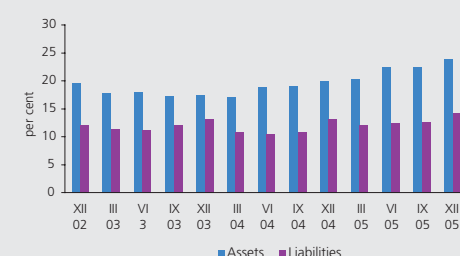


CHART 38
STRUCTURE OF ASSETS AND LIABILITIES VIS-À-VIS
NON-RESIDENTS AS OF 31 DECEMBER 2005
for banks with licences as of 31 December 2005

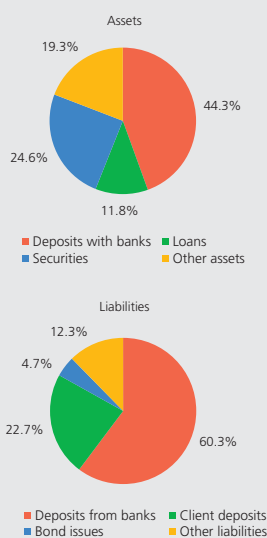


CHART 39
MARKET SHARES OF BANK GROUPS IN ASSETS AND
SELECTED PRODUCTS VIS-À-VIS NON-RESIDENTS IN PER CENT
for banks with licences as of 31 December 2005

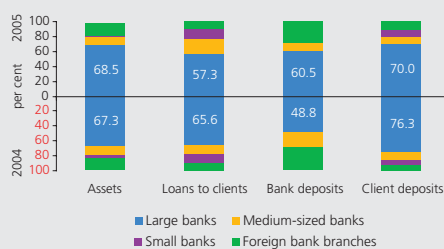


TABLE 11
PERCENTAGE SHARES OF NON-RESIDENTS IN TOTAL ASSETS,
LIABILITIES AND SELECTED TYPES OF BANKING PRODUCTS AS
OF 31 DECEMBER 2005; PERCENTAGES

for banks with licences as of 31 December 2005; for asset items,
the percentages are calculated from net asset values

	Large banks	Medium-sized banks	Small banks	Foreign bank branches	Banks, total
Assets	23.8	17.5	21.8	44.3	23.8
Liabilities	11.7	17.9	16.4	41.5	14.2
Loans provided	7.1	5.9	34.9	10.3	7.1
Deposits and loans with banks	41.9	39.1	5.0	67.9	44.0
Securities	39.4	26.6	20.8	0.1	27.0
Deposits accepted	5.5	4.5	19.7	9.6	4.9
Deposits and loans from banks	55.4	60.2	95.1	70.4	61.7
Receivables from derivatives transactions	71.0	70.7	35.3	62.4	69.4

the absolute level of the bank's asset and liability exposure (balance sheet and off-balance sheet). Another significant factor is the structure of non-resident assets and liabilities.

Domestic banks are in principle local, a fact that is reflected in the relatively low and stable share of transactions with non-residents. These transactions tend to move in line with foreign currency items, since approximately 70% of non-resident assets are denominated in foreign currency. As of 31 December 2005, non-resident assets amounted to CZK 725.0 billion, which represents 24.5% of total banking sector assets. This is an increase of CZK 183.2 billion on 2004, with their share of total assets up by 3.9 percentage points year on year. Non-resident liabilities totalled CZK 419.2 billion at the close of 2005 and their share of total liabilities was 14.2%, a year-on-year rise of CZK 70.8 billion and 1 percentage point respectively.

The share of non-resident off-balance-sheet transactions in total off-balance-sheet transactions did not change significantly in 2005. Off-balance-sheet assets vis-à-vis non-residents accounted for 60.8% of total off-balance-sheet assets (including memorandum accounts) at the end of 2005 (almost the same figure as a year earlier), while liabilities accounted for 49.8% (a year-on-year increase of 1.4 percentage point). The lower share in the case of liabilities is due to the volume of contingent liabilities received and assets accepted into custody or for management, which are part of off-balance-sheet liabilities and are predominantly of resident origin. As regards derivatives, the share of transactions with non-residents in their total volume remains slightly below 70%.

Receivables from, and liabilities to, banks are far and away the largest item of non-resident assets and liabilities, as in the case of foreign currency transactions. Receivables from foreign banks (excluding central banks), which were also the cause of the rise in total non-resident assets, account for 44.3% of total non-resident assets, as their volume increased by CZK 82.2 billion year on year, to CZK 321.4 billion. At 24.6%, securities are the second-largest component of non-resident assets. Receivables from non-resident clients make up only 11.8% of total non-resident assets. Receivables from non-residents account for 7.1% of the total volume of receivables from clients (a modest year-on-year rise of 0.8 percentage point).

Interbank transactions have an even more significant share on the non-resident liabilities side than on the assets side. Deposits from non-resident banks represent 60.3% of total non-resident liabilities. Their volume rose by CZK 41.2 billion in 2005, to CZK 252.9 billion. Deposits from non-resident clients represent 22.7% of total non-resident liabilities. Their volume rose by CZK 27.1 billion in 2005, to CZK 95.0 billion. Non-resident deposits account for 4.9% of the total volume of client deposits (a year-on-year increase of 1 percentage point).

The bulk of non-resident assets (68.5%) are held by the group of large banks. These held a total of CZK 496.5 billion in non-resident assets at the end of 2005, which represents 23.8% of the total assets of this group. The second-largest volume is recorded by foreign bank branches, with CZK 125.6 billion, which is 44.0% of their total assets. The non-resident assets and liabilities of building societies are negligible, making up 2.4% of their total assets and less than 0.1% of their total liabilities respectively.

3.4.2 Activities vis-à-vis individual regions and countries

(for banks with licences as of 31 December 2005)

Table 12 contains a list of the ten countries to which the Czech banking sector has the largest exposure (as measured by the volume of total assets). They all are EU countries. The exposure to these ten countries accounts for 82% of the total international exposure. The exposure to all the EU countries exceeds 90% of the total international exposure of the domestic banking sector. Except for an increase in the exposure to Slovakia, which moved to the top of the table, replacing Germany, and Luxembourg replacing the USA in last place, there were no major changes in this list relative to the end of 2004. The rise in exposure to Slovakia was due mainly to client loans and bonds.

The share of EU countries on the non-resident liabilities side is even higher than in the case of assets, amounting to almost 95%. Of the individual countries, residents of Germany have the largest exposure to the domestic banking sector (around CZK 80.8 billion), mainly due to deposits received from banks. The largest volume of client deposits continues to come from residents of Slovakia.

The values of, and trends in, the Herfindahl index in relation to selected products and countries allow us to evaluate, above all, the degree of concentration in the markets for these products within the framework of the individual countries of the EU. These values and trends at the same time indicate to what extent Czech banks are subject to country risk associated with the individual European economies for the selected products. The lower the Herfindahl index is, the more widely distributed the product is among the EU countries.

The Herfindahl index remains highest, i.e. the concentration is greatest, in the area of receivables from non-resident clients and deposits of non-resident clients. This is due in particular to a higher share of Slovak client loans and deposits by comparison with other EU countries.

TABLE 12

THE 10 COUNTRIES TO WHICH THE CZECH BANKING SECTOR HAS THE LARGEST EXPOSURE AS OF 31 DECEMBER 2005; CZK BILLIONS
for banks with licences as of 31 December 2005

	Assets, total	Deposits and loans with banks	Loans provided to clients	Bonds
Slovakia	195.9	40.1	36.0	16.5
Germany	129.1	97.9	4.5	15.2
United Kingdom	57.5	31.7	1.7	9.1
Netherlands	45.9	18.3	6.1	18.1
Austria	42.4	27.9	2.0	3.1
France	39.6	23.1	4.8	6.3
Belgium	27.1	22.3	0.2	0.0
Italy	26.1	7.1	1.8	17.1
Greece	18.9	0.6	0.1	18.2
Luxembourg	16.2	2.2	0.2	13.8

TABLE 13

THE 10 COUNTRIES WHICH HAVE THE LARGEST EXPOSURE TO THE CZECH BANKING SECTOR AS OF 31 DECEMBER 2005; CZK BILLIONS
for banks with licences as of 31 December 2005

	Liabilities, total	Deposits and loans from banks	Deposits received from clients
Germany	80.8	36.0	16.5
Belgium	72.4	4.5	15.2
Slovakia	67.8	1.7	9.1
United Kingdom	54.6	6.1	18.1
Austria	52.5	2.0	3.1
Luxembourg	32.1	4.8	6.3
Netherlands	18.6	0.2	0.0
USA	7.3	1.8	17.1
Russian Federation	5.8	0.1	18.2
Cyprus	5.6	0.2	13.8

CHART 40

HERFINDAHL INDEX OF CONCENTRATION OF BANKING EXPOSURE TO EU MEMBER STATES

for banks with licences as of 31 December 2005



4. CAPITAL ADEQUACY

(for banks with licences as of 31 December 2005)

Capital adequacy is of key importance in banking regulation and supervision. Generally, capital adequacy means the ratio of capital to the risks to which a given bank is exposed. This ratio should be high enough so that the capital covers any losses arising from the bank's activities or, to put it differently, so that such losses are borne by the owners of the capital and not directly by the creditors. Capital adequacy can theoretically be calculated for any entity. However, it is of practical importance in the regulation of entities that use a large amount of external funds in their activities as compared to their own funds. The main problem of capital adequacy is identifying the extent of the risks to which the bank is exposed. It is easier to determine the size of its capital, although there are sometimes problems deciding whether or not certain items count as capital. Therefore, the concept of capital adequacy is subject to constant development and revision, with other types of banking risks being included in the calculation and so on. This was also the main reason for the issuing of a new capital framework, known as Basel II, which should be implemented in 2007. It is aimed at enabling more accurate measurement of credit risks undertaken (mainly using banks' own models) and at including operational risks in the capital adequacy calculation.²⁷

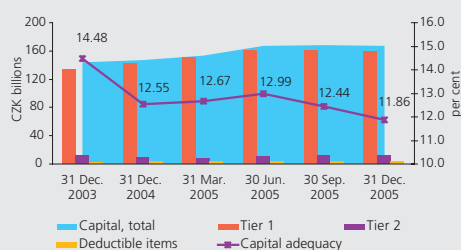
The total regulatory capital²⁸ (i.e. capital adjusted for the purposes of the capital adequacy calculation) increased by CZK 20.4 billion (13.9%) to CZK 167.1 billion in 2005. Increases in overall capital were recorded by all the bank groups. The main reason for the growth remained the retention of previous years' profits in banks' balance sheets. The banking sector recorded a net profit of CZK 32.9 billion in 2004, from which banks' shareholders were paid dividends totalling CZK 13.1 billion in 2005. CZK 1.3 billion was allocated to reserves and CZK 17.2 billion was left in the capital as retained earnings.

