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Česká národní banka
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ANNUAL REPORT

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ANNUAL REPORT

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OUR MISSION IS:

- to maintain low and stable inflation,
- to ensure smooth circulation of money and smooth payments,
- to oversee the stability of the financial system,
- to support the balanced and smooth development of the Czech financial market.

- Through *monetary policy* we seek to achieve price stability and thereby maintain confidence in the value of money and the exchange rate of the Czech koruna.
- By *supervising the financial market, issuing prudential rules and conducting financial market operations* we care for the stability and development of the financial system and protect its clients.
- By *managing the clearing system and issuing banknotes and coins* we ensure smooth payments and cash flows.
- *We administer the foreign exchange reserves* of the Czech state.

The building blocks of our mission**INDEPENDENCE**

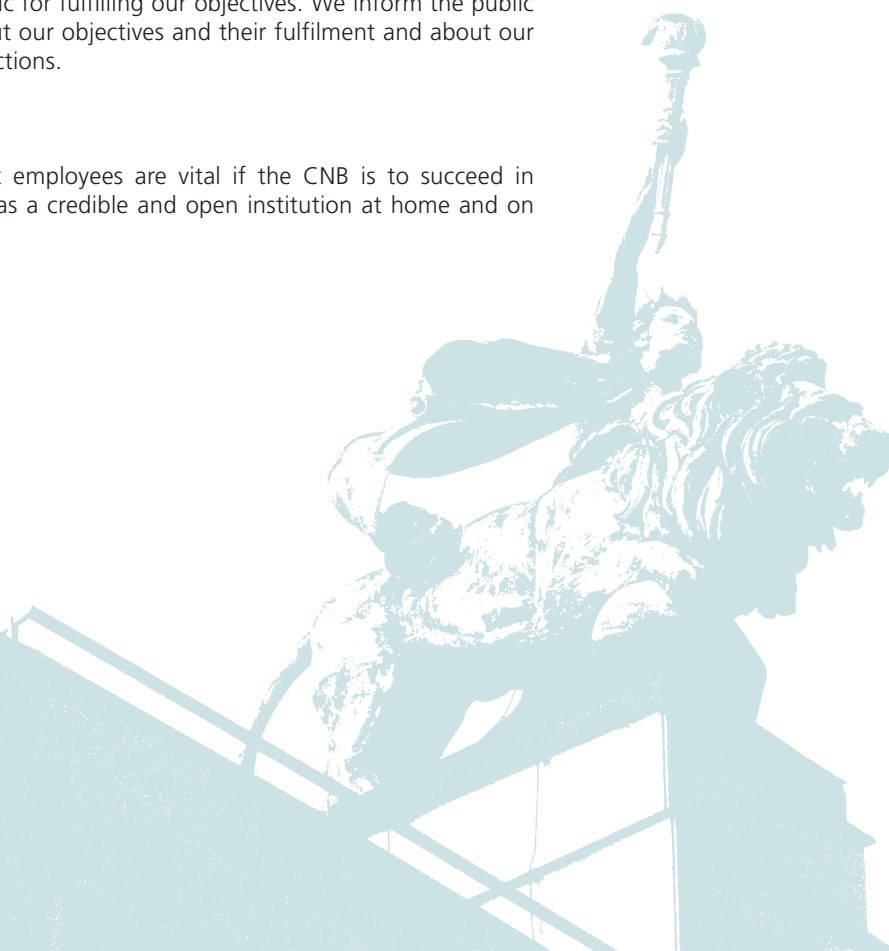
- Broad independence of the central bank is a key condition for successful implementation of monetary policy, i.e. for sustained non-inflationary growth of the economy, as well as for objective supervision of the financial market.

OPENNESS

- A high degree of independence must go hand in hand with a high degree of accountability to the public for fulfilling our objectives. We inform the public regularly and openly about our objectives and their fulfilment and about our opinions, plans and predictions.

PROFESSIONALISM

- Proficient and competent employees are vital if the CNB is to succeed in enhancing its reputation as a credible and open institution at home and on the international stage.



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The financial and economic crisis impacted fully on the real part of the economy in 2009. An unprecedented easing of monetary and fiscal policy was only partially successful in mitigating the consequences. Room for effective fiscal expansion was limited by growing debt and long-neglected structural imbalances, while monetary policy transmission was hindered by the financial market situation. The inflation target was undershot, but it was demonstrated more clearly than ever before that credible monetary policy based on a floating exchange rate can, at times of crisis, provide the domestic economy with a buffer that helps it to adapt and rebound towards further growth.

GDP shrank by 4.1% last year. This is the largest year-on-year contraction in the Czech Republic's short history – the crisis really took us by surprise with its speed and force. On the other hand, I should add that in regional comparison the Czech Republic is one of the less afflicted countries, despite the domestic economy's strong export orientation and close links with the euro area economy, particularly Germany. This favourable comparison indicates that the economy managed to stay competitive even in this difficult period.

However, the long-expected recovery is starting only slowly and there is considerable uncertainty about its strength and sustainability both in the Czech Republic and internationally. The economy started rebounding at last in the second half of last year, but the recovery is by no means dramatic so far. A steadily rising unemployment rate provides more evidence that the economy has not really turned the corner yet. The outlook for the near future is not very optimistic either. According to our current estimates, annual economic growth will be below 2% in the coming two years.

Inflation fell rapidly during the year in line with the sharp decline in economic activity. In the second half of the year, the annual inflation rate was close to zero, i.e. below the lower boundary of the target band. The undershooting of the inflation target is understandable in the context of the unexpectedly strong recession and according to our forecasts should be short-lived. Inflation should return to the target band in the second half of 2010. This forecast is in line with the expectations of other economic agents. For some time to come, however, the gradual rise in inflation will be a result of changes to indirect taxes and regulated prices rather than a reflection of economic recovery.

The economic contraction and decline in inflation occurred despite a considerable easing of both monetary and fiscal policy. The key interest rate – the main monetary policy instrument – fell to 1% at the close of the year. The public budget deficit was 5.9% of GDP and is likely to shrink only very gradually in the coming years. The long-term structural deficit widened further during the crisis, limiting the scope for fighting the crisis effectively.

Though the crisis and the uncertainty in the financial markets seriously complicated monetary policy-making, they simultaneously underlined the role of the exchange rate as an effective transmission channel. Monetary policy faced reduced effectiveness of the interest rate channel during the year. Market interest rates responded to the decline in the key rate with a lag and with reduced intensity, reflecting the financial market uncertainty. As a result, market rates came down more slowly than inflation, and real interest rates rose. With key interest rates cut to

almost the minimum level, the interest rate channel had practically nothing left to offer. By contrast, the weakening exchange rate – reacting to both the fall in interest rates and the increased uncertainty in the financial markets – became the main channel for easing monetary policy.

The crisis also affected the way we think about monetary policy-making, supervision and regulation. Previously strictly separated decision-making processes started to become more integrated so that we can use all related information in a timely fashion and respond to emerging imbalances in advance. Communication with the public was stepped up, particularly in the financial stability area. In the second half of the year, the CNB started to gear up for regular disclosure of banking sector stress tests results, which had previously been published just once a year in the Financial Stability Report.

The financial sector is withstanding the crisis better than the real economy. The financial sector was hit by the crisis only indirectly, through the secondary channels of loss of confidence, falling liquidity and asset prices and increased investor uncertainty. This had a temporary adverse effect on the financial results of some entities, but the financial sector quickly coped with these consequences.

The risks to financial stability declined slightly last year but remain high. The main risk is that of a renewed recession in Europe and therefore a postponed recovery in the Czech Republic. Another major risk ensuing from the current fiscal situation in some European countries is a potential loss of financial market confidence in the ability of governments to finance their growing national debts.

The stability of the banking sector remains at a very high level, despite the unexpectedly large contraction of the domestic economy. The non-performing loan ratio deteriorated last year and, according to our analyses, will not peak until late 2010/early 2011, but the banking sector remains profitable and well capitalised, and as a whole should remain resilient even to relatively extreme economic and market fluctuations.

The economic outlook remains very uncertain. Nonetheless, one can say that the economic decline has bottomed out and the economy is gradually returning to growth. The coming year, however, will be extremely tough and the economy will remain under great pressure. The gradually awakening external demand will provide the first major growth impulses. Overall, the Czech economy is in a good position on the notional “post-crisis” starting line. I believe that the central bank contributed to this through its long-term credible monetary policy and rigorous supervision of the financial market.



Zdeněk Tůma
Governor

The CNB's operations have been affected in recent years by decisions that have had a fundamental influence on its activities and organisational structure. In 2006, financial market supervision was integrated into the CNB (with supervision of the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change and payment system institutions being added to supervision of the banking sector). Other changes include a postponement of the euro changeover date. The CNB responded to these challenges by adopting a new internal vision and strategy providing a guide for the CNB's medium-term development.

The main medium-term objective: to maintain and further enhance the role of the CNB as a credible, open and competent public sector institution in the Czech Republic and to continue to enhance its reputation on the international stage.

The key areas of the new vision, from which plans for the individual sections of the bank have been derived, are the following.

Integration of monetary policy, financial stability and financial market supervision

Recent and current events in world markets necessitate a better understanding of the relationships between the financial sector and the rest of the economy on the analytical level and as regards monetary policy-making and financial market supervision and regulation. Many governments and central banks were caught off guard by the wide-ranging impacts of the crisis and had to take unconventional measures in order to maintain financial stability. Many of these measures were adopted in an emergency and their likely implications could not be analysed in detail. The crisis and the measures taken to counter it have also greatly complicated monetary policy formulation and implementation and have given rise to issues relating to correct monetary policy coordination and financial stability maintenance.

As a result, a debate has been going on in international economic forums for some time now about how to improve our understanding of the links between macroeconomic developments and the financial markets and how to incorporate these links into decision-making processes. It is increasingly apparent that the previous breakdown into monetary, liquidity, financial stability and prudential measures is becoming largely irrelevant. The originally relatively separate activities of the central bank need to communicate closely with each other to provide an integrated picture of the effects of risks and countermeasures across a wide spectrum of areas in the decision-making process. Cooperation and communication with other institutions are also crucial both on the national and international levels.

Although no specific euro adoption date has been decided yet, there is no reason to delay the preparations for the changeover. It will be useful to carefully analyse the experiences of all countries that have gone through, or are going through, the pre-accession ERM II mechanism.

Strategy for the institutional regulatory and supervisory set-up within the EU

The pressure to strengthen financial market regulation and centralise supervision is gaining strength in the wake of the global financial crisis. Efforts to concentrate supervision on a multilateral level are particularly apparent at European level. The CNB performs organisationally integrated supervision across all financial market sectors and enjoys many advantages from this set-up in comparison to other Member States. Despite generally supporting the harmonisation of rules appropriately regulating financial market business, the CNB believes it is vital to carefully analyse any further steps towards the reorganisation of supervision so as to avoid a hasty transfer of powers and competences to supranational bodies.



beyond the scope of their accountability, which in the case of regulation and supervision in each jurisdiction is still borne by national authorities.

The payment system, currency circulation and cost-effective use of regional branches

Significant changes have been taking place in the CNB's branches recently. Technological progress and better organisation have generated large cost savings in various areas of work performed by the branches. Changes are also ongoing in the processing and distribution of circulating currency, and the electronic payment services provided to the CNB's clients are undergoing major development. The CNB intends to further develop these areas in order to make them less labour intensive and costly and to provide more new services (for example, a project to introduce multi-denominational banknote processing has been launched). New responsibilities have been delegated to some branches (e.g. registration of insurance service providers and involvement in supervisory activities).

Priorities as regards the ESCB/EU

In the several years it has been active in EU authorities and institutions, the CNB has become a fully-fledged partner with a respected position in many areas. The EU authorities have a wide range of responsibilities, so it is neither realistic nor sensible for the CNB to have a "strategic" position in all these structures. Key areas to which the bank's main potential will be directed have therefore been defined. The strategic priorities (i.e. those which are at the CNB's focus of interest and where the CNB can make best use of its comparative advantage to support and achieve its interests and objectives) include financial market regulation and supervision, macro-financial stability, analysis of the compatibility of various monetary policy regimes with regard to the convergence process and future adoption of the euro, the breakdown of stereotypes in the segmentation of Europe (especially that into old and new member states), the assessment reports of EU authorities and institutions on the Czech Republic, and payment services. Other priority areas (i.e. those which are not strategic priorities but where the CNB should take an active approach and try to achieve its goals) include currency in circulation, the CNB's preparations for the introduction of the euro, modelling and the CNB's monetary policy regime, and statistics.

Human capital

A new phenomenon is the globalisation of relevant parts of the labour market and resulting potential growth in migration abroad. This trend, however, also provides an opportunity to recruit experts on the cross-border labour market. Despite the risks, the CNB seems to be maintaining its attractiveness as a place to work. It is also succeeding in developing high-quality employees and maintaining their competitiveness on the international scale.

MANAGEMENT AND ORGANISATION



The CNB's organisational structure consists of a headquarters in Prague and seven branches in Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava. The CNB has a two-tier management system. The Bank Board makes fundamental decisions relating to monetary policy, the development of core activities and the institutional development of the bank. Responsibility for implementing the Bank Board's decisions and the day-to-day running of the bank is delegated to the executive directors of departments and branches.

BANK BOARD

The Bank Board is the supreme governing body of the CNB and takes decisions as a collective body by a simple majority of the votes cast. It has seven members: the Governor (who chairs the Board), two Vice-Governors and four other Bank Board members each holding the office of Chief Executive Director. The members of the Bank Board, in addition to collectively managing the CNB, oversee the activities performed by the CNB's organisational units according to a scheme approved by the Bank Board (see the organisational chart of the CNB).



The Bank Board sets monetary policy in accordance with the CNB's primary objective, namely to maintain price stability, and decides on monetary policy measures, approves monetary instruments and the principles for CNB transactions, approves key measures relating to financial market supervision and financial stability, and rules on appeals in administrative proceedings. It sets the CNB's overall development strategy and decides on the bank's organisational structure and the responsibilities of the organisational units at its headquarters and branches. It also approves the CNB's budget and the CNB's Annual Financial Report, Inflation Reports, Financial Stability Reports and Financial Market Supervision Reports.

SENIOR MANAGEMENT

The executive directors of the CNB's departments and branches (management level BR-1) are responsible – subject to the CNB's overall strategy – for performance of the tasks falling within their areas of competence and powers as set out in the Organisational Statute. Their competences and responsibilities include in particular methodological and line management activities, including presenting proposals for solutions to issues of fundamental significance at Bank Board meetings. They carry out the decisions adopted by the Bank Board and set targets for the staff under them. The executive directors also perform the employer's rights and duties

under labour law in respect of employees. They are responsible for coordinating with other organisational units of the bank and with domestic and foreign partner institutions.

HEADQUARTERS

A new CNB Organisational Statute took effect on 1 July 2009. It is structured so that the CNB's activities are performed in line with the CNB's overall strategy, legal regulations and internal regulations. It is more transparent and briefer, retains the basic division into departments and branches, and redefines the internal control system of the CNB, including the basic levels of management and their competences, the forms and instruments of management, and the elements of the internal control system. It also allows more flexible decision-making on minor organisational changes at management level BR-1. It gives the executive directors of departments and branches delegated power to adapt the activities of individual departments of the organisational unit they manage to practical needs without the obligation to discuss these internal changes in the Bank Board.

Several changes were made to the activities of some organisational units of the CNB in 2009. As of 13 February 2009, the Bank Board decided to abolish the Crisis Management and Classified Information Protection Department and its area of responsibility was transferred to the Administration Department. Proceedings on administrative offences in the reproduction and imitation of money symbols and on administrative offences against money circulation were transferred from the Cash and Payment Systems Department to the Licensing and Enforcement Department. Services are now provided to CERTIS and SKD participants by the Cash and Payment System Department instead of the Information System Department.

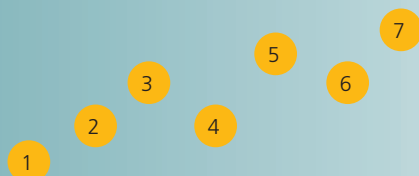
BRANCHES

The CNB's branches represent the bank in their regions of jurisdiction and are contact points for the CNB's relations with state and local authorities and other legal and natural persons that have registered offices or residence addresses in the relevant region when dealing with the CNB under the relevant legal rules. This does not affect the right of the said entities to deal with the CNB's headquarters in Prague.

The CNB's branches are responsible mainly for managing money reserves and maintaining accounts of the state budget and other CNB clients falling within their fields of competence. They make cash and non-cash payments, conduct the accounting of the branch, issue tax documents and operate safe deposit boxes.

To a specified extent the CNB's branches also conduct administrative proceedings, perform foreign exchange supervision, inspections of anti-money laundering measures and crisis management work falling within their fields of competence, and collect and process data on exchange office operations and regional data for business surveys. They receive and record enquiries, suggestions, notifications and announcements from the public and deal with them within their defined areas of competence.

In December 2009, the Bank Board decided to extend the branches' responsibilities in the area of supervision of investment and insurance intermediaries, with methodological support from the Financial Market Supervision Department. In compliance with the private-law provisions of Act No. 284/2009 Coll., on the Payment System, branches now perform consumer-protection supervision of selected entities subject to foreign exchange inspections.

**The Bank Board**

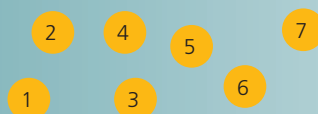
1. Zdeněk Tůma, 2. Miroslav Singer, 3. Robert Holman, 4. Pavel Řežábek,
5. Mojmír Hampl, 6. Eva Zamrazilová, 7. Vladimír Tomšík

**Executive Directors of Departments**

1. Jan Schmidt, 2. Marian Mayer, 3. Zdeněk Virius, 4. David Rozumek,
5. Karel Bauer, 6. Helena Kolmanová, 7. Kateřina Šmídková, 8. Ota Kaftan

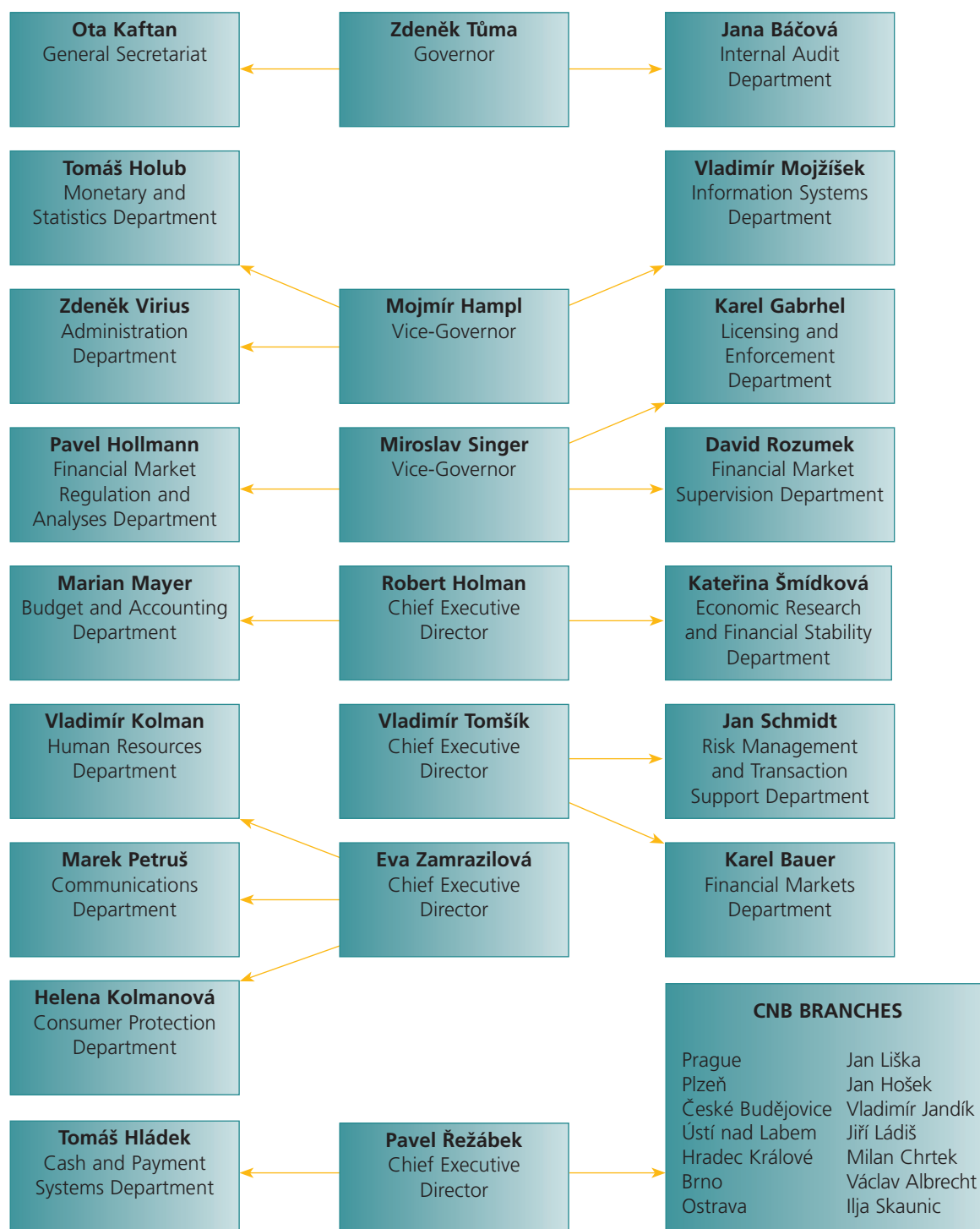
**Executive Directors of Departments**

1. Pavel Hollmann, 2. Marek Petruš, 3. Karel Gabrhel, 4. Tomáš Hládek,
5. Jana Báčová, 6. Vladimír Kolman, 7. Tomáš Holub, 8. Vladimír Mojžíšek

**Executive Directors of Branches**

1. Václav Albrecht (Brno branch), 2. Jan Liška (Prague branch),
3. Milan Chrtěk (Hradec Králové branch), 4. Jan Hošek (Plzeň branch),
5. Ilija Skaunic (Ostrava branch), 6. Jiří Ládiš (Ústí nad Labem branch),
7. Vladimír Jandík (České Budějovice branch)

ORGANISATIONAL CHART



OBJECTIVES AND TASKS AND THEIR FULFILMENT

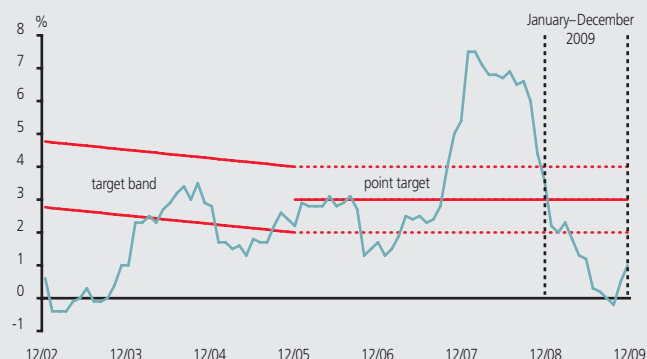


MONETARY POLICY AND ECONOMIC DEVELOPMENTS

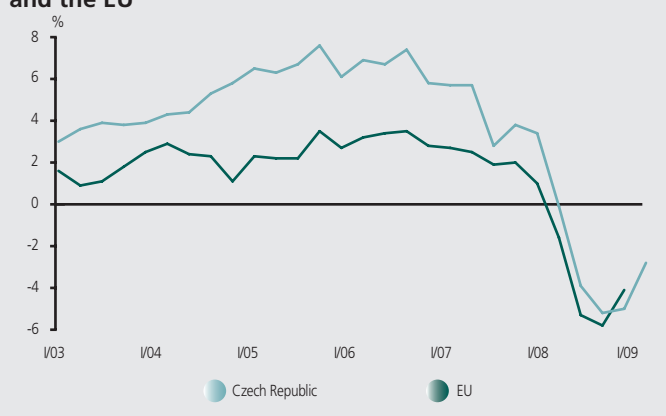
The CNB's primary monetary policy objective as laid down in the Act on the CNB is to maintain price stability. Since January 1998, this has been achieved under an inflation targeting regime in which the CNB tries to keep inflation close to a declared target. In the period from 2006 to 2009 the CNB's target was set in the form of annual growth in the consumer price index (CPI) of 3% with a tolerance band of ± 1 percentage point. With effect from the start of 2010, the CNB lowered the target to 2% with an unchanged tolerance band. This reduction was published well in advance, back in March 2007.

Monetary policy in 2009 was operating in difficult conditions resulting from the persisting global financial and economic crisis. Economic activity fell sharply at the beginning of 2009. Although the situation stabilised in subsequent quarters, the sharp decline in late 2008 and early 2009 resulted in strongly negative annual GDP growth throughout 2009. The domestic economic downturn passed through to the labour market with the usual lag. Inflation gradually fell, reaching slightly negative figures in October. Consumer price inflation rose in the remaining months of the year, but remained well below the lower boundary of the inflation target tolerance band. The CNB responded by sharply reducing key interest rates starting in August 2008. The exchange rate of the koruna was particularly volatile at the beginning of the year and was affected chiefly by external factors.

Fulfilment of the inflation target



Gross domestic product growth in the Czech Republic and the EU



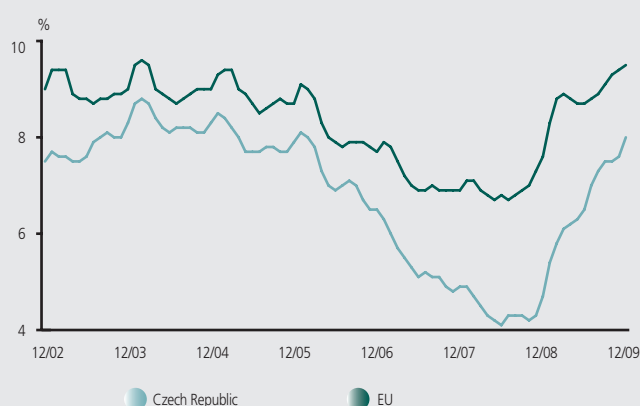
The unfavourable external demand situation resulted at the start of 2009 in a substantial decline in the performance of the Czech economy, comparable to that in the European Union as a whole. Given the high degree of openness of the Czech economy and its heavy dependence on external demand, exports – and consequently also investment – fell sharply. By contrast, household consumption continued rising quite rapidly, dampening the initial impact of the crisis on the Czech economy. Employment and the number of vacancies fell and unemployment rose, but this unfavourable labour market trend in terms of household income was offset by a rise in social benefits and other actions implemented as part of a set of anti-crisis budget measures. In response to increasing risk aversion at the start of 2009 the exchange rate of the koruna depreciated and showed considerable volatility. This depreciation was also fostered by the problems of some countries in the Central Europe region and by the inability of the foreign media and some analysts and financial market participants to appreciate the differences between those countries. Market interest rates continued to be affected by a high credit premium (the spread between the CNB's key interest rate and PRIBOR money market rates). At the beginning of the year, inflation declined sharply to the lower

boundary of the inflation target tolerance band as the one-off factors that had caused the high inflation in 2008 subsided.

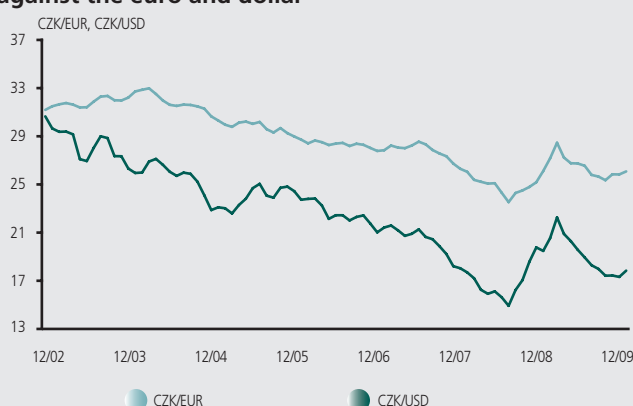
In this situation it was clear that to maintain inflation close to the point inflation target at the monetary policy horizon it would be necessary to keep lowering interest rates, a process commenced by the CNB back in August 2008. At its meeting in February, the CNB Bank Board decided to lower key interest rates by 0.5 percentage point in line with the message of the forecast. The two-week repo rate was thus 1.75%. Throughout the first half of the year, the CNB actively communicated the relatively sound fundamentals of the Czech economy, thereby helping to calm the exchange rate. Overall, however, the exchange rate depreciated during the crisis, partly helping the domestic economy to overcome the downswing in external demand.

The economic contraction – as measured in quarter-on-quarter terms – almost came to a halt in Q2. This was due partly to the adoption of anti-crisis measures abroad (car-scrapping incentives in particular). The annual decline in GDP deepened further, however. The labour market situation continued worsening. The fall in employment and in the number of new vacancies accelerated further and was accompanied by a rising unemployment rate. The latter, however, was still lower than in other EU countries. Improved financial market sentiment towards the Central European region, in line with lower risk aversion, caused the koruna to appreciate. Market interest rates reacted to the cuts in monetary policy rates, but the credit premium remained at unusually high values. Inflation decreased further, mainly because of the fading lagged effects of changes to indirect taxes and slowing growth in regulated prices against a backdrop of minimal or negative growth in other items of the consumer basket.

The unemployment rate in the Czech Republic and the EU



Nominal exchange rate of the koruna against the euro and dollar



The forecast contained in Inflation Report II/2009, which incorporated these latest trends, expected lower economic growth and correspondingly lower interest rates. In line with the forecast, the Bank Board decided at its meeting in May to cut interest rates by a further 0.25 percentage point. The two-week repo rate thus went down to 1.50%.

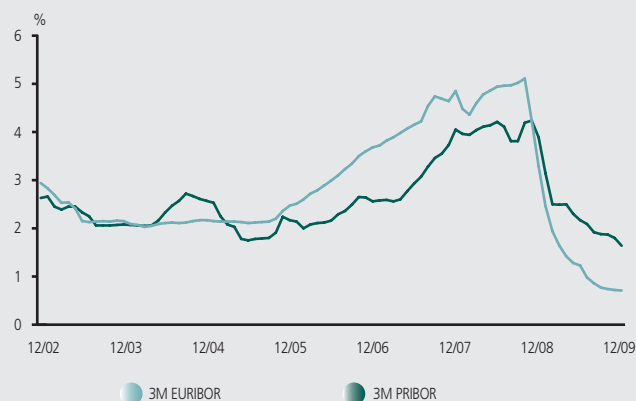
The slowdown in the annual decline in the Czech economy in Q3 confirmed the stabilisation of the economy which was indicated by quarter-on-quarter data as early as Q2. However, the adverse labour market situation worsened further in line with expectations. The koruna exchange rate continued appreciating in response to a gradual subsiding of the financial crisis and the announced package of austerity budget cuts for 2010. Market interest rates fell further, amid the decrease in

monetary policy rates accompanied by the gradually falling credit premium. Inflation decreased by more than one percentage point in 2009 Q3 and stood at zero in September. Most of the main price categories, particularly food prices, regulated prices and core inflation, i.e. adjusted inflation excluding fuels, contributed to the pronounced slowdown in annual consumer price inflation.

In the light of new information, the forecast contained in Inflation Report III/2009 made downward revisions to the economic growth outlook and, in line with the expected evolution of external demand, expected an asymmetric W-shaped recovery. The inflation forecast changed minimally, predicting only slightly positive inflation figures in the remainder of 2009 followed by a gradual return of inflation to the target during 2010. The interest rate path consistent with the forecast shifted downwards slightly. After discussing this forecast, the Bank Board decided unanimously at its meeting in August to lower key interest rates by 0.25 percentage point as in the previous quarter. The two-week repo rate thus decreased to 1.25%.

The slowdown in the annual decline in economic activity accelerated markedly in Q4. Quarter-on-quarter economic growth also increased slightly. The decline in GDP for 2009 as a whole was roughly 4%. However, the adverse labour market tendencies continued deepening as in previous quarters. The koruna exchange rate experienced a correction, depreciating to roughly its mid-year value. Market interest rates continued copying the downward trend in monetary policy rates. However, the decline in the risk premium slowed and so market interest rates remained higher than monetary policy rates. Domestic PRIBOR interest rates were higher than foreign EURIBOR rates with the same maturity in 2009.

Money market interest rates



Inflation in the Czech Republic and the EU



Inflation declined to slightly negative values in October, but increased again in the remaining months of the year owing to a considerable rise in fuel prices, which until then had been falling. Inflation as measured by the harmonised index of consumer prices (HICP) was roughly the same as that in the EU as a whole in the first half of 2009 and up to 1 percentage point lower in the second half of the year.