Some smaller banks partly increased their equity capital in 2005. However, the capital of the banking sector as a whole remained broadly unchanged. This was due to the merger of two banks and the conversion of one bank into a bank branch in 2005, which generated a capital reduction of CZK 1 billion. However, the decrease was offset by an equal increase in share premium in Tier 1.

Tier 2 capital grew by CZK 2.0 billion, despite the final dissolution of general reserves for standard loans, which used to be part of Tier 2.²⁹ The increase in this component of capital was thus mainly due to issues of subordinated bonds or the acceptance of subordinated debt in several banks and building societies.

Tier 3 capital is still not used in the domestic banking sector.

CHART 41
CAPITAL STRUCTURE
for banks with licences as of 31 December 2005



27 For more information on the new capital framework, see part A, section 4 of this publication.

28 Regulatory capital means capital determined in accordance with Heading II of Decree of the Czech National Bank No. 333 of 3 July 2002, stipulating the prudential rules of parent undertakings on a consolidated basis.

29 Under an amendment to the 2002 Act on Reserves for the Purposes of Determining the Income Tax Base, banks were obliged to use the general reserves created before 2002 to cover losses from write-offs and transfers of receivables and to cover losses from guarantees provided. Banks were obliged to release the unused reserves in favour of income, reducing the balance for each taxation period starting from 2002 by at least 25% of the balance on 31 December 2001 in order to dissolve them entirely on 31 December 2005 at the latest. This legislative adjustment was related to the alignment of Czech accounting standards with international accounting standards.

In 2005, the total capital requirements of the banking sector³⁰ rose by CZK 19.2 billion (20.6%) to CZK 112.8 billion. As in the case of capital, the capital requirements increased in all bank groups. The increase in the total capital requirements is mainly due to the capital requirement for banking portfolio credit risk. This reflects the higher lending activity of banks, reflected in a rise in assets with 100% and 50% risk weightings.³¹ As a result, the share of risk-weighted assets in the total assets of the banking sector continued to rise from 50.4% to 52.6% in 2005. The increase in assets with a 20% risk weighting is due mainly to an increase in the volume of derivatives transactions. The share of the capital requirement for banking portfolio credit risk in the total capital requirements increased by one percentage point to 93.4% year on year.

The capital requirement for trading portfolio risks increased by a mere CZK 430 million (6.0%) in 2005, mainly as a result of a rise in the capital requirement for the credit risk of this portfolio and for currency risk. Despite declining slightly, the capital requirement for general interest rate risk remains the most significant in the trading portfolio (representing 43% of the total capital requirement of the trading portfolio at the end of 2005). Only one large bank continues to calculate and report to the Czech National Bank selected capital requirements for trading portfolio risks using its own model.³²

The capital ratio of the banking sector was 11.86% as of 31 December 2005. This represents a year-on-year decrease of 0.69 percentage point. Nevertheless, this still safely exceeds the minimum requirement of 8%, which was met by all banks in 2005. Some banks, however, may run into capital constraints, given the significant increases in their loan portfolios. A total of six banks reported capital ratios between 8% and 10% as of the end of 2005. The further development of activities of these banks will thus depend *inter alia* on the distribution of their 2005 profits (how much will be left in the capital in the form of retained earnings) or on decisions to increase their regulatory capital in some other way.

CHART 42

RISK-WEIGHTED ASSETS

for banks with licences as of 31 December 2005

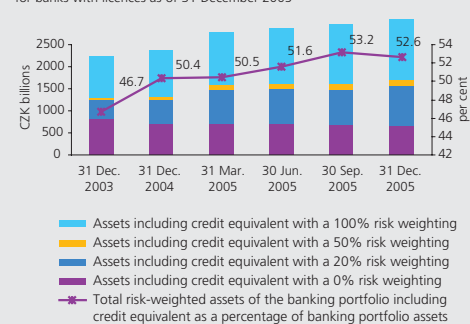


TABLE 14

BREAKDOWN OF BANKS BY CAPITAL ADEQUACY

for banks with licences as of 31 December 2005

	31 Dec. 00	31 Dec. 01	31 Dec. 02	31 Dec. 03	31 Dec. 04	31 Dec. 05
under 8%	0	0	0	0	0	0
8 to 12%	6	3	6	6	9	11
12 to 15%	5	7	8	6	7	3
15 to 20%	6	8	2	5	1	4
20 to 50%	4	4	7	5	6	4
over 50%	4	3	3	4	3	2

30 Capital requirements represent the amount of capital necessary to cover the risks undertaken, i.e. a bank's capital may not be lower than the capital requirements.

31 The 50% risk weighting applies to mortgage loans granted to natural persons and secured by residential property.

32 See the option laid down in Heading XI of Decree of the Czech National Bank No. 333 of 3 July 2002, stipulating the prudential rules of parent undertakings on a consolidated basis.

5. BANKING SECTOR PERFORMANCE

(for banks with licences as of 31 December 2005)

5.1 PROFIT FROM FINANCIAL ACTIVITIES AND PROFIT FROM OTHER OPERATING ACTIVITIES

In the longer term, stable financial management of banks is conditional on the ongoing creation of profit from financial activities, i.e. profit from core banking activities, which has to be high enough to cover the bank's operating expenses as well as the expenses incurred as a result of the banking risk undertaken by the bank (in particular the necessity to create provisions for outstanding loans).

The domestic banking sector recorded profit from financial activities of CZK 108.9 billion in 2005, up by CZK 5.4 billion (5.2%) year on year. The increases in the individual bank groups were as follows: large banks 1.9%, medium-sized banks 13.8%, small banks 46.3%, building societies 6.4% and foreign bank branches 12.7%.

The rise in profit from financial activities is mainly attributable to interest profit, which grew by CZK 4.3 billion (7.2%), amounting to CZK 64 billion. Its share in total profit from financial activities increased by 1 percentage point to 58.8%. The rise in interest profit was due to a significant increase in the volume of loans provided, reflected in a rise in interest income from other clients (i.e. excluding banks and general government), which now exceeds 50% of total interest income. The volume of interest income received from general government continues to decline, reflected in a gradual decrease in the exposure of the banking sector to such entities (in particular the Czech Consolidation Agency). Owing to the low interest rates on client deposits, interest expenses showed no major increases, even though client deposits grew in absolute terms.

In 2005, banks developed their business activities in a low interest rate environment. The competitive environment prevailing in key segments of the domestic banking market is limiting the size of, and growth in, banks' interest margins.

Profit from fees and commissions was CZK 31.8 billion in 2005, up by CZK 0.5 billion (1.6%) compared to 2004. However, the 2004 figures are increased by around CZK 2.4 billion as a result of an extraordinary specific transaction by one large bank. Adjusted for this one-off effect, the annual rise in profit from fees and commissions would be about 10.1%.³³ The higher profit from fees in 2005 was mainly due to growth in the number of transactions, in particular loans granted, income from payment services and income related to the sale and management of alternative investment products (especially mutual and pension funds, life insurance and so on). The prices (rates) of fees were broadly flat in 2005 due to competitive pressures and strong interest of the media and the public in this issue. Some banks slightly reduced or cancelled some of their fees to make their price lists simpler and more transparent.

With the exception of the large banks and building societies, all the bank groups recorded higher profit from fees and commissions compared to the previous year (the year-on-year comparison is affected by the above-mentioned accounting

CHART 43
STRUCTURE OF PROFIT FROM FINANCIAL ACTIVITIES BY PROFIT TYPE

for banks with licences as of 31 December 2005

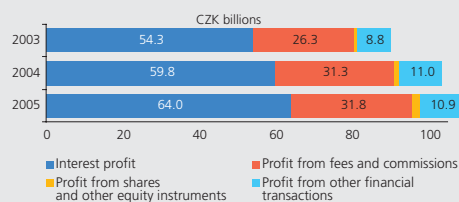
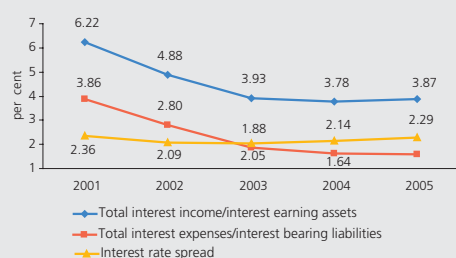


CHART 44
INTEREST RATE SPREAD

for banks with licences as of 31 December 2005



³³ The comparability of the data is further affected by a change in IAS 39, as a result of which fees related to a loan granted have since 2005 been accrued until the repayment of the loan (previously, this was one-off income in the period when the loan was granted), i.e. this change reduces profit from fees and commissions in 2005 compared to previous years.

operation by one large bank in 2004). Building societies recorded profit from fees and commissions of CZK 1.89 billion in 2005, compared to CZK 1.95 billion in 2004 (3.6%). This slight decrease chiefly reflects a decline in the total number of building savings contracts signed, from 5.899 million to 5.574 million.³⁴

Income from shares and participations amounted to CZK 2.2 billion in 2005, thus contributing to an annual increase in profit from financial activities of CZK 820 million. As usual, most of this income is attributable to large banks and consists mainly of dividends received from their subsidiaries and affiliates.

Profit from financial operations was CZK 10.9 billion in 2005, down slightly by CZK 177 million (1.1%) from a year earlier. Its most significant component is profit from foreign exchange transactions (CZK 4.7 billion), which consists mainly of profit from trading in foreign currencies (spreads in banks' exchange rates).

The higher growth in the total assets of the banking sector caused the ratio of profit from financial activities to total assets to fall slightly year on year, despite the higher profit from financial activities. The ratios of the main components of this profit (interest profit and profit from fees) to total assets saw similar developments.

The banking sector recorded profit of CZK 5.1 billion on other operating activities in 2005, compared to CZK 922 million a year earlier. On the income side, this item reflects the results of various specific one-off transactions, such as sales of banks' ownership interests, income from the sale of fixed assets, income from the sale of receivables and so on. In 2005, these included above all one large bank's income connected with the result of arbitration proceedings, income from the sale of real estate and profit from the sale of ownership interests. On the expenses side, this item was positively affected by the return of the mandatory Deposit Insurance Fund contribution to its initial rate of 0.1% of the average volume of insured deposits, which saved the banking sector CZK 1.28 billion compared to a year earlier.³⁵

5.2 ADMINISTRATIVE EXPENSES, WRITE-OFFS, CREATION AND USE OF PROVISIONS

The administrative expenses of the banking sector totalled CZK 51.8 billion in 2005, a year-on-year increase of CZK 3.0 billion (6.1%). Although the growth rate of administrative expenses was slightly higher in 2005 than in 2004 (6.1% against 2.7%), it is apparent that banks are continuing to exert pressure for efficient cost management. The higher administrative expenses are due mainly to personnel expenses, which grew by CZK 1.78 billion (7.3%) to CZK 26.3 billion. The average converted number of employees of the banking sector decreased to 37,625³⁶ in 2005, down by 2.4% compared to 2004. Average personnel expenses per employee thus increased by 9.9% to CZK 699,700 for the banking sector as a whole.