The last forecast in 2009 predicted that the decline in economic activity had already bottomed out and that the economy would grow during 2010. According to this forecast, inflation was to rise from 2010 Q2 onwards and slightly exceed the 2% inflation target at the end of 2010. Consistent with the forecast was a decline in market interest rates in 2009 followed by a gradual rise in 2010. At its November meeting, the Bank Board voted by a slim majority to leave key interest rates unchanged. At the following meeting in December, it decided to lower the repo rate by 0.25 percentage point to a new historical low of 1.00%.

More detailed information on economic developments and monetary policy implementation can be found in the quarterly Inflation Reports available on the CNB website (*Monetary policy – Inflation reports*).

In 2009, the CNB took a further significant step to increase monetary policy transparency by publishing the forecast-consistent path of the nominal koruna-euro exchange rate in fan chart form. This decision made the CNB the only central bank in the world to publish a forecast for a nominal exchange rate vis-à-vis a specific currency (although a handful of the most advanced inflation-targeting central banks do currently publish effective exchange rate forecasts). The disclosure of the exchange rate forecast in numerical form means that full transparency of the CNB forecast has been achieved. This, in turn, enhances the transparency of the Bank Board's monetary policy considerations, giving external observers a better understanding of CNB monetary policy. As in the case of the interest rate path, the published exchange rate path should be understood by the public as being conditional on the assumptions of the forecast and the information available at the time it was prepared, not as a binding commitment or preference of the CNB. The CNB succeeded in communicating this fact to the public and did not encounter any major problems with publishing its exchange rate forecast.

In autumn 2009, the CNB in cooperation with the Czech Ministry of Finance drew up an *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area* (available in the *Monetary policy – MP strategic documents – Euro area accession* section of the CNB website). This document, prepared every year, resulted in a recommendation not to set a target date for adopting the euro yet and thus not to attempt to enter the ERM II during 2010. This recommendation was based mostly on the fact that in the current conditions it is very unlikely that the Czech Republic will be able to fulfil the Maastricht convergence criteria in the medium term. The principal barrier to joining the monetary union will be a general government deficit exceeding 3%. The maintenance and further necessary increase in the Czech economy's alignment with the euro area in the coming years are also very uncertain.

FINANCIAL MARKET SUPERVISION

The CNB's competences as a supervisory authority

In accordance with Act No. 6/1993 Coll., on the Czech National Bank, the CNB is the supervisor of the financial market in the Czech Republic. To the extent stipulated in legal rules, the CNB supervises entities operating on the financial market, analyses the evolution of the financial system, sees to the sound operation and development of the financial market in the Czech Republic and contributes to the stability of the Czech financial system as a whole. When performing its tasks, the CNB cooperates with central banks and authorities supervising the financial markets of other countries and with international financial institutions and organisations engaged in financial market supervision. The CNB also works in close partnership with the Czech Ministry of Finance and with other state authorities to create a single strategy and unified rules applying to financial market regulation and supervision and to address important issues, e.g. the building of structures of joint EU supervision of financial markets, crisis management and information sharing in both the national and international context.

CNB supervision covers decisions on applications for licences, authorisations and prior approvals; inspection of adherence to the conditions stipulated in licences and authorisations; inspection of adherence to laws insofar as the CNB has the power to conduct such inspections under the law or special legal rules; inspection of adherence to the decrees and provisions issued by the CNB; collection of information needed

to perform supervision; verification of whether such information is true, complete and up-to-date; imposition of remedial measures and penalties; and proceedings regarding administrative offences.

The key areas for the CNB in the financial market area are the supervision of banks, branches of foreign banks, credit unions, electronic money institutions, branches of foreign electronic money institutions, small-scale electronic money issuers, payment institutions and small-scale payment service providers and supervision of the sound operation of the banking system. The CNB is also responsible for supervising insurance companies, reinsurance companies, pension funds and other entities operating in the financial market area. It also supervises investment firms, securities issuers, entities keeping a register of investment instruments, investment companies, investment funds, settlement system operators and investment instrument market organisers.

The CNB as the integrated supervisory authority

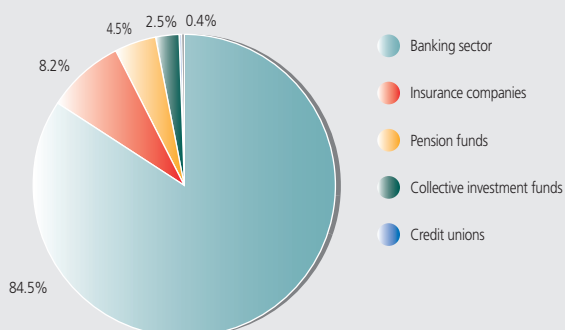
The CNB has been the integrated supervisor of the Czech financial market since April 2006. The original division of the supervisory departments by financial market sectors was replaced in 2008 by a functional organisational structure consisting of three departments – the Financial Market Regulation and Analyses Department, the Licensing and Enforcement Department and the Financial Market Supervision Department. This new sectoral set-up has proved fully successful amid the persisting global financial and economic crisis.

The CNB informs the Chamber of Deputies, the Senate and the Czech Government about its financial market supervision activities in its annual Financial Market Supervision Report, which also contains detailed information on developments in the individual sectors of the financial market. The Financial Market Committee, which was established in 2006, is informed about the CNB's main supervisory activities every six months. The CNB also publishes detailed information for specialists and the public on its website on an ongoing basis. The supervisory departments performed their activities in 2009 in line with the principles laid down in the strategic document *The Mission of the Czech National Bank for the Supervision of the Czech Financial Market*.

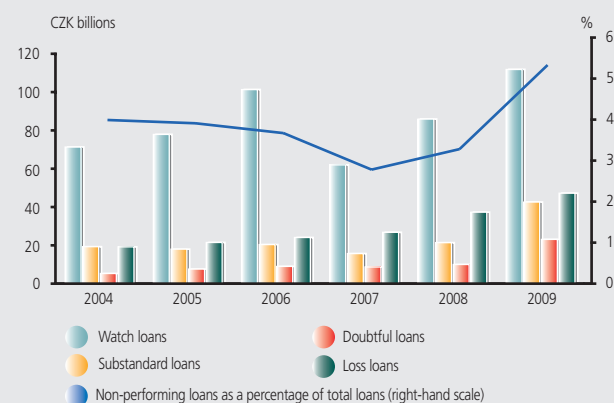
The financial market

The Czech financial market was hit by the global financial crisis in 2009 to a much lesser extent than the other markets of Central and Eastern Europe countries. This was due most of all to the financially stable Czech banking sector, which in terms of the volume of assets managed has a completely dominant position compared to the other financial market sectors supervised by the CNB.

Asset volume of supervised financial market entities as of 31 December 2009 (CZK billions)



Credit portfolio quality (individually assessed loans)



The Czech banking sector is in good condition. Its structure has long been almost unchanged. As of 31 December 2009, a total of 16 banks, 5 building societies, 16 foreign bank branches and 17 credit unions were offering banking services. However, the relatively large number of credit unions represents only about 0.4% of the balance-sheet assets of the credit institution sector. Foreign capital has a dominant role in the banking sector. Foreign investors directly or indirectly control over 97% of the total balance-sheet assets of the banking sector.

Banking sector indicators						
	12/2004	12/2005	12/2006	12/2007	12/2008	12/2009
No. of banks and foreign bank branches	35	36	37	37	37	39
Total assets (CZK billions)	2,635.6	2,954.4	3,151.8	3,750.6	4,046.0	4,092.9
Liabilities to clients (CZK billions)	1,731.8	1,919.6	2,102.2	2,430.5	2,596.6	2,726.7
Net profit (CZK billions)	32.9	39.1	38.0	47.0	45.7	60.2
Administrative expenses (CZK billions)	48.8	51.8	55.7	59.7	61.7	60.3
Capital adequacy (%)	12.5	11.9	11.5	11.6	12.3	14.1
Non-performing loans to client loans (%)	4.0	3.9	3.7	2.8	3.3	5.3
Recalculated no. of employees	38,500	37,199	37,894	38,708	38,579	37,573
No. of banking units	1,785	1,825	1,877	1,865	1,993	1,991
No. of ATMs	2,750	3,005	3,281	3,357	3,406	3,573

The balance-sheet assets of the banking sector were virtually unchanged during 2009 and amounted to CZK 4,092.9 billion at the year-end. Traditional banking still prevails in the banking sector. Loans provided¹ are the largest item in banks' balance sheets. At the end of 2009, their rate of growth was down year on year owing to the adverse situation in the domestic economy.

Sectoral breakdown of claims (in CZK millions)						
	12/2004	12/2005	12/2006	12/2007	12/2008	12/2009
Residents and non-residents, total	1,010,309	1,178,670	1,413,084	1,783,988	2,075,687	2,102,084
Residents	969,194	1,118,659	1,338,650	1,668,895	1,926,553	1,952,983
Non-financial corporations	459,502	525,350	634,876	743,380	848,068	782,160
public	25,861	25,194	23,987	37,170	34,465	28,001
national private	310,935	359,435	444,021	513,947	590,374	529,791
foreign controlled	122,706	140,722	166,868	192,263	223,229	224,369
Financial corporations	81,126	96,932	99,754	147,118	150,832	129,813
General government	114,877	81,463	67,630	57,482	54,279	66,241
Households	311,837	412,895	530,805	707,820	851,470	940,502
Households – trades	28,530	33,361	35,923	39,059	43,113	42,504
Households – individuals	283,307	379,535	494,882	668,761	808,358	897,998
Non-profit institutions serving households	1,852	2,019	5,586	13,096	21,903	34,268
Non-residents	41,115	60,011	74,433	115,092	149,134	149,100

Even in these conditions the debt of Czech households was more than 10% higher at the end of 2009 than a year earlier. The share of households (individuals) in the sector's total claims exceeded 42%. By contrast, banks' exposure to non-financial corporations decreased year on year (by almost 8%) for the first time in a long time.

The external economic conditions negatively affected the quality of the domestic banking sector's loan portfolio. The share of non-performing loans (i.e. substandard, doubtful and loss loans) rose by a full two percentage points year on year to 5.3% at the end of 2009.

Nevertheless, the Czech banking sector has long had sufficient funds. The roughly 67% share of client deposits represents the largest item on the liabilities side of banks' balance sheet. The economic crisis also led to a decline in the growth rate of deposits, but banks' liabilities to clients still rose by almost 5% year on year. The capital adequacy ratio is continuously increasing. In 2009 it rose by 1.8 percentage point year on year, to 14.1%.

¹ The data in the table are based on monetary and financial statistics data and differ from the banking supervision data owing to a different methodology. The main differences are described in the FAQs – *Frequently asked questions – monetary and financial statistics* section of the CNB website.

The banking sector has been profitable for years now. At the end of 2009, it generated a net profit of CZK 60.2 billion, which is almost one-third higher than in 2008. However, the amount was positively affected by some one-off items (e.g. sales of ownership interests). Excluding these extraordinary effects, the profit would have been comparable to that in 2008. Even so, this can be viewed as a very good result, particularly in the context of the domestic economic situation, which for banks is being reflected in deteriorating credit portfolio quality and a need to create larger provisions. Interest rate profit, which makes up the bulk of the banking sector's profit, rose by 5.4% year on year, whereas profit from fees and commissions was only 0.9% higher.

The insurance sector experienced no major changes or events that endangered its proper functioning and stability. However, the decline in the performance of the Czech economy caused a further slowdown in growth of gross premiums written, which are a basic indicator of the situation in the insurance market. A total of 35 domestic insurance companies (3 life, 17 non-life and 15 universal) and 17 branches of foreign insurance companies (4 life, 12 non-life and 1 universal)² were operating on the Czech market as of 31 December 2009. A large number of insurance companies and branches of insurance companies from EU and EEA Member States declared their intention to provide services temporarily in the Czech Republic. As of the end of 2009, they totalled 614. A gradual increase in the number of notified entities can also be expected in the future, both through the establishment of branches and through cross-border service provision. Notified entities providing cross-border insurance services are affecting the competitive environment on the non-life insurance market in particular.

As for capital origin, 24 domestic insurance companies are foreign-controlled and 11 are domestically controlled. Of the foreign shareholders, those from the Netherlands accounted for the largest share (27.2%) of the total registered capital of Czech insurance companies.

The decrease in economic output in the Czech Republic caused a fall in the growth rate of premiums written of 2.1 percentage points to 3.1%. The slowdown was due to a decline of 4.1 percentage points in growth of premiums written in the non-life insurance market to 1.2%. The life insurance area was relatively stable compared to the previous year; in 2009 premiums written rose (mainly as a result of growth in lump-sum premium payments) by 5.8%, i.e. by 0.7 percentage point more than in 2008. The life insurance market is showing essentially no signs of any major negative impacts of the present financial crisis.

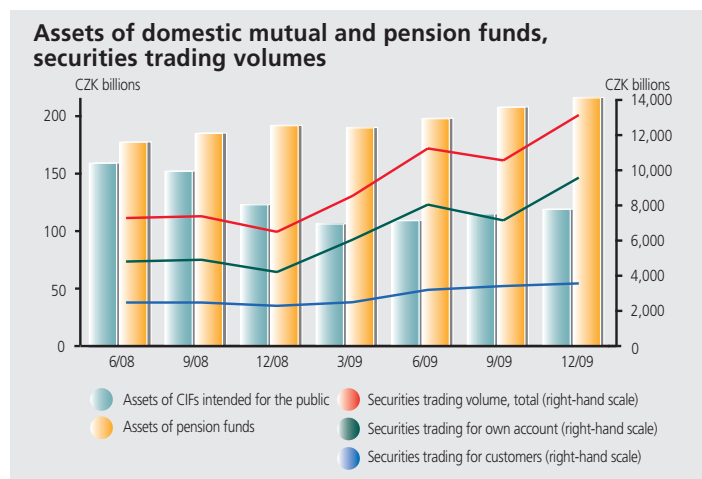
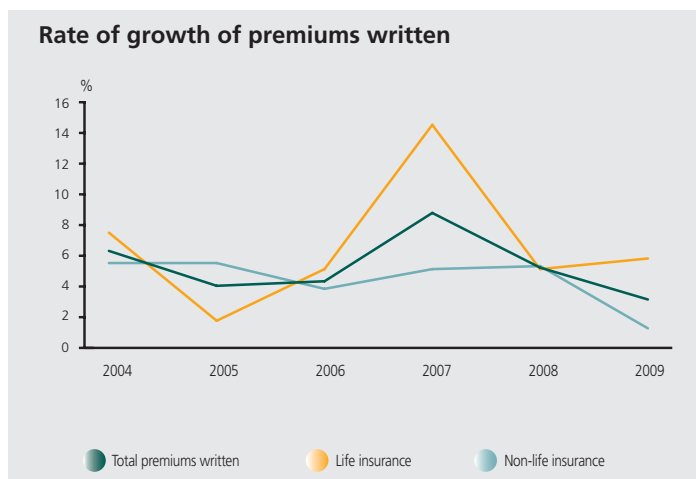
Premiums written (in CZK billions)						
	2004	2005	2006	2007	2008	2009
Total premiums written	112.6	117.1	122.1	132.9	139.8	144.1
Life insurance	44.2	45.0	47.2	54.1	56.9	60.2
Non-life insurance	68.4	72.1	74.9	78.8	82.9	83.9

In 2009, the share of life insurance in total premiums written increased by 1.1 percentage point compared to 2008, reaching a historical high of 41.8%. This share, however, is still lower than in advanced EU countries.

In 2009, the Czech capital market was affected by the continuing global financial crisis and the slower domestic economic growth resulting from the global economic crisis. The CNB closely monitored both the situation and the portfolios of supervised capital market entities. After bottoming out in late February and early

² These figures do not include the Czech Insurers' Bureau.

March 2009, the financial market situation and the results of individual entities started to improve slowly.



Following sharp growth in unit redemptions in 2009 Q1, particularly in money market funds, the collective investment sector gradually stabilised in the first half of the year. Thanks to the stabilisation of the government and corporate bond markets in spring 2009, the gradual restoration of investor confidence and funds' improving performance indicators, the volume of assets managed by funds gradually rose again. The total assets managed by domestic funds intended for the public amounted to CZK 118.9 billion at the end of 2009, i.e. around 3.2% less than a year earlier. A total of 22 investment companies, 8 depositories, 27 investment funds, 2 closed-end mutual funds and 139 open-end mutual funds (36 of them standard funds and 103 special funds) were subject to CNB supervision as of the end of 2009. Of the total number of funds, 58 were intended for qualified investors.