Other administrative expenses grew in total by CZK 1.2 billion (4.9%) to CZK 25.5 billion, mainly under advertising, audit, tax and legal consultancy, and outsourcing expenses.

CHART 45

PROFIT FROM FINANCIAL ACTIVITIES AS A PERCENTAGE OF ASSETS

for banks with licences as of 31 December 2005

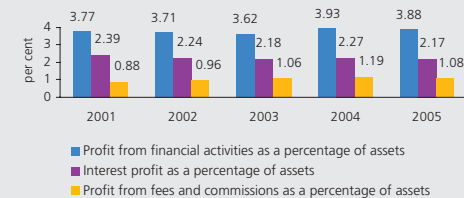
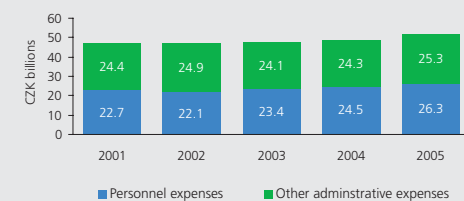


CHART 46

STRUCTURE OF ADMINISTRATIVE EXPENSES

for banks with licences as of 31 December 2005

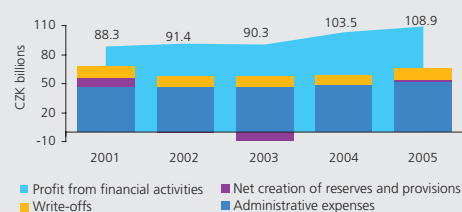


³⁴ This is the number of building savings contracts in the saving phase. Building societies recorded the highest number of contracts at the end of 2003 (6.3 million), this being a result of households' extraordinary interest in building savings schemes before the terms and conditions changed.

³⁵ The total contribution of the banking sector to the Deposit Insurance Fund was CZK 1.48 billion in 2005, compared to CZK 2.76 billion in 2004.

³⁶ This is the average number of employees in the given year converted into full-time equivalents; for example, a half-time employee is calculated as half an employee in the total number of employees.

CHART 47
SUFFICIENCY OF PROFIT FROM FINANCIAL ACTIVITIES
 for banks with licences as of 31 December 2005



Write-offs and creation of provisions amounted to CZK 13.1 billion in 2005, up by CZK 2.9 billion (27.2%) compared to 2004. Write-offs and creation of provisions for tangible and intangible assets totalled CZK 11.8 billion, up by CZK 1.3 billion (12.9%) on a year earlier. Write-offs and creation of provisions and reserves for receivables and off-balance-sheet instruments amounted to CZK 458 million at net value, which is almost the same as in 2004. However, slightly higher net creation of provisions for loans is apparent in the structure of the creation and release of provisions, reserves and write-offs of receivables, owing to the growth in loan portfolio (and the related growth in classified loans). In compliance with an obligation set out in the Act on Reserves, banks released or used the remainder of their general reserves to cover standard loan risks in 2005 (around CZK 2.3 billion).³⁷

Higher net creation of other reserves (up by CZK 1.7 billion year on year) again negatively affected profits in 2005. This is mainly associated with the creation of reserves for legal disputes in some banks and the greater use of such reserves in 2004.

5.3 NET PROFIT

The banking sector generated a net profit of CZK 39.1 billion in 2005, up by CZK 6.3 billion (18.8%) year on year. Summing up the aforementioned information, it can be said that this was due to significant growth in the major components of profit from financial activities (in particular interest profit), the ongoing control of administrative expenses and only low risk expenses (i.e. expenses related to the depreciation of assets as a result of risks undertaken). The reduction in the contribution to the Deposit Insurance Fund had a positive effect. Interest income is being driven primarily by a growing volume of loans provided, whereas income from fees is being aided chiefly by an increasing number of transactions, the growth in the number of loans provided and the increasing number of clients investing in alternative products. As in previous years, profit was affected by some specific transactions which caused a one-off increase in profit (in particular, an arbitration ruling, extraordinary dividend income of some large banks, income from the sale of real estate and ownership interests and the completion of the obligatory release of reserves). Net profit was also positively affected by lower taxation,³⁸ this being due to a cut in the corporate income tax rate (26%, against 28% in 2004) and to deferred tax.³⁹

Annual growth in net profit was recorded for all groups of banks except foreign bank branches. As regards the individual banks, only two banks and four foreign bank branches (most of which opened for business only recently) recorded a loss at the end of 2005.

CHART 48
COMPARISON OF NET PROFIT
 for banks with licences as of 31 December 2005

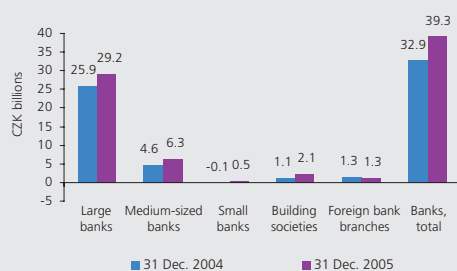
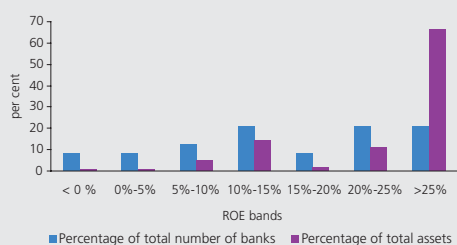


CHART 49
DISTRIBUTION OF RETURN ON TIER 1 AS OF 31 DECEMBER 2005
 for banks with licences as of 31 December 2005



5.4 PROFITABILITY, EFFICIENCY AND PRODUCTIVITY

Profitability indicators also showed a year-on-year improvement, thanks to the profits generated by the banking sector. Return on Tier 1 capital was 25.2% for the banking sector as a whole in 2005, up by 1.8 percentage points on a year earlier. The largest return on Tier 1 continues to be recorded by the group of large

³⁷ See also part B, section 4 - *Capital Adequacy*.

³⁸ Income tax for the banking sector as a whole declined by CZK 2.7 billion to CZK 9.8 billion year on year.

³⁹ In 2005, income from deferred income tax amounted to CZK 708.5 million, compared to expenses from deferred tax of CZK 479.6 million in 2004. Income from deferred income tax is mainly a result of the creation of provisions for bad loans, which will, however, be tax-deductible in future years, or if a bank writes off its assets faster than allowed by the tax regulations.

banks, with 28.8%. This group showed a year-on-year increase of 1.1 percentage points. An improvement in this indicator was also recorded for other bank groups. Medium-sized banks showed a return on Tier 1 of 15.6% at the end of 2005, while small banks and building societies recorded 13.4% and 22.7% respectively.

Return on assets also showed a slight year-on-year improvement in 2005, increasing by 0.14 percentage point to 1.4% for the banking sector as a whole. The highest return on assets continues to be recorded by the large banks, at 1.68% (up by 0.1 percentage point on a year earlier).

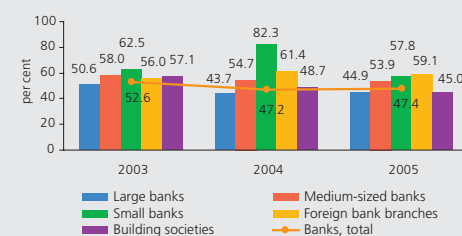
The ratio of administrative expenses to profit from financial activities showed a slight year-on-year deterioration of 0.4 percentage point in 2005, which was due to the large banks. The other bank groups recorded year-on-year improvements in this ratio.

The ratio of administrative expenses to profit from financial activities is one of the basic indicators of the work efficiency of banking institutions. High values indicate less efficient use of resources by some banks. However, when assessing this indicator, differences in the business orientation of the individual banks have to be taken into account. The ratio is also affected by the time that has elapsed since the bank opened for business, as newly established institutions are capable of attaining adequate profits only after some time has passed.

Profit from financial activities per employee grew by 7% year on year to CZK 2.9 million, while net profit per employee was up by 21.0% to CZK 1.04 million. On 31 December 2005, net assets per bank employee totalled CZK 78.7 million, up by 13.9% on a year earlier.

CHART 50
RATIO OF ADMINISTRATIVE EXPENSES TO PROFIT FROM FINANCIAL ACTIVITIES

for banks with licences as of 31 December 2005



AMA	Advanced Measurement Approaches
ATM	Automatic Teller Machine
BAC	Banking Advisory Committee
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BSC	Banking Supervision Committee
BSCEE	Banking Supervisors from Central and Eastern Europe
CBCB	Czech Banking Credit Bureau
CCB	Czech Credit Bureau
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESR	Committee of European Securities Regulators
CNB	Czech National Bank
COREP	Common Reporting Group
CPLG	Core Principles Liaison Group
CRC	Central Register of Credits
CRIF	Italian company CRIF S.p.A. - the sole shareholder of CCB
CSC	Czech Securities Commission
CZSO	Czech Statistical Office
EBC	European Banking Committee
EC	European Commission
EC	European Community
ECAI	External Credit Assessment Institutions
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EEC	European Economic Community
EFCC	European Financial Conglomerate Committee
EIOPS	European Insurance and Occupational Pensions Committee
ESC	European Securities Committee
FIN-NET	Consumer Complaints Network for Financial Services
FINREP	financial reporting
FSAP	Financial Services Action Plan
GdC	Groupe de Contact
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRB	Internal Ratings Based (approach to credit risk)
IWCFC	Interim Working Committee on Financial Conglomerates
LLCB	Leasing & Loan Credit Bureau
MoF	Ministry of Finance
MoU	Memorandum of Understanding
OECD	Organisation for Economic Cooperation and Development
OTC	over-the-counter
PRIBOR	Prague Interbank Offered Rate
RoE	Return on Equity
VaR	Value at Risk
WB	World Bank
WGAA	Working Group on Accounting and Auditing
WGC	Working Group for Capital
WGCR	Working Group on Credit Registers
WGDB	Working Group on Developments in Banking
WGFI	Working Group on Financial Information
WGMA	Working Group on Macroprudential Analysis