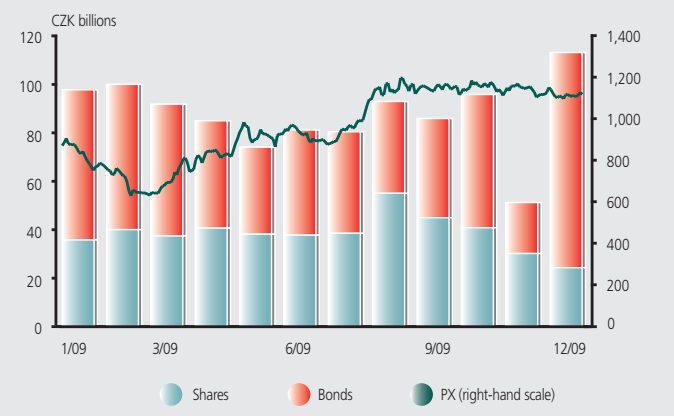
As of the end of 2009, the CNB registered 39 domestic investment firms (11 of them banks) and 17 foreign entities from EU countries providing investment services in the Czech Republic via a branch (14 of them banks). Six domestic investment companies providing property management services also held investment firm licences. The total volume of transactions executed by all investment firms was CZK 43,472 billion³ in 2009, up by 52.2% on a year earlier. This was mainly a result of an increased volume of trading on investment firms' own account, particularly by foreign bank branches. Investment firms carried out transactions for their clients worth CZK 12,652 billion, i.e. a 29% rise compared to the previous year.

In 2009, the pension fund sector consisted of ten entities. The sector recorded a profit of CZK 2.6 billion. Its total assets rose by 12.6% year on year, from CZK 191.7 billion to CZK 215.9 billion. The volume of planholders' funds in pension funds' liabilities grew by 7.5% year on year to CZK 200.7 billion.

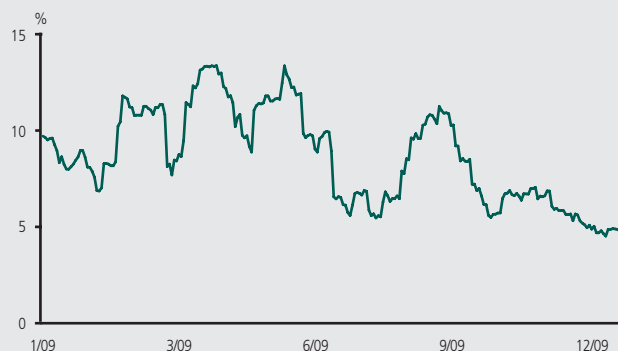
The situation on the Prague Stock Exchange also reflected the global economic situation. Its PX index stood at 1,117.3 points at the end of 2009 (up by 32.2% on a year earlier). The annual volume of share trades on the PSE was CZK 463.9 billion, a decline of 45.5% from the previous year. The total volume of bond transactions dropped by 9% to CZK 585.7 billion. The trading volume on the other domestic stock exchange, RM-SYSTÉM, increased by 26.2% from CZK 8.4 billion to CZK 10.6 billion

³ These figures exclude derivatives transactions.

PSE trading volumes and PX index



Historical volatility of PX index (20D, %)



in 2009. The RM index jumped by 20.4% year on year to 2,340.7 points from 1,943.9 points.

Financial market regulation

A series of laws and implementing regulations amending the conditions for the activities of financial institutions and other entities operating on the Czech market were adopted in 2009. The CNB worked in close cooperation with the Czech Ministry of Finance, which has primary responsibility for preparing laws in the financial market area, and prepared related decrees in conformity with its legal powers.

The principal changes in the regulations with respect to the implementation of European law were a collective amendment of legislation⁴ connected with the transposition of Directives 2004/109/EC (on transparency), 2007/44/EC (on qualifying holdings) and 2007/16/EC (on eligible assets of standard funds) and a new Payment System Act with the transposition of Directive 2007/64/EC (on payment services in the internal market). The Act on Banks was further amended in response to the financial crisis. Although the Czech banking sector was not affected strongly by the financial crisis, the new legislation widens the range of instruments available to allow rapid and transparent action in the interests of maintaining the stability of the banking system in the event of future negative developments.

The CNB's supervisory activities have also been affected fundamentally by a new Insurance Act, into which Directive 2005/68/EC (on reinsurance) has primarily been transposed. Other significant changes include more detailed requirements regarding the internal control systems of insurance companies, additions to the list of assets covering technical provisions, and a requirement for reports to be prepared by responsible actuaries. Amendments were also made to other laws in connection with the adoption of the new Insurance Act, e.g. the Act on Insurance Contracts and the Act on Insurance Intermediaries and Independent Loss Adjusters.

The frequent migration of planholders between pension funds, and the costs incurred as a result, led to the adoption of an amendment to the Act on Private Pension Insurance stipulating basic rules for recruiting new planholders and requirements for transparency of conduct of funds, including disclosure of commissions paid to intermediaries.

⁴ A collective amendment of the Capital Market Undertakings Act, the Act on Banks, the Act on Credit Unions and the Act on Collective Investment.

An amendment to the Commercial Code transposing Directive 2007/36/EC (on the exercise of certain rights of shareholders in listed companies) took effect at the end of the year. The aim of this amendment was to allow the convening of general meetings and voting by electronic means and to facilitate the cross-border exercise of voting rights. Attached to this amendment was a technical amendment of the Takeover Bids Act, initiated by the CNB with the aim of clarifying certain penalty provisions and supervisory powers, and of the Act on Administrative Fees.

In 2009, legislative work was completed on 11 decrees issued in connection with new laws in the financial market area. In the capital market area this included the publication of decrees newly regulating the manner of keeping a transactions and orders book of an investment firm and related information obligations, the rules regarding protection against market abuse and the requirements for transparency of issuers, the eligible investment instruments of standard funds and the requirements for the expertise of persons assisting investment firms in their activities.

In order to unify and streamline licensing and authorisation procedures, a decree was issued regulating the range of information submitted in applications under the Act on Banks, the Act on Credit Unions and the Capital Market Undertakings Act. This decree replaced the existing sectoral decrees.

Two decrees were issued in the insurance area following the adoption of the new Insurance Act. These decrees lay down in particular requirements relating to the internal control systems of insurance companies, solvency, financial placement limits and the information obligation towards the CNB. Following the adoption of the new Payment System Act and a related amendment to the Foreign Exchange Act, three decrees were issued regarding the activities of payment institutions, electronic money institutions and bureaux-de-change. In 2009, two provisions were published in the CNB Bulletin and ten official CNB information documents were also issued.⁵

Numerous other changes to the regulations were under preparation in 2009, mostly in order to transpose EC regulations. Completion of the legislative process for these amendments is expected in 2010. They include in particular an amendment to the Act on Banks transposing into Czech law Directive 2009/14/EC amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay, as well as a proposal for a new Act on Financial Collateral responding to Directive 2009/44/EC amending Directive 2002/47/EC on financial collateral arrangements.

International cooperation

The CNB's supervisory departments were actively involved in international activities. Within EU structures, participation in the activities of the European Commission's committees and working groups, the Lamfalussy Level 3 committees⁶ (CEBS⁷, CESR⁸, CEIOPS⁹) and the European Central Bank's committees¹⁰ was of key importance. Last year was characterised mainly by a discussion of changes in the institutional regulatory

⁵ A complete and up-to-date list of the CNB's decrees, provisions and official information relating to the financial market can be found in the *Financial market supervision – Legislation* section of the CNB website.

⁶ See the *Financial market supervision – Conduct of supervision – International activities* section of the CNB website.

⁷ Committee of European Banking Supervisors

⁸ Committee of European Securities Regulators

⁹ Committee of European Insurance and Occupational Pensions Supervisors

¹⁰ See the *EU and international relations – ECB and ESCB* section of the CNB website.

and supervisory set-up and in regulatory activities in response to the financial market crisis in 2008 and 2009. The CNB, together with the Ministry of Finance, was actively involved in the negotiation process on the proposed EC regulations under which a new agency for macro-prudential supervision (the European Systemic Risk Board – ESRB) is to be established and the three Level 3 committees are to be transformed into three European supervisory agencies: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the Insurance and Occupational Pensions Authority (EIOPA). These authorities are to be vested with wider powers at the expense of the powers of national supervisory authorities. The launch date for the new supervisory authorities has preliminarily been set at 1 January 2011, but the debate on the regulations in the European Parliament during 2010 may change these plans. Nonetheless, all the existing committees have started to gear up for their transformation.

In parallel with the preparations for their transformation, and in response to the financial crisis, the 3L3 committees and their working groups worked on enhancing the regulations and on further strengthening and harmonising supervisory culture and practice. These activities were based on several Ecofin Council resolutions and on commitments arising from G20 summit conclusions. They included in particular support for, and monitoring of, colleges of supervisors, work on a framework for crisis prevention, management and resolution, risk management and monitoring, revision of accounting standards, reporting, the compensation system and relations with non-cooperating jurisdictions.

In relation to the EU Council and its structures, the CNB worked with the Ministry of Finance on the preparation of opinions on the documents discussed in the Ecofin Council and in the Financial Services Committee (FSC) and the Economic and Financial Committee (EFC). These committees are tasked with providing support to the ECOFIN Council and a forum for preliminary discussions at the expert level and, among other things, are also engaged in financial regulation and supervision. From the outset the CNB upheld positions ensuing from its mission and principles and from the interests of the Czech Republic as a whole, i.e. the safeguarding of financial stability and fiscal sovereignty of the state, the independence of the national supervisory authority and non-infringement of its powers, the limitation of the efforts of European authorities to intervene directly against individual financial institutions, the prevention of asymmetry of delegated powers and responsibility for decisions taken, the reduction of costs of proposed solutions vis-à-vis market participants, the clear definition of the competences of the proposed authorities, etc.

As for cooperation with partner supervisory authorities the CNB concluded a bilateral memorandum of understanding with the China Banking Regulatory Commission. This took the number of supervisory authorities with which the CNB has signed bilateral memoranda of understanding to nine. The number of bilateral agreements in the insurance and capital market sectors remained unchanged at five and seventeen respectively.

In 2009, negotiations were organised within colleges of supervisors to ensure effective supervision of cross-border financial groups and enhance cooperation and exchange of information between home and host supervisors. The CNB is actively involved in seven colleges, namely those relating to the cross-border banking groups of Erste Bank, Volksbank, Raiffeisenbank, Société Générale, UniCredit, KBC and ING. The CNB also committed to mutual cooperation within these colleges by signing a multilateral agreement. Intensive cooperation with foreign supervisors of insurance companies, particularly those belonging to insurance groups operating in the Czech Republic, continued as well. Multilateral and bilateral meetings of supervisors of members of such groups took place in this context.

Financial market supervision

The CNB supervises the banking sector, the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change and institutions in the payment system area. It does so in the form of both off-site surveillance (continuous monitoring of the stability of the individual supervised sectors) and on-site examinations.

Off-site surveillance consisted in continuously monitoring the activity and financial performance of the individual entities operating on the financial market, checking compliance with the relevant legal rules, checking compliance with prudential rules and regularly assessing the financial condition of individual regulated entities. Information was obtained mainly from the statements and reports regularly submitted by individual entities on a solo and in some cases also a consolidated basis. Owing to the financial crisis in 2009, off-site surveillance focused more intensively on the impacts of financial market developments on the performance of domestic financial institutions. In this context, the portfolios of the supervised institutions were analysed in more detail and their exposure to risky entities or instruments was determined. The risk exposure was relatively low and so its impacts on institutions' financial results were limited. Considerable attention was also paid to the liquidity of key financial institutions. Extraordinary reporting of selected indicators was also introduced for a number of entities. Its frequency was gradually decreased and such reporting was terminated for almost all entities during autumn 2009.

The on-site inspections conducted in 2009 were based on an annual plan of activity compiled with due regard to the requirements of both off-site surveillance and foreign regulators. The main criteria applied in the creation of the plan included the significance and riskiness of individual institutions, the time elapsed since the last examination and current developments in global financial markets. The on-site inspections were performed in compliance with the legislation in force and focused on checking compliance with the regulatory rules laid down in legal and implementing regulations. The inspections also helped to identify the risks of present and future developments in regulated entities, check compliance with the rules of conduct and professional care and take timely corrective action. With respect to the prudential business of regulated entities the CNB's supervisors focused on verifying, assessing and evaluating procedures associated with risk identification, assessment, measurement, monitoring and management. The examined entities' managements were notified of any shortcomings detected. On-site examination reports were written and measures were imposed. Compliance with such measures was systematically monitored and evaluated. In justified cases, the CNB opened administrative proceedings with relevant entities based on the inspection results.

Numbers of on-site inspections	2009
Banks	6
Credit unions	2
Insurance companies	1
Insurance intermediaries	4
Collective investment institutions	3
Depositories	3
Pension funds	3
Investment firms	4
Investment intermediaries	2
Bureaux-de-change	362

In the course of 2009, eight examinations were carried out in credit institutions, two of them being credit unions. Although they were partial examinations, some of them were close in scope to comprehensive examinations. The examinations focused on credit risk management, liquidity, internal auditing, compliance, operational risk management, money laundering prevention, information systems and technology, and reporting systems for regulatory purposes.

As regards supervision of insurance companies, one examination was conducted. This focused primarily on the amount of reserves for claim payments, the loss-adjustment process and insurance risk management in non-life insurance. On-site examinations were conducted in four insurance intermediaries, concentrating on the obligation to carry on insurance intermediary activities with professional care. In connection with the involvement of CNB branches in examinations of insurance intermediaries, the branches were provided with methodological support for such examinations.

In the collective investment sector, one on-site inspection was terminated and one was conducted in an investment company and a non-autonomous fund managed by it. The latter focused on the prudential rules and rules of organisation for internal operations and on the rules of conduct and professional care in the management of collective investment fund assets.

In the area of private pension schemes, inspections were terminated in three pension funds. These had focused on compliance with the obligation to manage pension fund assets with professional care and compliance with the obligation to handle assets in a manner consistent with the interests of planholders, particularly as regards covering the direct and indirect costs of recruiting new planholders and related activities.

Three on-site inspections were terminated in depositories. These had concentrated on the handling of assets of collective investment funds and pension funds, the execution of orders, the method of valuation of assets of collective investment funds and pension funds and the calculation of the present value of mutual fund units or investment fund shares.

Six on-site inspections were commenced in investment services providers (four in investment firms and two in investment intermediaries). Five of these inspections were comprehensive, focusing on compliance with the rules for prudent provision of investment services, the rules of conduct towards clients and the keeping of registers. One specialised examination was carried out, concentrating on the keeping of registers and on foreign exchange issues.

The CNB performs on-site bureau-de-change supervision through its branches. The aim of the inspections was to verify all activities carried out by a particular non-bank foreign exchange entity and its individual establishments. The CNB carried out 362 on-site inspections in the foreign exchange area and inspected a total of 485 establishments.

Owing to the presence of international financial groups and the significance of foreign capital in the Czech financial market, cooperation with foreign regulators was stepped up. This mainly took the form of intensive sharing of information on the results of inspections, cooperation during validations of internal models applied within financial groups, and participation of CNB staff in inspections abroad.

Licensing activities in the financial market area

In 2009, the CNB conducted 85 administrative proceedings concerning regulated credit institutions (banks, branches of foreign banks, and credit unions), 11 of them banks and 74 credit unions. The largest number of proceedings as usual related to prior consents to the acquisition of qualifying holdings (51 proceedings) and to the approval of members of bodies and senior officers of credit unions (23 proceedings). The remaining administrative proceedings concerned, among others, regulatory consents to the establishment of a branch of a credit union abroad and to a decrease in a membership contribution. As regards electronic money institutions, which are also categorised in this sector according to European law, the CNB received no applications and conducted no administrative proceedings. One application for a payment institution licence was filed by the end of the year.

As the supervisory authority in the insurance area, the CNB conducted 118 administrative proceedings and issued 110 administrative decisions in 2009. An increased number of applications by foreign state or semi-state entities for consent to the acquisition of qualifying holdings in domestic insurance companies was recorded in the insurance market licensing area.

Numbers of supervised entities				
	As of 31 Dec. 2008	Additions	Losses	As of 31 Dec. 2009
Credit institutions, total	54	3	1	56
Banks	21	0	0	21
of which: building societies	5	0	0	5
Branches of foreign banks (operating under the single licence regime)	16	3	1	18
Credit unions	17	0	0	17
Insurance companies (incl. branches and reinsurance companies)	54	2	3	53
Domestic insurance companies	35	0	0	35
Branches of insurance companies from EU/EEA	17	2	3	16
Branches of insurance companies from third countries	1	0	0	1
Reinsurance companies	1	0	0	1
Investment companies	20	2	0	22
Investment funds	16	11	0	27
Open-end mutual funds	142	16	19	139
of which: standard funds	41	2	7	36
Closed-end mutual funds	2	0	0	2
Pension funds	10	0	0	10
Depositories	8	0	0	8
Investment firms	38	3	2	39
Non-bank investment firms	27	3	2	28
Investment firms – banks	11	0	0	11
Issuers of listed securities	68	3	10	61
of which: foreign	18	0	1	17
Regulated market operators	2	1	0	3
Settlement systems	3	0	0	3
Central depository	0	1	0	1

The trend of the entry of new entities into the collective investment sector continued in 2009. There was increased interest mainly in special funds for qualified investors, particularly those specialising in investment in real estate and real estate companies. In August 2009, an amendment to Act No. 189/2004 Coll., on Collective Investment, came into force which provided a significant impulse for the further development of non-autonomous investment funds, i.e. investment funds whose assets are managed by an investment company. A total of 241 administrative proceedings were conducted and 199 decisions were made in the collective investment area in 2009. Two decisions on the granting of investment company licences and 11 decisions on the granting of investment fund licences were issued. The most frequent administrative proceedings were those regarding the approval of changes in the statutes of collective investment funds (128). In all, 35 administrative proceedings concerned prior consent to the discharge of office of director of an investment firm or an investment fund, and 22 administrative proceedings were held on the granting of licences to establish a mutual fund. The CNB conducted 14 administrative proceedings concerning prior or subsequent consent to the acquisition of qualifying holdings in an investment company or an investment fund. A total of 12 authorisations to establish a mutual fund were revoked at the request of an investment company, and six authorisations to merge mutual funds were granted. The CNB held two administrative proceedings concerning authorisations to offer securities of a foreign special fund to the public in the Czech Republic. In connection with an amendment to the Collective Investment Act of August 2009, the CNB received a completely new type of application for

the granting of authorisation to convert an investment fund. This involved two administrative proceedings concerning permission for the merger of special funds for qualified investors with a non-regulated entity.

There were no substantial changes in the private pension area as regards the CNB's licensing, approval and authorisation activities. A total of 40 administrative proceedings were conducted, most of them relating to prior consents to the election of a person to a pension fund body, including the re-election of the existing members. The remaining administrative proceedings concerned the approval of changes to statutes or pension plans of pension funds.

The CNB issued 557 decisions in the area of investment services provision, 498 of which were decisions on the withdrawal of registration of investment intermediaries. Three decisions on the granting of investment firm licences and three decisions on the expansion of investment firm licences were issued. One decision was issued regarding the approval of auction rules. Five decisions concerned prior consents to the discharge of the office of director of an investment firm. The CNB issued consent to the acquisition of qualifying holdings in investment firms in five cases.

In the securities issuance area, the CNB issued 109 decisions. Most of them (104) related to bond issue conditions under Act No. 190/2004 Coll., on Bonds, securities prospectuses and combinations thereof for the purpose of offers to the public and admission of securities to trading on the regulated market under Act No. 256/2004 Coll., on Capital Market Undertakings. The remaining five proceedings concerned the disclosure duties of issuers of listed securities, and particularly permission to narrow the scope of annual reports. Three administrative proceedings were opened and three administrative decisions issued in the takeover bids area. As regards market infrastructure, the CNB issued six licensing decisions. The CNB received a total of 131 prospectus notifications from foreign regulators.

The Czech Republic's accession to the EU in 2004 opened up the Czech financial market to other entities entitled to benefit from the free movement of services under the single licence (the European passport). During 2009, the CNB received 421 announcements by foreign regulators of notifications of cross-border provision of services, of which 32 from banks¹¹ (one of them an electronic money institution), 68 from insurance companies¹², 109 from collective investment funds, 10 from investment companies and 203 from investment services providers. Nine banks (of which one electronic money institution), eight insurance companies, one investment company, 221 foreign collective investment funds and 85 investment services providers terminated their activities under the cross-border provision of services. As of 31 December 2009, there were thus 275 banks (of which 12 electronic money institutions), 614 insurance companies, 1,457 collective investment funds, 49 investment companies, 884 investment services providers and 19 payment institutions operating in the Czech Republic.

During 2009, the CNB received notifications of the intention to carry on business in the Czech Republic from 885 insurance intermediaries having a home Member State other than the Czech Republic (444 of them from Slovakia).

As of the end of 2009, a total of 24 representations of foreign banks and financial institutions were registered in the Czech Republic (three representations terminated

¹¹ In the case of foreign financial or credit institutions, three branches of foreign credit institutions in the EU submitted notifications in 2009 (first half of the year) for the first time (this figure is included in the total of 32 notifications).

¹² In addition to insurance companies, branches of insurance companies operating in other EU/EEA countries are notified in this manner. In 2009, the CNB was notified by foreign regulators of the intention of 32 branches to provide services in the Czech Republic (this figure is included in the total of 68 notifications).

their activities and one new one was registered in 2009). Such representations are not authorised to carry on business in the Czech banking sector, but intermediate and promote the services of their banks in the Czech Republic.

A total of 18,835 insurance intermediaries of all categories were newly listed in the Register of Insurance Intermediaries and Independent Loss Adjusters maintained by the CNB. At the end of 2009, a total of 105,980 insurance intermediaries were entered in the register, 8,003 of them foreign. In connection with the registration of insurance intermediaries, the CNB holds professional examinations of insurance agents and insurance brokers. In all, 576 candidates took these examinations and 558 passed. The CNB registered 9,120 investment intermediaries as of the end of 2009. It entered 7,602 entities in the list of tied agents and deleted 1,989 entities from the list in the course of 2009. The total number of tied agents registered by the CNB as of 31 December 2009 was thus 9,123.

In 2009, the CNB granted seven foreign exchange licences, five for providing money services, one for intermediating non-cash foreign exchange transactions and one for executing non-cash foreign exchange transactions. As of 31 December 2009, the CNB registered 201 valid foreign exchange licences.

Since September 2008, the CNB has been performing registrations for bureau-de-change activity through its branches. In 2009, it performed 390 such registrations. The CNB supervises more than 2,500 non-bank foreign exchange entities, which offer cash purchases or sales of foreign currency or intermediate non-cash foreign exchange transactions. Non-bank foreign exchange entities may carry on bureau-de-change activities or non-cash foreign exchange transactions or provide financial services only on premises registered for this purpose in advance by the CNB. In 2009, the CNB registered 191 new premises.

The CNB granted four permits to issue electronic money under the Payment System Act. A total of 55 entities had such a permit as of 31 December 2009. The Czech Republic holds a leading position among the EU Member States in terms of the number of electronic money institutions. These are primarily bus transport companies which issue chip cards that can be used to pay fares between regions to other transport companies. At the end of 2009, three companies were issuing electronic money for internet payments, one was using electronic money to enable employees to withdraw money from a social fund and one company was intermediating "micro-payments" for third-party services using a mobile application.

Penalty activities in the financial market area

Activity in the penalty proceedings area remained an integral part of financial market supervision in 2009 and consisted in the investigation of petitions, decision-making on the opening of administrative proceedings or the deferral of cases, and the conduct of first instance administrative proceedings, within which fines and remedial measures were imposed, licences revoked and registrations cancelled. A total of 96 administrative proceedings were under way in 2009, 62 of which were completed finally and conclusively. The CNB imposed fines totalling CZK 18 million.

The work also includes communication with law enforcement authorities, including the preparation of documents and opinions, and communication with the Finance Ministry's Financial Analytical Unit (FAU) as regards money laundering and terrorist financing.

Central Credit Register

The Central Credit Register (CCR) is an information system administered by the CNB which enables banks and foreign bank branches operating in the Czech Republic (hereinafter referred to as banks) to share information on the credit commitments

and payment discipline of their clients. The CCR contains information on businesses broken down by type of bank claims. All banks have access to the information in the CCR. All banks are also obliged to update their data in the CCR on a monthly basis and maintain the quality of the information stored in its database.

The next CCR development phase – “CCR Optimisation and Stabilisation” – was completed in 2009. In this phase, new versions of user modules of the application and a communication channel supporting direct interconnection of banks’ automated information systems with the CCR database were made available to users. Such technology accelerates and simplifies the access of banks to the CCR database and allows them to automate processes for assessing the payment discipline of their clients.

The number of enquiries submitted to the CCR by both banks and clients continued rising in 2009. In most cases, banks have access to the CCR built directly into their approval processes and operational risk management systems and benefit from direct connection of their information systems to the CCR database. The number of extracts from the CCR provided to clients increased by 63% compared to 2008 and this indicator will continue to rise. Clients can now also use data boxes for receiving extracts from the CCR.

Main operational characteristics of CCR				
	12/2006	12/2007	12/2008	12/2009
Number of registered debtors	356,247	403,417	461,277	497,726
of which: natural persons (entrepreneurs)	213,704	237,703	271,770	291,458
legal entities	142,543	165,714	189,507	206,268
Total volume of loans outstanding (CZK billions)	1,101	1,141	1,265	1,200
Number of CCR application users	2,284	2,422	2,472	2,194
Ad hoc credit commitment enquiries (thousands per year)	141	148	180	205
Number of pieces of credit commitment information in monthly reports (thousands per year)	2,250	2,390	2,800	3,038
Number of extracts made for clients (per year)	195	225	278	453

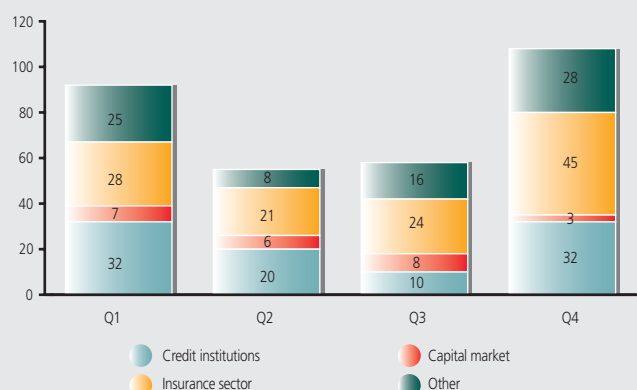
CONSUMER PROTECTION

The Consumer Protection Department (SAOOS) continued its work, which consists in receiving (at spotrebitel@cnb.cz) and investigating consumers’ complaints in accordance with competences arising under the Consumer Protection Act. As from 1 November 2009, this competence was extended to include the payment system area, i.e. complaints by consumers and small businesses relating to shortcomings in pre-contractual information provided in connection with payment services agreements. Complaints against entities operating on the financial market relate to breaches of the prohibition of unfair commercial practices, discrimination against consumers and requirements for proper information about prices.

In 2009, the SAOOS received a total of 313 consumer complaints. Of this number, 30% related to shortcomings in credit institutions, 37% were against insurance companies and insurance intermediaries, 8% concerned shortcomings in the operation of the capital market and 25% did not fall under any of the above categories.

Another competence of the department is financial education activity and the coordination of such activity within the CNB. In 2009, almost 700 primary and secondary school teachers were trained in seminars organised in cooperation with educational institutions and lecturers from the CNB. Part of a series of articles on the pitfalls of individual products on the financial market was published and more information was added to the consumer protection website. A financial education project team, supported organisationally and technically by the SAOOS, was set up at the end of the year.

Number of complaints received



CURRENCY IN CIRCULATION AND THE PAYMENT SYSTEM

Currency in circulation

The value of currency in circulation fell by CZK 11.9 billion in 2009, to CZK 387.3 billion at the end of the year. This was the first year-on-year decrease recorded since the introduction of the Czech currency in 1993. It was due to the gradual dissolution of money hoarded after extraordinary amounts were withdrawn from bank accounts in October 2008 in response to the global financial crisis.

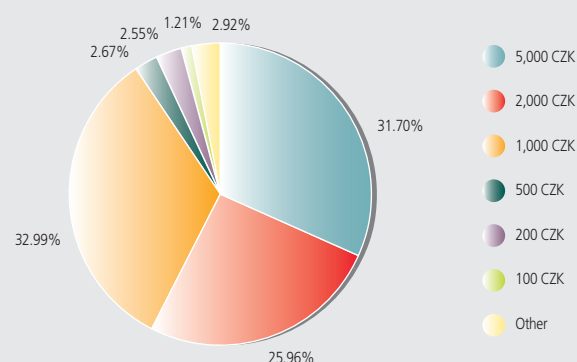
As of 31 December 2009, the CNB recorded 349.7 million banknotes and 1,647.9 million coins in circulation. The number of banknotes in circulation decreased by 3%, as did currency in circulation in koruna terms. The number of coins in circulation fell by 1,060.9 million to 1,647.9 million. This pronounced fall of 39% was due to the discontinuation of the possibility of exchanging ten-heller and twenty-heller coins in October 2009. Adjusted for the effect of these two denominations, the number of coins in circulation would have increased by 40.5 million.

Cash turnover at the CNB's branches amounted to CZK 1,481 billion in 2009 (compared to CZK 1,587 billion in 2008), a decrease of 6.7%. This decrease was due to the decline in economic activity resulting from the economic crisis.

Currency in circulation – 1 Jan. 2005 to 31 Dec. 2009



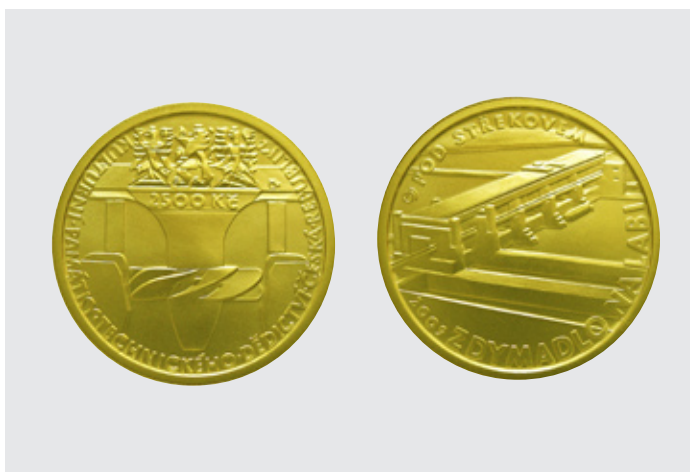
Structure of currency in circulation



Nonetheless, almost 7,000 tonnes of currency passed through the CNB's branches. Cash transactions of banks make up 99% of total cash transactions.

In 2009, the CNB put into circulation two new banknotes – 2009 versions of the CZK 500 and CZK 5,000 notes – with innovated security features at all levels, i.e. visible to the naked eye for the public, visible using simple aids for professionals, visible using more sophisticated professional cash handling devices and visible only using special sensors for handling at the central bank. The banknotes also have special features to affect the operation of reproducing devices in order to make reproduction more difficult.

In 2009, the CNB also put into circulation two gold coins from the Industrial Heritage Sites cycle and five silver commemorative coins. The coin designs and issue dates can be found on the CNB website (*Banknotes and Coins – Numismatics – Schedule of issuance for commemorative coins in 2006–2010*). The schedule of issuance for commemorative coins in 2011–2015, approved by the CNB Bank Board last year, is available at the same address.



A total of 28,000 gold coins were produced in 2009, of which 7,000 (25%) were of normal quality and 21,000 (75%) were of proof quality. Their total nominal value was CZK 70 million. In all, 145,460 commemorative silver coins were produced in 2009 – 56,000 (38.5%) of normal quality and 89,460 (61.5%) of proof quality. The total nominal value of the precious metal coins minted was CZK 99.1 million. They were minted from 1,701.9kg of silver and 217.7kg of gold.



Non-cash payment system

By law, the CNB operates the non-cash payment system, i.e. it maintains the accounts of the central bank and arranges interbank payments and settles short-term securities transactions. Non-cash payment transactions are executed through the CERTIS, SKD and ABO systems.