Survey of banks and foreign bank branches as of 31 December 2005

I. Banks

Bank	Start of operation	Equity capital in CZK millions (registered)	Number of banking outlets		Number of employees
			in Czech Rep.	abroad	
BAWAG Bank CZ a.s.	1 Feb. 1991	1,709	10		276
Citibank a.s.	24 Jun. 1991	2,925	5		748
Česká exportní banka, a.s.	1 Jul. 1995	1,850	0		119
Česká spořitelna, a.s.	1 Jan. 1969	15,200	646		10,492
Českomoravská hypoteční banka, a.s.	10 Jan. 1991	2,635	25		373
Českomoravská stavební spořitelna, a.s.	8 Sep. 1993	1,500	0		604
Českomoravská záruční a rozvojová banka, a.s.	1 Mar. 1992	2,132	6		263
Československá obchodní banka, a.s.	1 Jan. 1965	5,105	225	105	8,268
eBanka, a.s.	1 Jan. 1991	1,185	171		868
GE Money Bank, a.s.	22 Jun. 1998	510	201		2,117
HVB Bank Czech Republic a.s.	1 Jul. 1992	5,125	25		1,120
HYPO stavební spořitelna a.s.	1 Oct. 1994	500	9		138
IC Banka, a.s.	6 Apr. 1994	500	1		38
J&T BANKA, a.s.	18 Dec. 1992	934	0		162
Komerční banka, a.s.	1 Jan. 1990	19,005	366		7,390
Modrá pyramida stavební spořitelna, a.s.	16 Dec. 1993	500	0		364
PPF banka a.s.	1 Sep. 1993	769	2		122
Raiffeisenbank a.s.	1 Jul. 1993	2,500	49		1,124
Raiffeisen stavební spořitelna a.s.	7 Sep. 1993	650	0		195
Stavební spořitelna České spořitelny, a.s.	1 Jul. 1994	750	0		221
Volksbank CZ, a.s.	1 Jan. 1994	819	18	1	453
Wüstenrot - stavební spořitelna a.s.	11 Nov. 1993	660	0		183
Wüstenrot hypoteční banka a.s.	23 Dec. 2002	600	0		30
Živnostenská banka, a.s.	1868	1,360	42		800

II. Foreign bank branches

Bank	Start of operation	Home country	Number of local outlets		Number of employees
			in Czech Rep.	abroad	
ABN AMRO Bank N.V.	6 May 1993	Netherlands	1		108
CALYON S.A., organizační složka	1 Nov. 2005	France	1		81
COMMERZBANK Aktiengesellschaft, pobočka Praha	1 Dec. 1992	Germany	4		249
Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka	1 Dec. 1993	Germany	0		65
Fortis Bank SAV/NV, pobočka Česká republika	1 Aug. 2005	Belgium	0		9
HSBC Bank plc - pobočka Praha	1 May 1997	United Kingdom	0		49
ING Bank N.V.	1 Sep. 1993	Netherlands	0		212
Oberbank AG pobočka Česká republika	1 Oct. 2004	Austria	8		90
PRIVAT BANK AG der Raiffeisenlandesbank Oberösterreich, pobočka Česká republika	1 Jan. 2005	Austria	1		5
Raiffeisenbank im Stiftland eG pobočka Cheb, odštěpný závod	2 Jan. 1995	Germany	2		36
Všeobecná úverová banka a.s., pobočka Praha	14 Jan. 1993	Slovakia	0		22
Waldviertler Sparkasse von 1842	1 May 1994	Austria	7		146

III. Banks in liquidation or in bankruptcy proceedings

Bank	Start of operation	Revocation of licence
AB Banka, a.s. in liquidation	1 Apr. 1991	15 Dec. 1995
Agrobanka Praha, a.s., in liquidation	1 Jul. 1990	2 Sep. 1998
COOP BANKA, a.s. in liquidation	24 Feb. 1992	6 May 1998

III. Banks in liquidation or in bankruptcy proceedings (continued)

Bank	Start of operation	Revocation of licence
Česká banka, akciová společnost Praha - in liquidation	28 Feb. 1992	15 Dec. 1995
EKOAGROBANKA, a.s. in liquidation	1 Nov. 1990	31 May 1997
Kreditní banka Plzeň, a.s. - in liquidation	1 Jan. 1991	8 Aug. 1996
Kreditní a průmyslová banka a.s.	1 Apr. 1991	31 Aug. 1995
Moravia Banka, a.s. in liquidation	2 Jul. 1992	9 Nov. 1999
Plzeňská banka a.s. - in liquidation	1 Oct. 1993	4 Jul. 2003
Pragobanka, a.s.	1 Oct. 1990	24 Oct. 1998
První slezská banka a.s., in liquidation	12 Jan. 1993	13 May 1996
Realitbanka, a.s.	1 Nov. 1991	17 Apr. 1997
Union banka, a.s. "in liquidation"	15 Nov. 1991	2 May 2003
UNIVERSAL BANKA, a.s.	15 Feb. 1993	10 Feb. 1999
Velkomoravská banka, akciová společnost.	3 Nov. 1992	10 Jul. 1998

IV. Banks dissolved without liquidation

Bank	Start of operation	Termination of licence	Reason
Bank Austria (ČR) a.s.	1 Jan. 1992	30 Jun. 1998	merger
Bank Austria Creditanstalt Czech Republic, a.s.	1 Apr. 1991	1 Oct. 2001	merger
BAWAG International Bank CZ a.s.	12 May 1992	31 Mar. 2005	merger
HYPO-BANK CZ a.s.	26 Feb. 1992	31 Dec. 1998	merger
Poštovní banka a.s.	1 Jan. 1991	31 Dec. 1993	merger
Westdeutsche Landesbank (CZ), a.s.	operation not started	20 Jan. 1998	operation not started

V. Banks dissolved with liquidation

Bank	Start of operation	Termination of licence	Completion of liquidation
Evrobanka, a.s., in liquidation	1 Oct. 1991	30 Jun. 1997	5 Mar. 2001
Banka Bohemia, a.s. - in liquidation	1 Feb. 1991	not revoked	9 Oct. 2003
Baska a.s. "in liquidation"	13 Dec. 1990	31 Mar. 1997	4 Feb. 2004

VI. Former banks now operating only as joint-stock companies without a banking licence

Bank	Start of operation	Termination of licence
BANKA HANÁ, a.s.	11 Jan. 1991	1 Dec. 2000
Erste Bank Sparkassen (CR) a.s.	1 Feb. 1993	30 Sep. 2000
Foresbank, a.s.	7 Sep. 1993	1 Mar. 1999
INVESTIČNÍ A POŠTOVNÍ BANKA, akciová společnost	1 Jan. 1990	7 Aug. 2002
SOCIETE GENERALE BANKA, a.s.	15 Apr. 1991	18 Nov. 1999

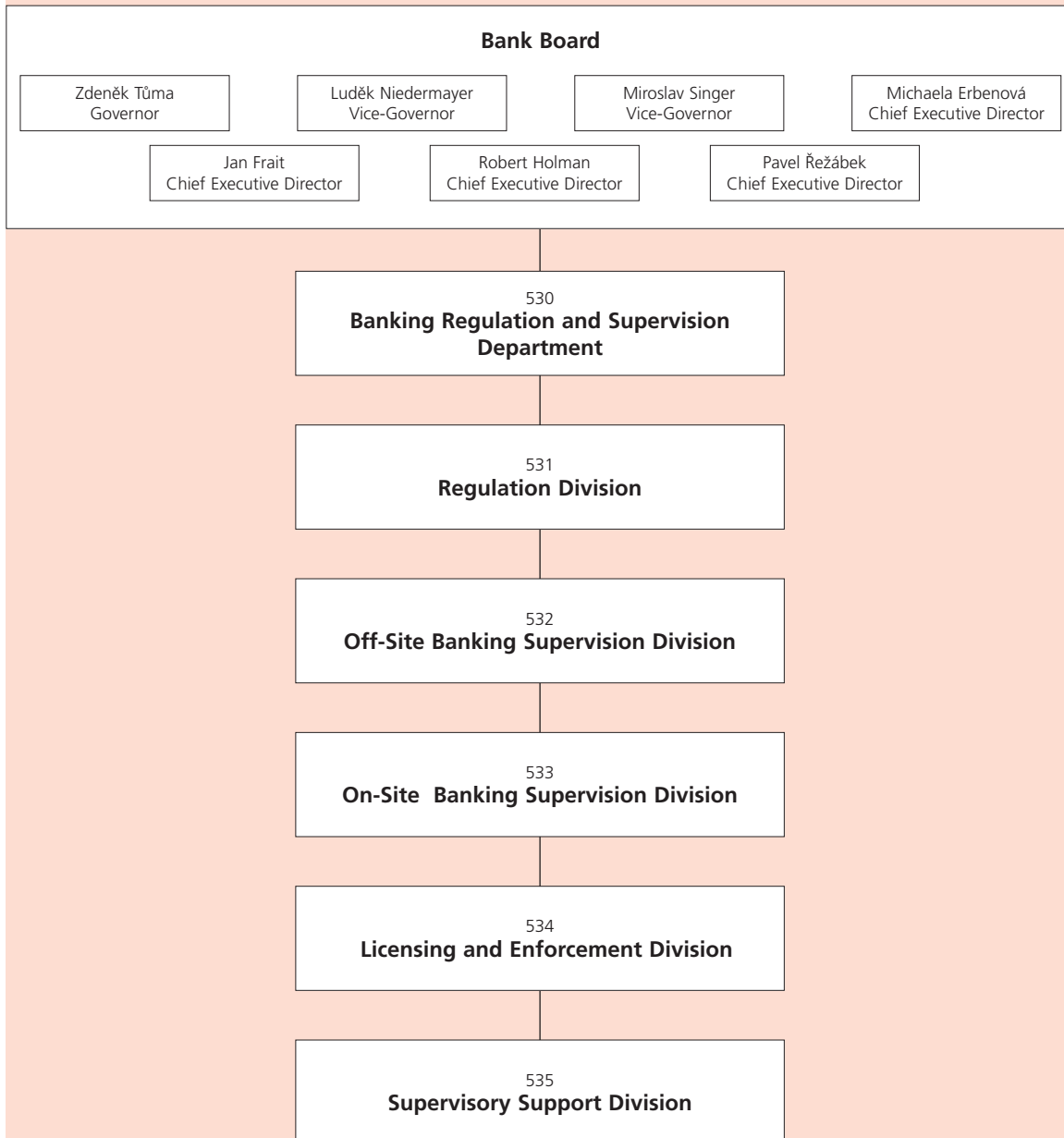
VII. Branches whose licences have terminated

Bank	Start of operation	Termination of licence	Reason
SOCIETE GENERALE, pobočka Praha	1 Jan. 1998	31 Mar. 2002	merger

VIII. Former state financial institution (transformed into a non-banking institution)

Bank	Start of operation	Termination of licence
Konsolidační banka Praha, s.p.ú	23 Feb. 1993	31 Aug. 2001