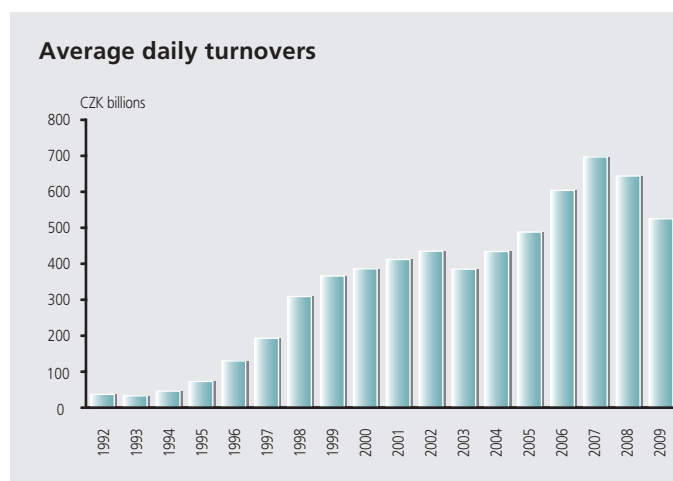
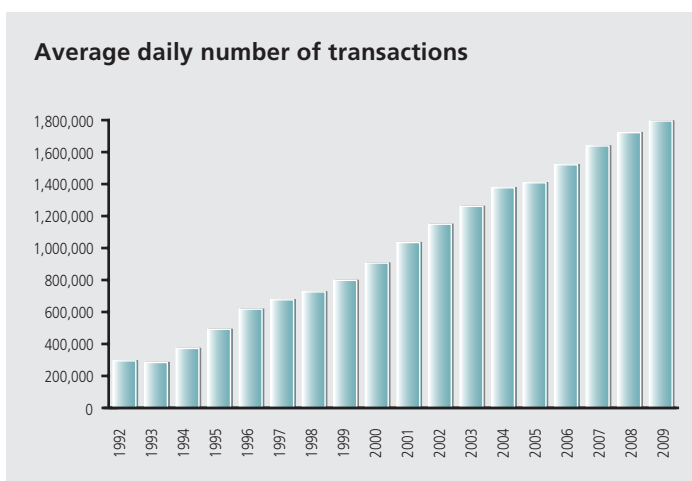
The CNB works together with the Ministry of Finance in preparing laws in the payment system area, prepares implementing legal regulations and is also involved in the preparation of European legislation.

CERTIS – interbank payment system

The CERTIS system processes interbank payments in the Czech Republic. Banks, credit unions and foreign bank branches are participants in this system. As of 31 December 2009, CERTIS comprised 44 direct participants and 7 third parties, for example, card payment clearing houses and securities clearing and settlement institutions.

CERTIS processed 450 million transactions in 2009 (up by 3.2% year on year) with a total value of CZK 131,679 billion (down by 19.2%). The system processed a daily average of 1.79 million transactions. The average daily value of the transactions was CZK 525 billion.

The following charts show the number of transactions processed and the volume of funds transferred in CERTIS since 1992.



SKD – short-term securities settlement system

The short-term securities settlement system (SKD) operated by the CNB is a separate register of securities and a settlement system for the securities recorded therein. In SKD, records are kept of the securities issued by the Czech Republic (the Czech Ministry of Finance) with maturities of up to one year, the short-term securities issued by the CNB with maturities of up to six months, and other bonds with maturities of up to one year.

SKD is being modified to reflect legal and tax changes. The CNB also monitors developments in EU settlement systems, particularly the connection of such systems to TARGET2, the proposed Target2-Securities single settlement system and the CCBM2 collateral management system, which will be relevant to the Czech Republic as it prepares to adopt the euro.

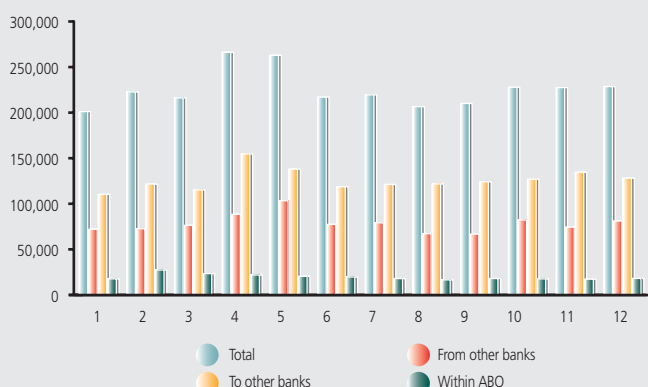
As of 31 December 2009, a total of 155 owner accounts – belonging to 109 clients (securities owners) – were registered in SKD. In all, 18 agents and 5 custodians use the system. Agents are banks that provide securities settlement services to their securities owning clients. They have direct interactive access to the SKD system. Custodians administer securities accounts owned by persons other than custodians, i.e. customers of custodians.

The securities recorded in SKD are used mainly as collateral for intraday credit, which the CNB extends to banks for accounting purposes within CERTIS, for the needs of the CNB's repo operations and for the needs of the Ministry of Finance for daily management of Treasury liquidity during the year.

ABO – accounting and payment system

As of 31 December 2009, the ABO system maintained 42,065 live accounts, 10,003 of which were internal accounts, 4,111 employees' accounts and 27,951 accounts of legal entities. As regards the accounts of legal entities, 24,251 fall into the regulated Treasury accounts category. The other accounts are mostly owned by state institutions, as well as banks, foreign financial institutions, etc.

ABO – Daily average number of transactions



Development of the ABO system continued in 2009 within the ABO6 project. New functions in the ABO-K internet banking application were put into operation. In 2009, the migration of clients to ABO-K was completed. This further reduced written payment orders and terminated the older methods of electronic communication of clients with the CNB (transmission of payment orders by e-mail and via the Smooth Bulk Payments application).

The ABO system processes about 200,000 accounting transactions daily, most of them payments constituting state budget revenues and expenditure. There is minimal year-on-year growth in payments.

Legislation

Act No. 284/2009 Coll., the Payment System Act, and Act No. 285/2009 Coll., amending some laws in connection with the adoption of the Payment System Act, took effect on 1 November 2009. The Payment System Act replaces Act No. 124/2002 Coll., on Transfers of Funds, Electronic Payment Instruments and Payment Systems (the Payment System Act). The CNB was actively involved in the preparation of the new law. The Act implements the following European directives into the Czech legislation:

- Directive 2007/64/EC on payment services,
- Directive 2000/46/EC relating to the taking up, pursuit of and prudential supervision of the business of electronic money institutions,
- Directive 1998/26/EC on settlement finality in payment and securities settlement systems.

The Act introduces regulation of non-bank payment services providers, payment institutions and small-scale payment services providers. It is linked to the current regulation of electronic money issuers and payment systems with settlement finality and stipulates rules for the payment system; above all it newly regulates and specifies the obligations of payment services providers towards their clients.

The following decrees were issued in connection with the adoption of the new Payment System Act:

- Decree No. 374/2009 Coll., on the pursuit of business of payment institutions, electronic money institutions, small-scale payment services providers and small-scale electronic money issuers,
- Decree No. 375/2009 Coll., on reporting by payment institutions, small-scale payment services providers and electronic money institutions to the Czech National Bank,
- Decree No. 376/2009 Coll., on bureau-de-change activity, replacing the previous decree relating to the Foreign Exchange Act in connection with an amendment to the Foreign Exchange Act,
- Decree No. 32/2010 Coll., on payment systems with settlement finality, which replaced the repealed Decree No. 548/2002 Coll.

PREPARATIONS FOR INTRODUCING THE EURO IN THE CZECH REPUBLIC

The adverse economic situation and the deterioration of the Czech Republic's public finances are currently hampering fulfilment of the economic (Maastricht) criteria that are a precondition for euro area entry.

However, the Czech Republic has been making technical, legislative and institutional preparations for adoption of the single currency for several years now. The preparations are being organised by the National Coordination Group for the Introduction of the Euro (NCG) through six working groups. The CNB is represented in the NCG's leadership. It is directly responsible for the activities of the Financial Sector Working Group and participates in the management of the Communication Working Group. CNB representatives take part in all the other working groups (e.g. the Legislation Working Group and the Information Technology and Statistics Working Group).

As no target date has yet been set for euro adoption in the Czech Republic, only methodological work can be performed at the moment. In 2009, important events from the CNB's point of view included the preparation of the first version of the communication strategy for the changeover and an update of the methodology for preparing the financial sector for conversion of capital market products, interest rates and account balances (for details, see the *International relations, technical assistance – The euro* section of the CNB website). A decision was also taken on the future adaptation of the legal environment to the introduction of the euro. The Czech Government approved a "gradual adaptation" method in March 2009. Only key legal regulations will be amended with effect from the Czech Republic's entry into the euro area. Other legislation will be adjusted gradually. This approach is in line with the view long preferred by the CNB.

The NCG's activities and agenda for the period ahead are evaluated once a year in the *Report on the Fulfilment of the National Changeover Plan* submitted to the Czech Government. In 2010 the NCG is focusing on preparing the methodology for the adaptation of the state administration to euro adoption and the methodology for conversion of information systems, as well as continuing work related to the preparation of euro communication activities.

FINANCIAL MARKET OPERATIONS

The CNB implements monetary policy by means of a system of monetary policy instruments. The main instruments used are financial market operations, automatic facilities and reserve requirements. Financial market operations play a pivotal role in steering short-term interest rates on the interbank market. The CNB Bank Board sets three interest rates: the two-week repo rate, the discount rate and the Lombard rate. The main monetary policy rate is the two-week repo rate. A change in these interest rates produces a monetary policy impulse that transmits through financial market operations to short-term interest rates on the interbank market. The discount and Lombard rates provide the floor and ceiling respectively for short-term interest rates on the money market. Changes in the repo rate (set half-way between the above two rates) are usually accompanied by symmetrical changes in the discount and Lombard rates.

The repo rate was lowered from 2.25% to 1.00% in four steps during 2009: by 0.5 percentage point to 1.75% with effect from 6 February, by 0.25 percentage point to 1.50% with effect from 11 May, by 0.25 percentage point to 1.25% with effect from 7 August and by 0.25 percentage point to 1.00% with effect from 17 December. The discount and Lombard rates were adjusted so that the spread vis-à-vis the repo rate was always ± 1 percentage point. The December rate cut was the exception to this rule, as the discount rate was left unchanged at 0.25% and its spread vis-à-vis the repo rate decreased to 0.75 percentage point. The reason for this change was that the discount rate is often used in the legislation as a reference rate for the calculation of interest.

The CNB manages the liquidity of the banking sector through money market operations so as to maintain an optimum liquidity level for compliance with the reserve requirement. This ensures that short-term interest rates are stable at the desired level. The decision-making on the central bank's money market operations is based on a daily analysis and forecast of banking sector liquidity and on the money market situation.

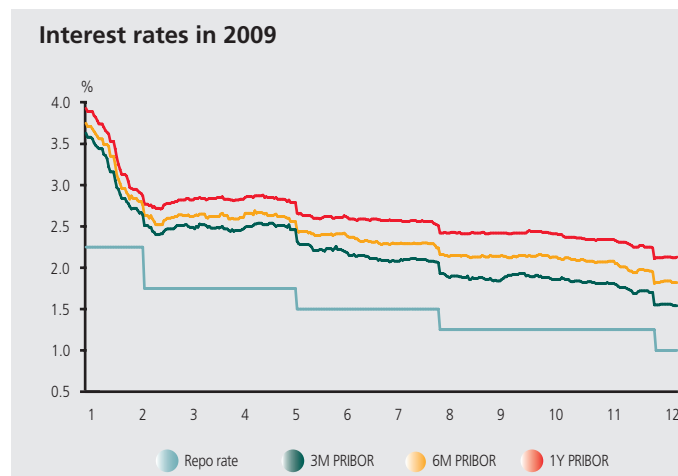
In 2009, the main instrument for managing short-term interest rates was the repo, announced three times a week with a maturity of 14 days. Given the persistent excess liquidity in the Czech banking system, the CNB used these operations to absorb excess reserves (unlike for example the ECB, which provides liquidity). The liquidity absorbed is remunerated at the repo rate at most. The excess liquidity absorbed in monetary operations in 2009 varied between CZK 230 billion and CZK 378 billion, the average being CZK 348 billion. The average amount of liquidity absorbed fell by approximately CZK 28 billion relative to the 2008 average. This was due mainly to a rise in the average volume of currency in circulation compared to the previous year and the continuing sell-off of returns on international reserves.

The CNB's instruments also included two "automatic" facilities – the marginal lending facility and the deposit facility. Under the lending facility, the CNB lends overnight funds to banks against eligible collateral in the form of securities. Such loans are charged interest at the Lombard rate. The Lombard rate thus provides a ceiling for short-term interest rates. The CNB accepts CNB-issued bills, bonds issued and unconditionally guaranteed by the Czech Republic and koruna securities issued or unconditionally guaranteed by EU governments and selected multilateral issuers as

Excess liquidity in 2009



Interest rates in 2009

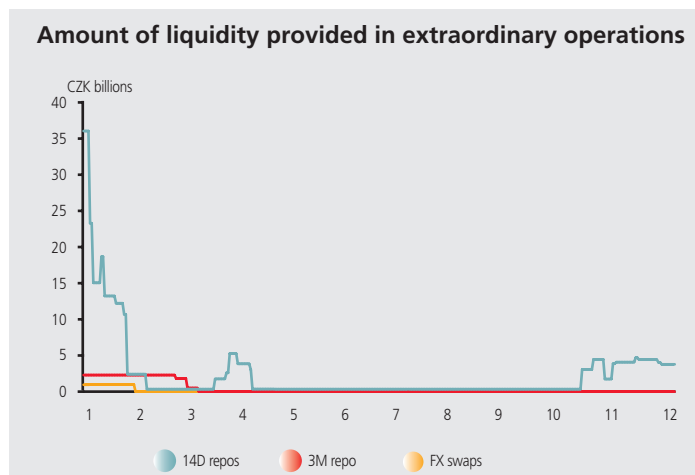


collateral. The deposit facility gives banks the option of making overnight deposits with the CNB at the discount rate. The discount rate provides a floor for short-term interest rates. The minimum volume for these operations is CZK 10 million. Fine-tuning operations (ad hoc repos and reverse repos under market conditions) are used only rarely. In 2009, the CNB continued issuing its own bills, which it used as collateral for open market operations. In addition, CNB bills are used by banks as collateral against intraday credit from the CNB. Such credit is provided to ensure the smooth running of the payment system at CNB Clearing. The CNB charges no interest on such credit. There is automatic spillover into the marginal lending facility in the event of non-repayment of intra-day credit at the end of the day.

Extraordinary operations

These operations are not standard instruments. The CNB executed them in October 2008 in response to the financial crisis. Extraordinary operations continued to be available to banks in 2009 and their discontinuation was postponed to the end of 2010. These operations are aimed at increasing liquidity on the secondary government bond market and opening other channels for providing funds to banks that may be facing restricted access to loans on the interbank market. They took the form of reverse repos and foreign exchange swaps. In the reverse repos, the CNB supplied liquidity to banks against pledged securities with maturities of 14 days or three months. The interest rate on the 14-day operations was set 10 basis points above the CNB's repo rate and the rate on the three-month operations equalled the CNB's

Amount of liquidity provided in extraordinary operations



repo rate plus 30 basis points. Foreign exchange swaps to provide koruna liquidity against the euro were offered to banks with maturities of up to three months. Of these operations, the 14-day liquidity-supplying repos were used the most often, although there was minimal interest in terms of the number of counterparties and so the liquidity-providing operations were generally supplementary. These measures were welcomed even by banks that did not use the facilities, as they provided a channel for obtaining liquidity if the need arose.

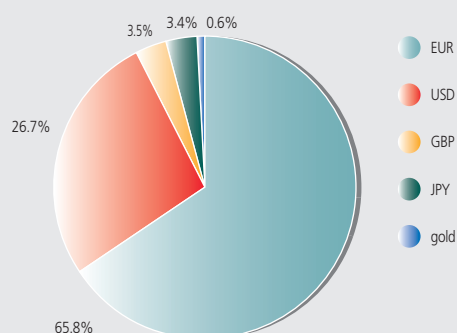
The CNB also executed collateral exchanges. These were operations in which a bank temporarily received a more liquid security in exchange for a less liquid one. The aim of these operations was not to provide additional liquidity to banks, but to provide securities to banks for secondary market operations and for obtaining intraday credit.