Organisational structure of CNB Banking Supervision
as of 31 December 2005



Breakdown of banks into groups

I. Large banks		IV. Foreign bank branches	
1.	Česká spořitelna, a.s.	1.	ABN AMRO Bank N.V.
2.	Československá obchodní banka, a.s.	2.	CALYON BANK CZECH REPUBLIC, a.s.
3.	HVB Bank Czech Republic a.s.	3.	COMMERZBANK Aktiengesellschaft, pobočka Praha
4.	Komerční banka, a.s.	4.	Deutsche Bank Aktiengesellschaft Filiale Prag, organizační složka
		5.	Fortis Bank SA/NV, pobočka Česká republika
		6.	HSBC Bank plc - pobočka Praha
		7.	ING Bank N.V.
		8.	Oberbank AG pobočka Česká republika
		9.	PRIVAT BANK AG der Raiffeisenlandesbank Oberösterreich, pobočka Česká republika
		10.	Raiffeisenbank im Stiftland eG pobočka Cheb, odštěpný závod
		11.	Všeobecná úverová banka a.s., pobočka Praha
		12.	Waldviertler Sparkasse von 1842
II. Medium-sized banks		V. Building societies	
1.	BAWAG Bank CZ a.s. (po sloučení)	1.	Českomoravská stavební spořitelna, a.s.
2.	Citibank a.s.	2.	HYPO stavební spořitelna a.s.
3.	Česká exportní banka, a.s.	3.	Modrá pyramida stavební spořitelna, a.s.
4.	Českomoravská hypoteční banka, a.s.	4.	Raiffeisen stavební spořitelna a.s.
5.	Českomoravská záruční a rozvojová banka, a.s.	5.	Stavební spořitelna České spořitelny, a.s.
6.	GE Money Bank, a.s.	6.	Wüstenrot - stavební spořitelna a.s.
7.	Raiffeisenbank a.s.		
8.	Volksbank CZ, a.s.		
9.	Živnostenská banka, a.s.		
III. Small banks			
1.	eBanka, a.s.		
2.	IC Banka, a.s.		
3.	J&T BANKA, a.s.		
4.	PPF banka a.s.		
5.	Wüstenrot hypoteční banka a.s.		

Main indicators of monetary and economic developments in the Czech Republic

		2001	2002	2003	2004	2005
Gross domestic product ^{1) 2)}	Volume (in CZK billions)	1,617.6	1,641.9	1,694.4	1,773.8	1879.4
	Increase (in per cent)	2.6	1.5	3.2	4.7	6.0
Output - percentage increase ²⁾	Industry	6.0	2.7	5.8	9.9	8.1
	Construction	6.8	-3.5	11.2	4.5	3.7
Prices ³⁾	Inflation rate (in per cent)	4.7	1.8	0.1	2.8	1.9
Unemployment ⁴⁾	Unemployment rate (in per cent)	8.5	9.2	9.9	9.2	8.9
Foreign trade	Exports (in CZK billions)	1,269.6	1,254.4	1,370.9	1,713.7	1,875.2
	Imports (in CZK billions)	1,386.3	1,325.7	1,440.7	1,736.0	1,834.9
	Balance (in CZK billions)	-116.7	-71.3	-69.8	-22.3	40.4
Average wage ²⁾	Nominal (in per cent)	8.7	7.3	6.6	6.6	5.4
	Real (in per cent)	3.8	5.4	6.5	3.7	3.4
Balance of payments	Current account (in CZK billions)	-124.5	-136.4	-160.6	-167.3	-61.7
	Financial account (in CZK billions)	172.8	347.8	157.1	183.7	137.9
Exchange rate ⁵⁾	CZK/USD	38.04	32.74	28.23	25.7	23.95
	CZK/EUR	34.08	30.81	31.84	31.9	29.78
Average interbank	7-day	5.15	3.61	2.30	2.23	1.97
deposit rate (PRIBOR)	3-month	5.18	3.55	2.28	2.36	2.01
	6-month	5.21	3.56	2.28	2.48	2.05
Discount rate (in per cent) ⁶⁾		3.75	1.75	1.00	1.50	1.00
Lombard rate (in per cent) ⁶⁾		5.75	3.75	3.00	3.50	3.00
2W repo rate (in per cent) ⁶⁾		4.75	2.75	2.00	2.50	2.00
PX capital market index ⁶⁾		n.a.	460.7	659.1	1,032.0	1,473.0

Source: CZSO (macroeconomic indicators)

1) At constant 1995 prices

2) Percentage increase on a year earlier

3) Inflation rate in December of the given year

4) Average registered unemployment rate; based on existing methodology since 2004

5) Annual averages from monthly averages

6) End-of-period figures

Liabilities
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
in CZK millions						
Liabilities to banks	285,320	361,134	316,823	305,873	306,214	409,691
of which: liabilities to banks payable on demand	45,943	65,187	91,544	79,517	61,582	65,813
central banks	28	2	2	2	2	10,503
other banks	45,915	65,185	91,543	79,515	61,580	55,310
other liabilities to banks	239,377	295,948	225,279	226,357	244,632	343,878
central banks	106	77	64	65	52	18,554
other banks	239,271	295,870	225,215	226,292	244,580	325,324
Liabilities to clients	1,665,887	1,731,850	1,784,622	1,903,783	1,954,369	1,919,559
of which: payable on demand	792,201	844,625	832,372	884,766	915,396	960,792
other liabilities	873,686	887,224	952,250	1,019,017	1,038,972	958,766
Liabilities from debt securities	201,680	214,619	227,032	245,509	255,877	262,046
of which: issued debt securities	196,310	201,466	214,108	231,611	239,187	247,935
short-term	107,554	115,536	120,409	128,903	128,423	105,633
long-term	88,756	85,931	93,698	102,708	110,764	142,302
other payables	5,370	13,153	12,924	13,898	16,690	14,111
Other liabilities	152,534	107,876	147,952	165,663	147,142	113,818
Deferred revenues and accrued expenses	12,538	4,130	5,245	5,160	5,357	4,666
Reserves	23,643	16,520	14,084	14,081	14,195	12,764
Subordinated liabilities	7,829	8,158	8,455	11,587	11,752	11,996
Equity capital	68,272	70,416	69,388	69,588	69,581	69,820
Own shares	617	3	32	0	7	7
Share premium	8,609	11,296	12,596	12,508	12,509	12,930
Reserve funds and other funds created from profit	30,456	31,105	31,056	32,169	32,186	31,999
Reserve fund for new valuation	0	0	0	0	0	0
Capital funds	524	525	524	504	1,084	1,079
Valuation differences	1,273	2,886	8,151	11,875	10,000	6,815
Retained profits (accumulated losses) from previous periods	38,948	42,185	74,343	60,078	58,492	58,048
Profit (loss) for the accounting period	30,193	32,852	11,676	22,754	31,930	39,139
Total liabilities	2,527,707	2,635,554	2,711,945	2,861,133	2,910,687	2,954,369
in per cent						
Liabilities to banks	11.29	13.70	11.68	10.69	10.52	13.87
of which: liabilities to banks payable on demand	1.82	2.47	3.38	2.78	2.12	2.23
central banks	0.00	0.00	0.00	0.00	0.00	0.36
other banks	1.82	2.47	3.38	2.78	2.12	1.87
other liabilities to banks	9.47	11.23	8.31	7.91	8.40	11.64
central banks	0.00	0.00	0.00	0.00	0.00	0.63
other banks	9.47	11.23	8.30	7.91	8.40	11.01
Liabilities to clients	65.91	65.71	65.81	66.54	67.14	64.97
of which: payable on demand	31.34	32.05	30.69	30.92	31.45	32.52
other liabilities	34.56	33.66	35.11	35.62	35.70	32.45

Income and expenses
(for banks with licences as of 31 December 2005; in CZK millions)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Interest income	99,603	102,644	27,116	53,758	80,166	107,144
Interest expenses	45,300	42,885	11,623	22,279	32,460	43,100
Interest profit (including securities)	54,303	59,760	15,492	31,479	47,706	64,043
Income from fees and commissions	35,657	38,085	9,130	18,884	28,504	38,899
Expenses from fees and commissions	9,314	6,760	1,236	3,000	4,747	7,068
Profit from fees and commissions	26,343	31,326	7,894	15,884	23,756	31,831
Interest profit (including fees and commissions)	80,645	91,085	23,386	47,363	71,462	95,874
Profit from shares and other equity instruments	824	1,369	40	1,651	2,099	2,189
Profit from financial transactions	8,783	11,031	3,025	5,933	8,666	10,854
Profit from financial activities, total	90,252	103,486	26,451	54,947	82,227	108,918
Administrative expenses	47,513	48,819	12,402	25,097	37,574	51,786
Creation of reserves and provisions, write-offs and receivables transfer losses (net)	733	10,274	2,051	4,737	7,331	13,070
Other operating income (+) / expenses (-)	-744	922	3,227	3,191	3,046	5,134
Gross operating profit	41,251	45,366	15,224	28,380	40,445	49,271
Extraordinary income (+) / expenses (-)	11	-10	1	-1	0	1
Pre-tax gross profit	41,262	45,355	15,225	28,380	40,445	49,272
Taxes	11,068	12,503	3,549	5,626	8,515	10,133
Net profit	30,193	32,852	11,676	22,754	31,930	39,139

Profitability and efficiency
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Profit from banking activities/assets in per cent	3.62	3.96	3.98	4.05	3.97	3.88
Gross profit/assets in per cent	1.65	1.74	2.29	2.09	1.95	1.75
Net profit/assets in per cent	1.21	1.26	1.76	1.68	1.54	1.39
Net profit/Tier 1 in per cent	23.80	23.34	32.06	30.09	27.63	25.16
Total interest income/interest earning loans in per cent	3.92	3.77	4.12	3.98	3.92	3.87
Total interest expenses/interest bearing deposits in per cent	1.89	1.64	1.75	1.65	1.60	1.58
Interest rate spread in per cent	2.03	2.13	2.37	2.33	2.32	2.29
Net interest margin in per cent	2.26	2.36	2.47	2.43	2.41	2.37
Number of employees in banking sector	39,004	38,158	38,011	38,028	37,976	37,540
Per employee in CZK thousands:						
total assets	64,806	69,070	71,346	75,238	76,645	78,699
profit from financial activities	2,314	2,712	2,784	2,890	2,887	2,901
net profit	774	861	1,229	1,197	1,121	1,043
administrative expenses	1,218	1,279	1,305	1,320	1,319	1,379
personnel expenses	600	643	168	337	511	699
General operating expenses/assets in per cent	1.90	1.87	1.87	1.85	1.81	1.84