Management of the CNB's international reserves in 2009

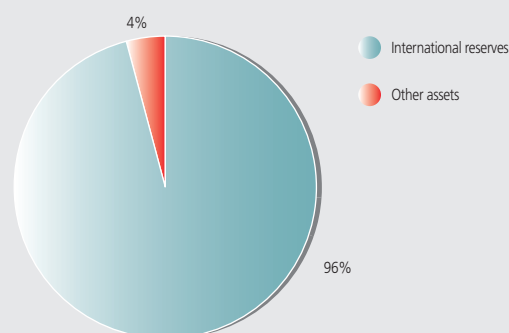
International reserves are the CNB's foreign assets in convertible currencies. The volume of the reserves is published regularly in the *Financial Markets* section of the CNB website. The actively managed portfolio (mostly securities) accounts for around 95% of the international reserves. The remainder consists of passively held assets – SDR (3%), monetary gold (0.6%) and reserve positions with the IMF (0.6%). At the end of 2009, the international reserves represented approximately 96% of the CNB's assets, and the return on these reserves was the CNB's most significant revenue item.

The CNB holds international reserves to support its independent monetary and exchange rate policy-making and as a source of foreign exchange liquidity for CNB clients, to whom the CNB sells foreign currency in exchange for koruna. In managing the international reserves, the CNB aims to attain maximum and stable returns subject to compliance with the stipulated liquidity restrictions and market and credit risk limits. The actively managed international reserves portfolio can be roughly divided into a EUR portfolio and a USD portfolio, which is partly diversified into JPY and GBP using currency forwards. The return on the JPY and GBP positions forms part of the return on the USD portfolio. As regards the currency structure, the actively managed international reserves portfolio was allocated as follows at the end of 2009: 65.8% EUR, 26.7% USD, 3.5% GBP, 3.4% JPY and 0.6% gold. This represents a slight change from the previous year, mainly due to the gradual transfer of a portion of the dollar portfolio into the euro portfolio.

Currency allocation as of 31 Dec. 2009



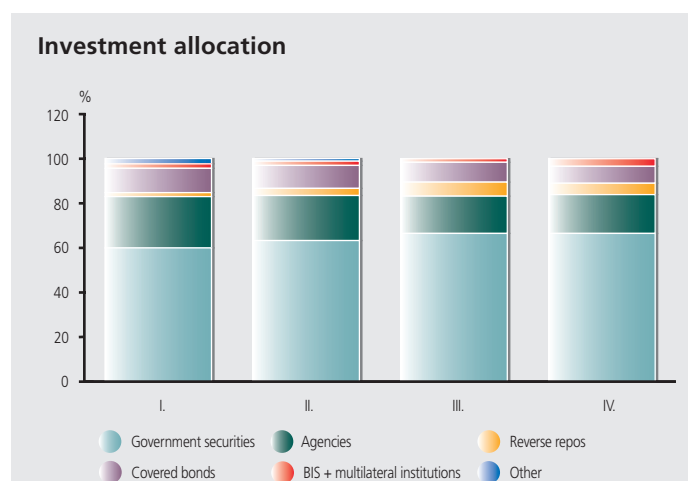
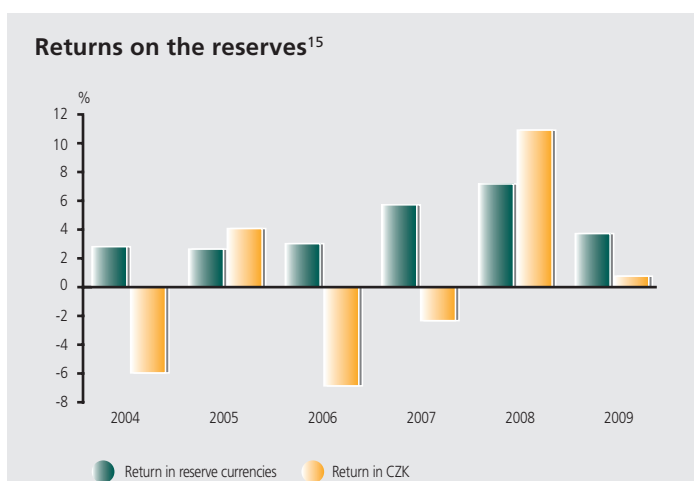
Share of international reserves in CNB balance-sheet assets



Portfolio managers invest the international reserves in particular instruments in compliance with the principles of the CNB's reserve management policy and subject to investment opportunities and the situation on the financial markets. The largest part of both portfolios is invested in securities issued by the governments of OECD countries, government-guaranteed securities, or securities issued by eligible agencies and multilateral institutions with maturities of more than one year. At the same time, both portfolios are invested mainly in credit instruments with the highest available rating. After the minimisation of credit exposure to banks in 2008, trading was restricted to investments in government securities of selected governments and selected securities guaranteed by such governments.

The market value of the CNB's actively managed international reserves portfolio was CZK 730 billion at the end of 2009, up by CZK 24 billion on a year earlier. The rise in the reserves in koruna terms was due to external flows¹³ into the reserves (CZK 45 billion) and portfolio returns (CZK 24 billion). By contrast, the sell-off of previous returns in exchange for koruna (CZK 25 billion) and appreciation of the koruna against the dollar (CZK 11 billion) and the euro (CZK 9 billion) acted towards a decrease in the reserves. No foreign exchange interventions were made in 2009. In euro terms, the market value of the international reserves was EUR 27.6 billion (an annual increase of EUR 1.4 billion) and in dollar terms it rose by USD 3.3 billion to USD 39.7 billion. Besides the aforementioned factors, the market value of the international reserves (expressed in these terms) was affected by the euro-dollar exchange rate.

The parameters defining the interest rate risk assumed are also set separately for each portfolio. The parameters set in 2009 continued to be based on the requirement that the portfolios should not record a loss over the investment horizon, which is one year for the euro portfolio and three years for the dollar portfolio. The modified duration¹⁴ of the euro portfolio decreased gradually during 2009 from two and a half years to one year and that of the dollar portfolio was deliberately shortened in January 2009 from four years to around two years.



¹³ External flows originate from purchases/sales of foreign currency from/to CNB clients and client deposits in foreign currency. Foreign exchange transactions with CNB clients were the biggest contributor, increasing the reserves by a total of EUR 1,020 million. Foreign exchange deposits of clients rose by EUR 738 million in 2009.

¹⁴ A variable expressing the sensitivity of the price of an interest-bearing instrument to interest rate movements. The same decrease in interest rates means a larger increase in the price of an instrument with a longer duration and a smaller increase in the price of an instrument with a shorter duration.

¹⁵ Returns measured by market valuation do not always have to equal revenues in accounting.

The rate of return on the reserve portfolios is measured both in absolute terms and relative to benchmark portfolios. Measuring the relative rate of return indicates how successful the strategies implemented by the portfolio managers were relative to the benchmark portfolios. The rate of return on the euro portfolio was 4.42% p.a. and that on the dollar portfolio 2.03% p.a. in 2009. The relative rate of return (i.e. the difference between the rate of return on the actual portfolio and that on the benchmark) was 106.1 basis points for the euro portfolio and 211.2 basis points for the dollar portfolio. Both relative rates of return were the highest in the CNB's history. These extraordinary returns were due mainly to high credit spreads on government securities at the start of the year caused by the financial market crisis and to a subsequent significant narrowing of those spreads as a result of extremely strong demand for these bonds, in which more than one-half of the portfolios is invested. The rate of return on the gold portfolio in USD including exchange rate gains was 28.17%; in koruna terms the yield was 21.69%.

The equity portfolios are managed externally by BlackRock and State Street. A second step in investing in stock indices was taken in 2009. At the end of 2009, stocks represented 4.9% of the market value of the international reserves. According to the plan approved by the Bank Board, the equity exposure will increase steadily to 10% of the international reserves in 2011. The strategy of a gradual, and not sudden, increase in equity exposure proved to be wise and clearly more advantageous than investing in a single step. The rate of return on the euro portfolio with the MSCI Euro benchmark was 27.45%, the dollar stock portfolio with the S&P 500 benchmark returned 26.20%, the sterling portfolio with the FTSE 100 benchmark generated 26.82% and the return on the yen portfolio with the Nikkei 225 benchmark was 20.94%. In 2009, equities again fostered a decrease in the portfolios' overall market risk, i.e. the aggregate risk parameters for fixed-income instruments and the equity component. This provides confirmation that the right strategy was chosen. The negative correlation with the yield on fixed-income instruments and the volume share set in the international reserves were the main starting points for the inclusion of stock index investments.

The overall rate of return on the international reserves, measured as a weighted average of all portfolios in the corresponding currency, was 3.72% (down by 3.45 percentage points from 2008). The weighted average of the return on the portfolios in koruna terms, i.e. including exchange rate gains and losses, was 0.76%, down by 10.15 percentage points from a year earlier.

In 2009 the International Monetary Fund increased the allocation of SDR on the CNB's balance sheet. This took place in two steps: the first, taken on 28 August 2009, involved an increase of SDR 607 million (general allocation) and the second, taken on 9 September 2009, involved a rise of SDR 173 million (special allocation). The conversion stemming from the designation mechanism did not take place in 2009, so the impact on the international reserves management results was zero.

ECONOMIC RESEARCH

Economic research at the CNB creates an analytical and knowledge base for monetary policy-making, financial market supervision and maintaining financial stability, and furthers the development of the central bank's human capital. Economic research also helps to develop the CNB's position within the ESCB and vis-à-vis the domestic and international academic community. Details on research activities can be found in the *Economic research* section of the CNB website.

In 2009, a total of 15 internationally reviewed articles were published in the CNB Working Paper Series and the CNB Research and Policy Notes. Two review issues of the Economic Research Bulletin also came out, the first focusing on evaluating the Czech Republic's experience with inflation targeting over the last ten years and

the second dealing with financial and global stability issues. Many CNB research papers were also published in prestigious international and regional economic journals. Experts from foreign central banks, multilateral organisations and major universities collaborate with CNB economists on research projects. In 2009, CNB economists won the Austrian central bank's Olga Radzyner Award, the Financial Risk Management Award of the French Centre des Professions Financières and the Czech Economic Society's prize for their research publications. According to RePEc, the largest bibliographical database of economic research papers, CNB economic research ranked among the best 10% of economic research institutions in Europe. The relevance and quality of research outputs were assessed in a new review report called *CNB Economic Research in 2009*.

The research project coordinators are involved in the monetary policy-making process through the preparation of opinions on the situation reports on economic developments and the minutes and transcripts of monetary policy meetings. These opinions ensure that the usual analytical activities are subject to internal review, thereby fostering better decision-making. The topics raised during monetary policy discussions are taken into account when setting research priorities so that the CNB's research projects focus on topics relevant to the central bank. Research project results are also regularly used in the annual Financial Stability Report and the Analyses of the Czech Republic's Current Economic Alignment with the Euro Area.



In 2009 the CNB held its fifth Research Open Day, which presents the results of CNB economic research to a broader professional audience. The ERD Award for the best research paper is regularly presented at this event. As in previous years, the CNB organised three seminars of leading world economists jointly with the Czech Economic Society and the Centre for Economic Research and Graduate Education (CERGE-EI). The speakers were David De Jong (University of Pittsburgh), Lucrezia Reichlin (London Business School) and Charles Calomiris (Columbia University).

CNB economists are actively involved in the international Wage Dynamics Network (WDN), which studies the dynamics of wages and labour costs and their implications for monetary policy throughout Europe. This network is coordinated by the ECB and involves economists from national central banks and the ECB as well as leading external experts.

The CNB Bank Board's advisory body for economic research is the Research Advisory Committee, whose members include leading foreign experts. The Committee's main role is to provide a foundation for the Bank Board's decisions on research projects. In 2009, the members of the Committee were: Iain Begg (European Institute at

the London School of Economics), Nicoletta Batini (International Monetary Fund), Andrew Blake (Bank of England), Martin Čihák (International Monetary Fund), Carsten Detken (European Central Bank) and László Halpern (Hungarian Academy of Sciences). The President of the Committee is CNB Governor Zdeněk Tůma and its Chairman is Chief Executive Director Robert Holman. The internal members of the Committee are the Executive Directors of the CNB's Economic Research Department, Monetary and Statistics Department, Financial Market Supervision Department, Financial Market Regulation and Analyses Department and Risk Management and Transactions Support Department, together with the four research project coordinators.

FINANCIAL STABILITY

Maintaining financial stability is one of the CNB's main objectives under the Act on the Czech National Bank. The CNB defines financial stability as a situation where the financial system operates with no serious failures or undesirable impacts on the present and future development of the economy as a whole, while showing a high degree of resilience to shocks.

Financial stability analysis in some respects differs significantly from other analytical activities at the CNB. Unlike banking supervision analysis, it covers not only banks, but also non-bank financial institutions (investment companies and funds, pension funds, insurance companies, capital market undertakings, etc.). The target of interest is not the stability of individual financial institutions, but the stability of the financial sector as a whole. The main difference compared to the CNB's macroeconomic analysis and forecasting is that financial stability analysis is not aimed at modelling the most probable development of the economy. Instead, it involves testing the impact of improbable, but plausible, adverse scenarios which could threaten the stability of the entire financial system. Considerable progress was achieved in the stress testing area in 2009. The analytical system was refined and stress test results were communicated more intensively with the finance profession and the public. It was decided that the banking sector stress test results would be disclosed regularly in press releases from February 2010. Stress tests for the entire financial sector are published in the annual Financial Stability Report.

The Financial Stability Report is the most important communication tool in the area of financial stability. This report, published annually since 2004, aims to assess developments in the past year and to identify potential risks to the stability of the Czech financial system in the period ahead. The CNB has a legal obligation to submit this report to the Chamber of Deputies (the lower house of the Czech Parliament). The 2009/2010 Financial Stability Report will be published in June 2010. It will be made available in electronic form in both Czech and English in the *Financial Stability* section of the CNB website.

Increased pressures on financial stability stemming from the global financial crisis were recorded in 2009. Owing to a fall in external demand and a worldwide tightening of the financial conditions, Czech economic growth started to slow sharply in the second half of 2008. So far during the crisis, however, the Czech financial system has been among the most stable in the EU. A further deepening of the recession in Europe and a high degree of uncertainty are the main risks identified in the latest Financial Stability Report.

Financial stability is also gradually gaining significance at the level of international cooperation. Financial stability experts represent the CNB in the official committees and working groups of the European System of Central Banks (Banking Supervision Committee, Working Group on Macro-Prudential Analysis, Working Group on Banking Developments). Regular cooperation has also been established on



a regional basis, especially in the area of stress testing. CNB experts also participate in other international projects (e.g. projects within the European System of Central Banks) and are involved in providing foreign technical assistance in the financial stability area.

Research publications in the field of financial stability also serve as a channel of communication with professional economists. The results can be found in research publications (for details, see the CNB website and the *Economic research* section of this report), in articles and papers published in professional journals and in the thematic articles of the Financial Stability Report.

STATISTICS

The CNB's statistics expanded the traditional information resources in the fields of monetary policy and financial stability for internal analyses and professional economists. The content and structure of the statistics were further adjusted to European and international standards and the requirements of domestic analysts. The statistics compiled by the CNB are fully comparable with those of other EU Member States, even though most European standards become formally binding only upon euro adoption. International comparability is an undeniable advantage of harmonised statistics. Representatives of the CNB's statistical divisions take part in preparing the methodology and structure of EU statistical products. They are heavily involved, being members of three ESCB and Eurostat statistical committees and more than ten standing working groups. In 2009, they also became more involved in work teams created to deal with special tasks, especially the introduction of new statistics.

In addition to methodological activities and compilation of statistics, the CNB is paying significant attention to optimising the collection of underlying data from reporting agents and thereby minimising the reporting burden. The main method used at the CNB is coordination of reporting with supervisory departments so that each piece of data is collected only once. The single data collection principle is also applied when working in cooperation with the CZSO, as the two institutions share information in accordance with the legislation and under a mutual written agreement. The extent of the data shared in this way was broadened further in 2009. The burden on reporting agents is also being reduced through the use of efficient methods that focus on collecting primary data without creating respondent-level aggregates.

In 2009, the statistics on monetary financial institutions and collective investment funds started to use a new statement that monitors holdings of individual securities. This progressive method of collecting underlying data is considered more precise and has enhanced these statistics. New requirements stemming from the relevant ECB regulations were also incorporated into bank reporting. The CNB's representatives were actively involved in a specialised working group tasked with proposing the harmonisation of statistical and regulatory reporting for banks. In doing so they drew on four years of experience with harmonised collection of banking data at the CNB.