Loans

(for banks with licences as of 31 December 2005; gross loans granted in the Czech Republic; in CZK millions)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Total loans	950,685	1,010,321	1,058,019	1,095,985	1,147,319	1,185,514
of which: short-term	251,185	258,943	281,119	302,981	316,440	307,548
medium-term	286,104	258,262	264,906	250,254	251,525	261,114
long-term	413,396	493,116	511,994	542,750	579,354	616,852
Total loans	950,685	1,010,321	1,058,019	1,095,985	1,147,319	1,185,514
of which: non-financial sector	427,572	459,502	482,385	501,226	521,099	525,455
financial sector	83,016	81,126	81,521	88,640	92,916	96,932
government sector	158,731	114,877	121,140	92,847	85,126	81,463
small businesses	24,677	28,530	28,561	30,025	31,156	33,372
households	210,810	283,319	295,939	321,578	345,345	379,537
other	45,879	42,967	48,473	61,669	71,677	68,755
Total loans	950,685	1,010,321	1,058,019	1,095,985	1,147,319	1,185,514
of which: agriculture and forestry	20,399	22,869	22,249	23,011	24,483	24,120
manufacturing	148,962	154,164	161,788	167,434	171,978	171,671
construction	13,368	16,648	18,756	21,260	22,173	20,335
financial intermediation and insurance	159,330	111,984	121,705	120,318	114,289	114,627
transport	23,001	20,838	21,473	23,944	24,123	26,023
wholesale and retail trade; hotels and restaurants	110,327	119,266	127,144	131,903	141,489	140,832
other	475,298	564,552	584,904	608,117	648,783	687,907

Deposits

(for banks with licences as of 31 December 2005; deposits received in the Czech Republic; in CZK millions)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Total deposits	1,596,381	1,668,895	1,725,395	1,844,341	1,891,014	1,850,239
of which: demand	780,503	832,648	820,358	872,992	901,958	948,689
time	815,878	836,247	905,037	971,349	989,056	901,550
of which: short-term	550,640	553,667	626,210	682,612	703,033	619,819
medium-term	260,356	275,292	271,365	280,135	276,366	269,985
long-term	4,882	7,288	7,462	8,602	9,657	11,747
Total deposits	1,596,381	1,668,895	1,725,395	1,844,341	1,891,014	1,850,239
of which: non-financial sector	362,076	384,490	348,100	380,762	376,640	447,775
financial sector	93,986	78,004	88,640	85,969	91,630	93,655
government sector	117,426	124,765	192,341	254,669	285,334	157,607
small businesses	60,502	66,645	73,276	75,449	76,804	69,965
households	897,288	952,661	961,550	981,441	982,960	1,007,369
other	65,103	62,330	61,488	66,051	77,647	73,867
Total deposits	1,596,381	1,668,895	1,725,395	1,844,341	1,891,014	1,850,239
of which: agriculture and forestry	11,822	13,147	13,855	14,338	12,550	16,557
manufacturing	92,370	100,226	91,342	107,727	99,653	111,360
construction	34,437	33,721	25,842	24,255	28,344	37,496
financial intermediation and insurance	104,891	99,763	99,649	98,631	108,113	109,295
transport	23,586	21,749	20,746	22,789	24,067	26,286
wholesale and retail trade; hotels and restaurants	99,293	88,588	90,520	91,582	96,434	108,106
other	1,229,982	1,311,700	1,383,441	1,485,019	1,521,853	1,441,139

Classified and non-performing loans
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Classified loans in CZK millions	114,009	118,826	125,448	126,327	131,116	127,738
as a percentage of total loan volume	11.15	10.84	12.77	12.34	12.27	11.73
of which: watch loans	64,400	74,320	77,954	78,842	84,027	80,657
substandard loans	19,298	19,344	21,777	21,164	18,738	17,988
doubtful loans	6,913	5,306	5,558	5,627	7,121	7,624
loss loans	23,398	19,857	20,159	20,695	21,231	21,481
Non-performing loans in CZK millions	49,608	44,506	47,494	47,485	47,090	47,093
as a percentage of total loan volume	4.85	4.06	4.83	4.64	4.41	4.33
Weighted classification in CZK millions	32,299	27,913	29,008	29,648	30,458	30,672
as a percentage of total loan volume	3.16	2.55	2.95	2.90	2.85	2.82
Reserves and provisions in CZK millions	38,039	30,877	28,842	29,065	29,483	29,781
Percentage coverage of weighted classification by reserves and provisions	117.77	110.62	99.43	98.03	96.80	97.09

Quick assets
(for banks with licences as of 31 December 2005; in CZK millions)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Cash	37,503	34,011	30,902	30,757	30,381	33,440
Deposits and loans with CNB	484,836	449,971	517,196	536,325	526,019	483,810
of which: required reserves	21,215	20,897	28,308	26,443	25,932	19,650
Current accounts with banks and 24 hour time deposits	37,772	47,690	75,284	89,877	56,505	43,719
Treasury bills	334,424	313,462	368,782	383,190	370,743	383,445
CNB bills	13,161	18,972	3,290	39,726	46,558	3,928
Total quick assets	907,696	864,106	995,453	1,080,401	1,030,383	948,343
Trading securities	25,428	22,439	46,812	54,328	54,039	54,890
of which: bonds	23,937	18,458	37,776	42,867	41,524	44,456
equity securities	1,491	3,981	9,035	11,462	12,515	10,434
Total liquid assets	933,124	886,545	1,042,265	1,134,729	1,084,421	1,003,233
Quick assets as a percentage of total assets	35.91	32.79	36.71	37.76	35.40	32.10
Liquid assets as a percentage of total assets	36.92	33.64	38.43	39.66	37.26	33.96

Assets and liabilities by residual maturity as of 31 December 2004

(for banks with licences as of 31 December 2005; in CZK millions)

	Total	under 1 week	1 week to 1 month	1 to 3 months	3 to 6 months	of which 6 months to 1 year	1 to 2 years	2 to 5 years	over 5 years	non-specified
Total assets	2,635,554	486,659	375,877	158,258	127,874	198,688	176,602	431,206	420,195	260,196
Total liabilities	2,635,554	1,419,876	245,776	130,454	73,901	93,337	118,947	212,375	58,355	282,535
Net balance sheet position	x	(933,217)	130,101	27,804	53,973	105,351	57,655	218,831	361,841	-22,339
Cumulative net balance sheet position	x	(933,217)	(803,116)	(775,312)	(721,339)	(615,988)	(558,332)	(339,501)	22,339	0
as a percentage of total assets	x	(35.41)	(30.47)	(29.42)	(27.37)	(23.37)	(21.18)	(12.88)	0.85	0.00
Liabilities taking into account demand										
deposit liquidity	2,635,554	510,065	336,757	221,435	255,863	229,809	255,418	348,846	194,826	282,535
Net balance sheet position	x	(23,406)	39,120	(63,177)	(127,989)	(31,120)	(78,816)	82,359	225,369	-22,339
Cumulative net balance sheet position	x	(23,406)	15,713	(47,464)	(175,453)	(206,573)	(285,389)	(203,030)	22,339	0
as a percentage of total assets	x	(0.89)	0.60	(1.80)	(6.66)	(7.84)	(10.83)	(7.70)	0.85	0.00

Assets and liabilities by residual maturity as of 31 December 2005

(for banks with licences as of 31 December 2005; in CZK millions)

	Total	under 1 week	1 week to 1 month	1 to 3 months	3 to 6 months	of which 6 months to 1 year	1 to 2 years	2 to 5 years	over 5 years	non-specified
Total assets	2,954,369	604,193	372,542	145,049	129,760	238,281	209,886	478,004	504,722	271,932
Total liabilities	2,954,369	1,613,009	236,844	185,946	78,376	101,028	124,024	219,168	85,597	310,378
Net balance sheet position	x	(1,008,815)	135,698	(40,897)	51,384	137,254	85,862	258,836	419,124	(38,446)
Cumulative net balance sheet position	x	(1,008,815)	(873,117)	(914,015)	(862,630)	(725,377)	(639,514)	(380,678)	38,446	0
as a percentage of total assets	x	(34.15)	(29.55)	(30.94)	(29.20)	(24.55)	(21.65)	(12.89)	1.30	0.00
Liabilities taking into account demand										
deposit liquidity	2,954,369	596,907	338,454	287,557	281,596	253,443	276,439	371,583	238,013	310,378
Net balance sheet position	x	7,286	34,088	(142,507)	(151,836)	(15,161)	(66,553)	106,421	266,709	-38,446
Cumulative net balance sheet position	x	7,286	41,374	(101,133)	(252,969)	(268,131)	(334,684)	(228,263)	38,446	0
as a percentage of total assets	x	0.25	1.40	(3.42)	(8.56)	(9.08)	(11.33)	(7.73)	1.30	0.00

Capital, capital requirements and capital adequacy
(for banks with licences as of 31 December 2005; in CZK millions)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Tier 1	133,910	141,328	149,775	161,016	160,456	159,845
Tier 2	11,993	9,402	7,963	10,874	11,438	11,367
Deductible items	2,227	4,033	4,128	4,506	3,998	4,070
Total capital	143,676	146,696	153,610	167,384	167,895	167,142
Total capital requirement	79,392	93,512	96,964	103,092	107,971	112,755
Capital requirement A - banking portfolio	73,776	86,346	89,548	95,121	100,314	105,159
Capital requirement B - trading portfolio	5,616	7,166	7,416	7,972	7,657	7,596
Capital adequacy in per cent	14.48	12.55	12.67	12.99	12.44	11.86

Foreign exchange activities
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Assets						
in CZK millions						
Loans granted (gross)	158,115	161,984	173,532	178,096	190,636	177,856
Securities (gross)	99,111	130,549	131,946	174,166	181,249	140,395
Deposits and loans with banks (gross)	105,114	167,474	130,286	158,009	155,509	240,482
Other (gross)	63,668	40,159	68,684	70,350	64,050	107,384
Total assets (gross)	426,008	500,165	504,448	580,621	591,444	666,117
as a percentage of foreign exchange assets						
Loans granted (gross)	37.12	32.39	34.40	30.67	32.23	26.70
Securities (gross)	23.27	26.10	26.16	30.00	30.65	21.08
Deposits and loans with banks (gross)	24.67	33.48	25.83	27.21	26.29	36.10
Other (gross)	14.95	8.03	13.62	12.12	10.83	16.12
Total assets (gross)	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total in foreign currencies and CZK						
Loans granted (gross)	15.43	14.73	16.19	15.87	16.22	14.76
Securities (gross)	18.41	24.54	21.38	25.53	26.47	21.27
Deposits and loans with banks (gross)	35.01	41.70	38.06	43.07	41.47	52.38
Other (gross)	8.50	5.83	8.96	9.05	8.38	14.89
Total assets (gross)	16.31	18.37	18.03	19.69	19.72	21.88
Liabilities						
in CZK millions						
Deposits received	203,138	205,202	197,842	213,634	227,315	241,997
Deposits and loans from banks	133,434	208,228	170,033	170,488	169,678	242,462
Bond issues	34,735	38,094	36,497	41,934	40,833	39,694
Other	67,616	23,145	30,362	31,890	35,424	24,475
Total liabilities	438,922	474,668	434,733	457,947	473,250	548,629

Foreign exchange activities (continued)
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Liabilities						
as a percentage of foreign exchange liabilities						
Deposits received	46.28	43.23	45.51	46.65	48.03	44.11
Deposits and loans from banks	30.40	43.87	39.11	37.23	35.85	44.19
Bond issues	7.91	8.03	8.40	9.16	8.63	7.24
Other	15.40	4.88	6.98	6.96	7.49	4.46
Total liabilities	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total in foreign currencies and CZK						
Deposits received	12.19	11.85	11.09	11.22	11.63	12.61
Deposits and loans from banks	46.79	57.67	53.68	55.75	55.42	63.70
Bond issues	17.22	17.75	16.08	17.08	15.96	15.15
Other	3.14	1.00	1.30	1.30	1.41	0.96
Total liabilities	17.36	18.01	16.03	16.01	16.26	18.57
Off-balance-sheet assets						
in CZK millions						
Derivatives transactions	1,049,812	1,085,762	1,261,231	1,355,521	1,343,463	1,320,577
Other off-balance-sheet transactions	119,148	122,813	171,182	158,892	158,100	131,837
Total off-balance-sheet assets	1,168,960	1,208,575	1,432,413	1,514,413	1,501,563	1,452,414
as a percentage of foreign exchange off-balance-sheet assets						
Derivatives transactions	89.81	89.84	88.05	89.51	89.47	90.92
Other off-balance-sheet transactions	10.19	10.16	11.95	10.49	10.53	9.08
Total off-balance-sheet assets	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total in foreign currencies and CZK						
Derivatives transactions	31.68	27.35	28.93	31.36	31.03	31.17
Other off-balance-sheet transactions	20.23	22.54	26.63	25.12	23.40	20.69
Total off-balance-sheet assets	29.95	26.77	28.63	30.57	30.00	29.80
Off-balance-sheet liabilities						
in CZK millions						
Derivatives transactions	1,021,878	1,110,788	1,315,234	1,448,624	1,435,810	1,406,520
Other off-balance-sheet transactions	149,679	153,116	202,331	191,606	204,776	161,050
Total off-balance-sheet liabilities	1,171,557	1,263,904	1,517,565	1,640,230	1,640,585	1,567,570
as a percentage of foreign exchange off-balance-sheet liabilities						
Derivatives transactions	87.22	87.89	86.67	88.32	87.52	89.73
Other off-balance-sheet transactions	12.78	12.11	13.33	11.68	12.48	10.27
Total off-balance-sheet liabilities	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total in foreign currencies and CZK						
Derivatives transactions	30.93	28.19	30.24	33.57	33.35	33.36
Other off-balance-sheet transactions	32.68	42.64	44.52	47.53	46.09	44.19
Total off-balance-sheet liabilities	31.14	29.40	31.59	34.76	34.54	34.22

Activities vis-à-vis non-residents
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Assets						
in CZK millions						
Loans granted (gross)	67,915	69,645	75,364	83,408	94,120	85,606
Securities (gross)	134,591	159,460	175,242	220,563	225,037	178,326
Deposits and loans with banks (gross)	171,881	239,163	212,682	246,090	254,084	321,361
Other (gross)	83,213	73,603	102,182	109,446	99,287	139,746
Total assets (gross)	457,600	541,870	565,469	659,507	672,527	725,039
as a percentage of assets vis-à-vis non-residents						
Loans granted (gross)	14.84	12.85	13.33	12.65	13.99	11.81
Securities (gross)	29.41	29.43	30.99	33.44	33.46	24.60
Deposits and loans with banks (gross)	37.56	44.14	37.61	37.31	37.78	44.32
Other (gross)	18.18	13.58	18.07	16.60	14.76	19.27
Total assets (gross)	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total vis-à-vis residents and non-residents						
Loans granted (gross)	6.63	6.33	7.03	7.43	8.01	7.11
Securities (gross)	25.00	29.98	28.39	32.33	32.87	27.02
Deposits and loans with banks (gross)	57.25	59.55	62.13	67.08	67.75	70.00
Other (gross)	11.11	10.69	13.33	14.09	12.99	19.38
Total assets (gross)	17.52	19.91	20.21	22.37	22.42	23.81
Liabilities						
in CZK millions						
Deposits received	66,710	67,843	64,824	79,669	96,097	94,966
Deposits and loans from banks	169,795	211,729	193,673	188,524	187,712	252,899
Bond issues	15,672	19,267	17,500	19,588	19,548	19,566
Other	81,005	49,526	54,862	67,448	63,872	51,728
Total liabilities	333,182	348,364	330,860	355,229	367,228	419,158
as a percentage of liabilities vis-à-vis non-residents						
Deposits received	20.02	19.47	19.59	22.43	26.17	22.66
Deposits and loans from banks	50.96	60.78	58.54	53.07	51.12	60.33
Bond issues	4.70	5.53	5.29	5.51	5.32	4.67
Other	24.31	14.22	16.58	18.99	17.39	12.34
Total liabilities	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total vis-à-vis residents and non-residents						
Deposits received	4.00	3.92	3.63	4.18	4.92	4.95
Deposits and loans from banks	59.51	58.63	61.13	61.63	61.30	61.73
Bond issues	7.77	8.98	7.71	7.98	7.64	7.47
Other	21.61	15.10	14.31	16.61	16.20	14.25
Total liabilities	13.18	13.22	12.20	12.42	12.62	14.19

Activities vis-à-vis non-residents (continued)
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Off-balance-sheet assets (excluding memorandum accounts)						
in CZK millions						
Derivatives transactions	2,311,561	2,668,386	2,910,679	2,926,757	2,936,134	2,938,770
Other off-balance-sheet transactions	83,630	80,494	136,132	106,984	128,444	91,100
Total off-balance-sheet assets	2,395,191	2,748,880	3,046,811	3,033,740	3,064,578	3,029,869
as a percentage of off-balance-sheet assets vis-à-vis non-residents						
Derivatives transactions	96.51	97.07	95.53	96.47	95.81	96.99
Other off-balance-sheet transactions	3.49	2.93	4.47	3.53	4.19	3.01
Total off-balance-sheet assets	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total vis-à-vis residents and non-residents						
Derivatives transactions	69.75	67.22	66.76	67.72	67.81	69.37
Other off-balance-sheet transactions	14.20	14.77	21.17	16.91	19.01	14.30
Total off-balance-sheet assets	61.37	60.89	60.90	61.23	61.23	62.17
Off-balance-sheet liabilities (excluding memorandum accounts)						
in CZK millions						
Derivatives transactions	2,299,093	2,672,677	2,914,536	2,904,695	2,917,021	2,930,160
Other off-balance-sheet transactions	158,170	127,128	212,686	177,831	202,063	144,894
Total off-balance-sheet liabilities	2,457,263	2,799,805	3,127,222	3,082,526	3,119,084	3,075,054
as a percentage of off-balance-sheet liabilities vis-à-vis non-residents						
Derivatives transactions	93.56	95.46	93.20	94.23	93.52	95.29
Other off-balance-sheet transactions	6.44	4.54	6.80	5.77	6.48	4.71
Total off-balance-sheet liabilities	100.00	100.00	100.00	100.00	100.00	100.00
as a percentage of the total vis-à-vis residents and non-residents						
Derivatives transactions	69.59	67.83	67.00	67.31	67.75	69.50
Other off-balance-sheet transactions	34.53	35.40	46.80	44.11	45.48	39.76
Total off-balance-sheet liabilities	65.32	65.12	65.09	65.33	65.66	67.13

Selected bank group indicators
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Large banks						
Total assets (in CZK millions)	1,569,840	1,575,296	1,674,959	1,782,408	1,810,724	1,808,942
Loans granted (net) (in CZK millions)	608,082	641,695	602,746	632,806	667,005	676,985
Deposits received (in CZK millions)	1,139,463	1,117,473	1,162,803	1,218,240	1,252,541	1,208,674
Total off-balance-sheet assets (in CZK millions)	2,303,095	2,613,087	2,935,889	2,954,183	2,970,673	2,839,692
Receivables from derivatives transactions (in CZK millions)	1,921,196	2,264,119	2,517,140	2,545,888	2,548,702	2,422,119
Profit from financial activities (in CZK millions)	64,508	75,217	18,395	38,772	57,859	76,627
Net profit (in CZK millions)	21,934	25,899	35,920	34,341	31,864	29,169
Non-performing loans / total loans (in per cent)	5.15	4.00	5.33	4.99	4.74	4.69
Capital adequacy (in per cent)	13.56	11.04	11.38	11.84	11.38	10.75
Quick assets / total assets (in per cent)	36.51	32.19	37.77	38.05	36.42	33.10
Medium-sized banks						
Total assets (in CZK millions)	393,954	415,198	422,250	450,343	453,092	446,359
Loans granted (net) (in CZK millions)	209,662	227,996	241,198	251,962	255,650	271,277
Deposits received (in CZK millions)	188,266	188,905	192,293	218,014	224,778	220,893
Total off-balance-sheet assets (in CZK millions)	800,186	899,806	1,048,082	1,078,549	1,112,518	1,215,692
Receivables from derivatives transactions (in CZK millions)	675,051	786,931	921,439	947,713	969,393	1,087,836
Profit from financial activities (in CZK millions)	14,936	16,836	4,847	9,590	14,349	19,375
Net profit (in CZK millions)	4,727	4,638	6,076	6,288	5,999	6,110
Non-performing loans / total loans (in per cent)	6.01	6.17	6.05	6.01	5.75	5.27
Capital adequacy (in per cent)	16.50	17.27	16.51	16.76	15.93	15.20
Quick assets / total assets (in per cent)	27.73	23.97	25.00	26.48	23.34	17.90
Small banks						
Total assets (in CZK millions)	36,537	40,750	43,622	48,064	61,179	58,380
Loans granted (net) (in CZK millions)	11,678	18,778	21,611	23,129	27,037	30,755
Deposits received (in CZK millions)	24,766	29,582	31,634	33,807	45,654	40,672
Total off-balance-sheet assets (in CZK millions)	13,196	18,882	17,420	15,468	16,915	20,406
Receivables from derivatives transactions (in CZK millions)	6,518	13,662	10,456	8,919	10,175	12,734
Profit from financial activities (in CZK millions)	1,801	1,854	613	1,228	1,944	2,704
Net profit (in CZK millions)	535	-128	505	684	758	464
Non-performing loans / total loans (in per cent)	6.33	4.40	3.99	3.70	3.43	3.40
Capital adequacy (in per cent)	35.16	21.35	19.65	18.21	17.28	17.80
Quick assets / total assets (in per cent)	46.85	32.44	40.19	42.52	43.12	31.72

Selected bank group indicators (continued)
(for banks with licences as of 31 December 2005)

	31 Dec. 2003	31 Dec. 2004	31 Mar.	30 Jun.	30 Sep.	31 Dec.
Foreign bank branches						
Total assets (in CZK millions)	261,697	288,386	243,332	251,331	250,222	281,262
Loans granted (net) (in CZK millions)	91,148	85,944	90,557	91,705	95,282	87,544
Deposits received (in CZK millions)	64,659	98,379	97,043	124,363	117,654	110,332
Total off-balance-sheet assets (in CZK millions)	777,633	971,117	988,571	893,415	891,966	785,526
Receivables from derivatives transactions (in CZK millions)	711,375	904,963	910,679	819,349	801,355	713,895
Profit from financial activities (in CZK millions)	4,159	4,221	1,107	2,406	3,619	4,512
Net profit (in CZK millions)	1,867	1,349	1,732	1,903	1,733	1,310
Non-performing loans / total loans (in per cent)	2.34	1.40	1.43	1.45	1.37	2.07
Capital adequacy (in per cent)	0.00	0.00	0.00	0.00	0.00	0.00
Quick assets / total assets (in per cent)	35.33	34.09	30.86	33.84	26.25	27.45
Building societies						
Total assets (in CZK millions)	265,678	315,924	327,782	328,988	335,469	359,427
Loans granted (net) (in CZK millions)	75,629	99,445	87,508	94,148	101,109	107,795
Deposits received (in CZK millions)	248,734	297,511	300,848	309,358	313,741	338,987
Total off-balance-sheet assets (in CZK millions)	9,036	11,597	12,666	12,787	13,146	12,548
Receivables from derivatives transactions (in CZK millions)	0	0	0	0	0	0
Profit from financial activities (in CZK millions)	4,849	5,358	1,489	2,951	4,457	5,700
Net profit (in CZK millions)	1,129	1,095	2,471	2,293	2,219	2,086
Non-performing loans / total loans (in per cent)	1.92	1.78	2.17	2.18	2.19	2.06
Capital adequacy (in per cent)	13.28	10.81	11.39	11.08	10.39	10.55
Quick assets / total assets (in per cent)	43.58	46.21	50.22	53.91	51.62	48.40

Concentration

(for banks with licences as of the given date; classified loans exclude credit to Slovak Collection Unit)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Percentage share in banking sector						
3 largest banks						
Total assets (net)	56.88	54.35	56.15	56.75	56.94	55.63
Loans granted to clients (net)	52.88	51.84	49.31	49.53	49.85	49.66
Deposits and loans with banks (net)	43.87	43.35	41.41	46.78	42.73	48.71
Securities excluding Treasury bills and CNB bills (net)	77.97	76.43	76.19	76.98	78.95	77.85
Tangible and intangible assets	81.86	80.44	80.45	80.42	80.22	80.36
Deposits received from clients	64.14	60.46	59.38	57.94	57.95	57.31
Issues of short-term and long-term bonds	49.30	50.88	50.82	48.84	52.08	55.32
Total off-balance-sheet assets	51.12	52.85	53.18	53.44	53.66	55.49
Receivables from derivatives transactions	52.49	52.85	54.59	54.26	54.92	57.07
Profit from financial activities	66.87	68.04	64.90	66.07	65.75	65.62
Administrative expenses	64.32	63.09	61.48	62.11	62.14	61.93
Net profit (profitable banks only)	66.99	63.09	72.14	71.67	70.80	69.78
Classified loans	65.68	58.24	59.22	58.85	60.76	59.28
Quick assets	59.38	55.70	60.53	59.65	62.26	59.39
Tier 1	59.41	55.94	56.56	57.33	57.47	57.34
Total capital	56.34	52.09	52.68	54.49	54.54	54.40
Foreign exchange assets	54.57	55.32	60.62	63.00	61.13	60.53
Assets vis-à-vis non-residents	65.24	63.65	65.82	68.07	66.40	65.45
5 largest banks						
Total assets (net)	65.77	63.97	66.08	66.40	66.30	65.49
Loans granted to clients (net)	64.45	64.05	61.51	61.75	62.21	61.80
Deposits and loans with banks (net)	55.23	57.90	54.06	59.29	57.69	64.58
Securities excluding Treasury bills and CNB bills (net)	87.80	86.59	86.09	86.06	86.76	86.61
Tangible and intangible assets	86.55	85.52	85.50	85.46	85.33	85.24
Deposits received from clients	73.55	70.54	70.48	69.13	69.11	68.69
Issues of short-term and long-term bonds	65.95	71.66	73.43	73.11	75.50	79.47
Total off-balance-sheet assets	74.53	76.36	75.78	75.87	75.33	76.54
Receivables from derivatives transactions	75.41	77.89	77.20	77.33	77.06	78.15
Profit from financial activities	77.74	78.98	75.77	76.53	76.44	76.61
Administrative expenses	74.77	73.46	71.98	72.25	72.45	72.65
Net profit (profitable banks only)	79.23	85.63	82.12	81.30	80.97	81.35
Classified loans	77.40	70.64	70.92	71.08	72.81	71.74
Quick assets	66.99	65.07	70.10	68.93	71.78	69.69
Tier 1	73.40	71.06	72.09	73.19	73.37	73.32
Total capital	70.38	67.29	68.13	70.02	70.03	69.98
Foreign exchange assets	73.08	74.62	73.24	75.77	74.23	77.96
Assets vis-à-vis non-residents	77.02	76.07	74.51	75.67	74.86	77.68

Concentration (continued)

(for banks with licences as of the given date; classified loans exclude credit to Slovak Collection Unit)

	31 Dec. 2003	31 Dec. 2004	2005			
			31 Mar.	30 Jun.	30 Sep.	31 Dec.
Percentage share in banking sector						
10 largest banks						
Total assets (net)	79.38	77.96	78.38	78.95	78.82	79.30
Loans granted to clients (net)	79.50	79.48	78.22	78.52	78.70	78.92
Deposits and loans with banks (net)	78.18	77.81	75.28	79.85	76.86	80.77
Securities excluding Treasury bills and CNB bills (net)	97.84	97.19	96.95	96.86	96.93	96.69
Tangible and intangible assets	92.60	91.86	92.53	92.55	92.48	92.62
Deposits received from clients	86.98	84.56	84.94	83.94	84.15	83.84
Issues of short-term and long-term bonds	89.93	94.74	94.51	95.31	95.60	96.70
Total off-balance-sheet assets	94.45	94.68	94.26	94.14	94.04	94.02
Receivables from derivatives transactions	96.16	96.37	96.29	96.28	96.54	96.18
Profit from financial activities	87.65	88.76	86.61	86.67	86.69	87.02
Administrative expenses	86.72	86.63	86.59	86.30	86.17	86.14
Net profit (profitable banks only)	90.07	93.02	91.19	90.56	89.86	91.59
Classified loans	89.66	89.04	88.58	88.57	88.61	88.82
Quick assets	81.09	81.31	82.11	82.48	85.08	83.63
Tier 1	87.02	86.67	87.43	87.73	87.64	87.62
Total capital	86.21	84.80	85.25	85.97	85.65	85.72
Foreign exchange assets	89.66	89.49	88.26	89.68	88.55	91.21
Assets vis-à-vis non-residents	88.99	89.68	89.49	90.08	89.20	91.01

Box 1

**Active participation of CNB Banking Supervision staff in EU committees and working groups
(as of 31 May 2006)**

Name of committee	Description	Name of group	Description
CEBS Committee of European Banking Supervisors	Co-operation between banking supervisors; alignment of supervisory practices		
		Groupe de Contact (GdC)	Pillar II principles - Basel II (assessment by supervisors; assessment of capital adequacy by banks; outsourcing principles; governance of banks); co-operation between supervisors
		Working Group on Financial Information (WGFI)	Defining the content and scope of common financial statements and capital adequacy reporting; requirements for auditors
		Expert Group on Capital Requirements	Recommending models for validation; assessment of rating agencies; recommendations for credit, market and operational risk measurement and management
EBC European Banking Committee Representative - Ministry of Finance Technical expert - CNB	Technical details of banking directives		
Representatives of the Ministry of Finance and the CNB		Own Funds	Conceptual criteria for new definition of own funds
EFCC European Financial Conglomerates Committee	Directive on Financial Conglomerates		
IWFCF Interim Working Committee on Financial Conglomerates	Identification of financial conglomerates and co-ordination of regulators; content of supervision of financial conglomerates		

Box 1 (continued)

Active participation of CNB Banking Supervision staff in EU committees and working groups
(as of 31 May 2006)

Name of committee	Description	Name of group	Description
BSC Banking Supervision Committee (a committee of the European System of Central Banks)	Measures to promote banking and financial stability in the EU		
		Working Group on Macroprudential Analysis (WGMA)	Analyses and data collection to promote financial stability
		Working Group on Developments in Banking (WGDB)	Analyses and projects to monitor developments in banking sectors in the EU
		Working Group on Credit Registers (WGCR)	Development of a system for sharing information from national credit registers
		Task Force on Crisis Management (joint group with the CEBS)	Development of recommendations and standards for effective cross-border co-operation between supervisors and central banks in crisis management situations
BCBS Basel Committee on Banking Supervision			
		Core Principles Liaison Group (CPLG)	Development and updating of core principles for effective banking supervision (part of FSAP); Basel II issues
		Working Group for Capital	Principles of implementation of Basel II - co-operation between home and host supervisors; discretion

Box 2**Lamfalussy process⁴⁰**

European Commission (Commission)			
Level 1 Core principles	ECOFIN Council of Economics and Finance Ministers		European Parliament
Level 2 Technical details - Comitology	EBC	ESC	EIOPC
Level 3 Supervisory convergence	CEBS	CESR	CEIOPS
Level 4 Enforcement	Monitoring of compliance with EU legislation	Monitoring of compliance with EU legislation	Monitoring of compliance with EU legislation

Abbreviations:

EBC	European Banking Committee
CEBS	Committee of European Banking Supervisors
ESC	European Securities Committee
CESR	Committee of European Securities Regulators
EIOPC	European Insurance and Occupational Pensions Committee
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors

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