Statements on individual securities holdings started to be used for compilation of the balance of payments. These data are integrated with information from the centralised securities database operated by the ECB. Besides raising the quality of inputs for the compilation of the balance of payments, this minimises the burden on respondents. As regards harmonisation with EU standards, the CNB started sending more detailed breakdowns of balance of payments flows to the ECB and harmonising them with the information provided to Eurostat.

As a relatively new and complex area of statistics, the financial accounts statistics are still in their development phase. In 2009 the time series for stock data were reconstructed on the basis of higher-quality data sources. Cooperation on harmonising financial accounts output with the national accounts compiled by the CZSO continued. The main methods included sharing underlying information from respondents and harmonising compilation methods.

In the context of the financial crisis, the CNB needed information more frequently than usual in order to assess the latest developments. Some of this information was used for regulatory purposes and some for monetary analyses. The sending of high-frequency data was arranged with banks in advance and this cooperative approach was beneficial to both sides. The CNB's statistical units also helped to prepare the second "Statistics – Investment in the Future" conference, organised jointly with the CZSO and the Prague University of Economics in September 2009. More than 100 statisticians and economists from around the world attended this conference and many excellent presentations were given. In March 2009 the CNB organised its first foreign technical assistance statistical seminar.

THE CNB AS THE BANK OF THE STATE

The CNB maintains accounts and provides payment and other banking services for the state and the public sector under Act No. 6/1993 Coll., on the Czech National Bank, as amended, and Act No. 218/2000 Coll., on Budgetary Rules and on the Amendment of Some Related Acts (Budgetary Rules), as amended. Its clients are state organisational units, revenue and customs offices, labour offices, the Czech Social Security Administration, subsidised organisations and business entities that receive subsidies from the state budget, and some state funds. The CNB also maintains accounts connected to the budget of the European Communities. At the end of 2009, the CNB maintained 27,000 accounts for these clients. The accounts were used for tens of thousands transactions. For example, 6.2 million transactions relating to state social benefits and 8.0 million health insurance and employment policy contributions were recorded on these accounts in 2009 as a whole.

Support for Treasury liquidity management

The CNB is working in close partnership with the Ministry of Finance on a Treasury development project. Since approximately 2000, the CNB has been providing and gradually refining a whole range of services, in particular payment services and related daily liquidity management. Budget chapter administrators have access to an interactive internet application that enables them to actively manage budget limits

for individual Treasury expenditure accounts, i.e. to set limits, to check account settings and to check drawings on accounts.

As part of its Treasury liquidity management support function, the CNB is responsible for consolidation of state funds on the Single Treasury Account¹⁶ with the aim of maximising their efficient use and minimising debt service costs. The daily process is based on intensive communication with the responsible employees of the Ministry of Finance throughout the working day. In the morning of every working day the flows of funds from and to the Treasury are jointly estimated. At the start of the day, and then several times during the day, current-day expenditures are compared with their coverage on the state accounts in the CNB's settlement and payment system (ABO). For this activity, the CNB created and is constantly improving a system of automated transmission of information on the Treasury balance. This system transmits information several times an hour to the relevant CNB units and the Ministry of Finance. The monitoring of current financial flows allows the volume and direction of the (investment or borrowing) daily money market operations vis-à-vis the Treasury to be set. In other words, surplus Treasury funds are invested in the financial market in the form of repos or saved as deposits. Conversely, if there is a temporary lack of coverage of Treasury expenditures, additional funds are obtained by selling T-bills in the financial market.

Thanks to improvements in liquidity management, the single account balance fell slightly further to around CZK 7 million in 2009. Transactions in the billions of korunas are meanwhile recorded on the state budget accounts every day. In other words, the daily average of unused Treasury funds was very low relative to the volume and frequency of the financial flows in both directions.

Support for state debt financing

The CNB also assists the Ministry of Finance in the area of state debt management, where it acts as a fiscal agent. This chiefly involves organising and carrying out primary sales of government bonds at both short and long maturities.

In 2009, the CNB organised 23 primary sales of T-bills in the form of Dutch auctions on behalf of the Ministry of Finance. In these auctions, the Ministry issued T-bills totalling CZK 169.6 billion with maturities of 3, 6, 9 and 12 months. The CNB also executed 22 auctions of medium-term and long-term bonds for the Ministry of Finance, at which bonds totalling CZK 203.3 billion were sold. These involved both the re-opening of existing issues and new issues (with maturities of 3, 10 and 15 years).

The CNB also acts as administrator of government bond issues. This mainly involves making coupon payments to government bond holders (coupon payments for 14 issues were made last year) and redeeming the principal on maturing issues. Two issues, totalling CZK 98 billion, were redeemed in 2009. Together with other secondary market activities, the long-term debt outstanding rose from CZK 873.4 billion in 2008 to CZK 1,031.6 billion at the end of 2009. As regards foreign currency bonds, the CNB executed an auction of eurobonds with a variable coupon linked to the 6M EURIBOR on behalf of the Ministry of Finance. This totalled EUR 262.5 million.

¹⁶ The Single Treasury Account is defined in Act No. 218/2000 Coll., on Budgetary Rules and on the Amendment of Some Related Acts (Budgetary Rules), as amended, which specifies the accounts subject to consolidation. Above all, they include revenue and expenditure accounts of the state budget, revenue offices' accounts, state financial assets accounts, accounts of funds of state organisational units and Treasury liquidity management accounts. Work is now under way on including National Fund accounts.

EUROPEAN AND INTERNATIONAL COOPERATION, FOREIGN TECHNICAL ASSISTANCE

European Central Bank, European System of Central Banks

Since 1 May 2004, the CNB has been a member of the European System of Central Banks (ESCB), which comprises the European Central Bank (ECB) and the 27 national central banks (NCBs) of the EU. The CNB Governor regularly attends meetings of the ECB General Council – one of the ECB's three decision-making bodies, along with the Governing Council and the Executive Board. The General Council meets four times a year. The governors of all the NCBs of the EU countries and the ECB are represented in it.

In 2009 the General Council meetings were again dominated by macroeconomic, monetary and financial developments around the world and in the EU (broken down into euro area and non-euro area countries). All the discussions reflected the global financial and economic crisis. The General Council also discussed the planned change to the European supervisory system, which envisages the creation of new pan-European financial supervisory authorities: the European Systemic Risk Board (ESRB) and the European System of Financial Supervisors (ESFS). The Council also discussed a document summarising the legislative process for the adoption of legal acts on the establishment and operations of the ESRB and a document concerning support for the ESRB's activities by the ECB and NCBs. Furthermore, the General Council discussed regular reports on public finance, the prohibition of monetary financing and the functioning of ERM II, issues to be discussed at the IMF Annual Meeting, a report on developments in the banking sector, the timing of exit strategies for countries hit hardest by the financial crisis, public finance issues in individual countries, etc.

As in previous years, CNB representatives were actively involved in the work of the ESCB's 13 committees and 38 working and expert groups. The main items on the agenda were issues relating to the economic and financial crisis, the new regulatory and supervisory framework for the financial sector and information on the current situation in the banking sectors of various countries. More than 150 documents were prepared in written consultations and written procedures at the CNB in 2009. In 25 cases the CNB made comments in the form of a Governor's letter to the President of the ECB. Written consultations arise from the Member States' duty to consult the ECB on any draft legislation falling within its fields of competence. This duty applies to the CNB as well as to other state authorities in the Czech Republic. At the same time, they provide an opportunity to comment on the opinions issued by the ECB on new European and national legal regulations concerning the fields of competence of the ESCB/ECB. Three consultations took place on the Czech side. The CNB consulted the ECB on changes to the Act on Banks connected with the financial crisis and on the Act on the Circulation of Banknotes and Coins. The Ministry of Industry and Trade consulted the ECB on the draft Consumer Credit Act.

Relations with EU Council bodies

The CNB's representation in bodies linked to the Council of the European Union also plays an important role. In the first half of 2009 the Czech Republic held the Presidency of the Council of the European Union. The CNB was therefore involved in preparing and organising related events – the conference "Five Years After" (held in Prague on 2 March 2009) and above all the informal ECOFIN meeting held in Prague on 3–4 April 2009, attended by the finance ministers and central bank governors of EU countries.

The CNB Governor regularly attends the informal meetings of ECOFIN held twice a year in the country that holds the Presidency of the Council of the European Union. Following the Prague meeting, the second meeting of 2009 took place in September in Gothenburg, Sweden. A CNB vice-governor also regularly attends

the meetings of the Economic and Financial Committee (EFC), which acts in an advisory capacity to the Council of the European Union. This committee usually meets in Brussels. The CNB is also actively involved in the work of the EFC Sub-Committee on International Monetary Fund Matters (SCIMF).

The main topics at ECOFIN and numerous EFC meetings in 2009 were the current economic situation in the wake of the financial crisis, the coordination and alignment of anti-crisis measures, stress tests in the banking and insurance sectors, the Stability and Growth Pact and IMF-related issues. The new supervisory structure in the EU was a hot topic in both these bodies. Both the CNB Governor at the ECOFIN Council and the CNB Vice-Governor at the EFC strongly promoted the CNB's position on the key principles of the proposed measures.

During the Czech Presidency the recast E-money Directive was successfully approved in a form significantly reducing the regulatory burden on electronic money issuers. The initiative proposing a European framework for integrated regulation and supervision of the financial market at the national level promoted by the CNB during the Czech Presidency was overshadowed by the opening of the debate on the de Larosière report and by the subsequent Commission communication on the new organisation of supervision and the submission of related legislative proposals. In relation to this topic, the CNB pointed out that transferring powers to European authorities was incompatible with maintaining full accountability, including for the fiscal impacts, at the national level. A fragile compromise on the legislative proposals was reached at the ECOFIN Council meeting of 2 December 2009. The proposals were then forwarded to the European Parliament for debate.

A new issue which the Czech Republic had to deal with at the level of the EU Council and subsequently the European Council was the meeting of the G-20 (newly transformed to a meeting of the heads of state of the member countries). As part of its Presidency, the Czech Republic represented the entire EU in the G-20 in the first half of 2009. This required a high degree of coordination with all European countries. Two top-level meetings took place within the G-20 – one on 2 April in London and the other on 24–25 September in Pittsburgh; CNB experts participated in working groups on the IMF and financial market issues. During the year, the G-20 responded to the ongoing financial and economic crisis and announced a number of joint initiatives relating to, *inter alia*, the financial market, macroeconomic policies and the reform of international financial institutions, including the IMF.

EU Committee

The CNB is an associate member of the main coordination body for the Czech Republic's relations with the European Union – the EU Committee. The Committee meets at two levels. At the government level, it consists of the highest state officials (the prime minister, ministers, the CNB governor and others) and discusses fundamental policy issues associated with the Czech Republic's membership of the EU. At working level (deputy ministers), the Committee prepares documents for the government-level Committee and approves broad positions, instructions and mandates for the activities of the Czech Republic's representatives in the EU Council and its working bodies. Twice a year the CNB submits a report on relations with the ESCB/ECB to the Committee at the working level.

In the first half of the year the work of the Committee was strongly influenced by the Czech Republic's Presidency of the Council of the European Union. New coordination procedures and processes were defined for this purpose. The main coordination role of the EU Committee was endorsed at both its levels. Weekly meetings were introduced at the government level. Outside the EU Committee meetings, a regular videoconference was introduced between the Office of the Government and the Permanent Representation in Brussels, in which EU Committee members could participate. The videoconference summarised

the topics discussed during the past week and the outlook for the coming week, including the adoption of the Coreper agenda. Important new elements included monitoring of "Presidency agendas", i.e. summaries of information on particular topics containing an overview of the issue and the objective to be achieved during the Czech Presidency.

International Monetary Fund

The global financial crisis triggered a need for reform of the international monetary and financial system. The IMF preserved its central role in preventing and resolving crises. On the basis of a G-20 agreement the IMF's disposable funds were increased from the pre-crisis level of USD 250 billion to around USD 770 billion, and a reform of its credit facilities was launched. General and special SDR allocations were made to enhance global liquidity. These increased the allocated SDRs to USD 317 billion. To protect low-income countries, the Fund supported a financial plan to mobilise additional funds for subsidising concessional financing. Attention was also focused on the supervision of member states. Its multilateral dimension will be strengthened, integration with the financial sector will be increased, and the Fund will draw up an analysis of the exit strategy from the measures adopted in connection with the financial crisis. Another important change is the establishment of a global early warning system in cooperation with the Financial Stability Board.

If it is to perform these new tasks successfully, the Fund's legitimacy will have to be bolstered. This will require fundamental reforms in the area of governance, where quotas play a key role. As most emerging and developing countries do not regard the 2008 quota reform as sufficient, the member countries have agreed to speed up the 14th general revision of quotas so that it is completed by January 2011. The aim will be to significantly increase the voting power of the aforementioned group of countries.

The Annual Meeting in Istanbul in October 2009 identified the most important areas for the IMF to focus on in the period ahead. These include a revision of the IMF's mandate, financial role and governance. The Czech Republic was actively involved in these reforms. Following the April 2008 quota reform and the May 2008 investment mandate reform, which require a change to the Articles of Agreement of the IMF, the government in Resolution No. 173 of 9 February 2009 recommended that the Czech President should ratify the amendments to the Articles of Agreement following approval by the Czech Parliament.

Under a European Council decision made during the Czech Presidency, the EU Member States decided to grant the IMF loans totalling EUR 75 billion. On 20 April 2009, the Czech Government approved the Czech Republic's participation in this initiative with a contribution of EUR 1.03 billion. On 27 July 2009, the government approved accession to the general allocation of SDRs, under which the Czech Republic subsequently received SDR 780 million.¹⁷

The CNB also communicated actively with the IMF last year, with the positive outcome that the Central and Eastern European region was viewed no longer as a homogeneous whole but as a group of countries with different economic trends and situations.

Bank for International Settlements

A delegation of CNB representatives headed by the Governor attended the Annual General Meeting of the Bank for International Settlements (BIS) in June 2009. The General Meeting decided to pay a dividend of SDR 265 per share for the financial

¹⁷ In 2009 it received SDR 173 million in connection with the one-off 1997 allocation and SDR 607 million under the 2009 general SDR allocation.

year 2008/2009. With its holding of 5,705 shares, the CNB thus received SDR 1,511,825. In addition, the CNB Governor attended the regular meetings of central bank governors of BIS countries held every two months. In 2009, these meetings focused on proposals for solving regulatory issues responding to the new challenges caused by the global financial crisis. The CNB, represented by a vice-governor, attended the autumn meeting of the new Basel Consultative Group (BCG), which is part of the Basel Committee on Banking Supervision.

Organisation for Economic Cooperation and Development

In 2009, the meetings of OECD committees and other working bodies focused on analysing the impacts of the economic and financial crisis on the world economy. The CNB was involved in this work mainly through its participation in meetings of the OECD's Economic Policy Committee and Committee on Financial Markets. Moreover, regular OECD publications, which are widely recognised for their quality and depth of analysis, continued to be drawn up. In particular, the CNB was heavily involved in the preparation and discussion of the OECD's economic review of the Czech Republic. The review was discussed at the OECD in January 2010 in the presence of a Bank Board member. The CNB's macroeconomic policy and financial market supervision performance during the crisis is assessed positively in the report.

CNB representatives also represented the bank in various international forums organised by the OECD and attended specialised seminars, for example in the area of financial education and economic research.

European Bank for Reconstruction and Development

Relations between the Czech Republic and the EBRD fall mainly within the competence of the Ministry of Finance. The Finance Minister is the Czech governor in this international financial institution, with the CNB Governor acting as his alternate.

The CNB Governor attended the EBRC annual meeting in London in May 2009, where he gave a speech as head of the Czech delegation. Numerous conferences and discussion panels were held during the meeting, attended by top banking and financial executives. With his active participation and presentations in these forums the CNB Governor helped explain the Czech Republic's macroeconomic situation and policy and thereby enhance its reputation and assessment. He also clarified the reasons for the Czech financial sector's relatively high resilience to the ongoing global financial crisis. In the preparations for the annual Transition Report, the CNB provided the EBRD with updated figures on the Czech banking sector.

Foreign technical assistance

Thanks to its experience of the process of economic transformation and integration into European and international structures, the CNB has been a sought-after provider of technical assistance for many years. Central banks in transforming economies seeking membership of the EU and central banks in the countries of the former Soviet Union and the Balkans are very interested in the events organised by the CNB under its technical assistance programme. On the other hand, the feedback from participants in seminars and consultations organised both in Prague and in target countries is beneficial for CNB experts, too.

A total of 31 foreign technical assistance events were held in 2009. Eight seminars took place, attended by 133 people from 28 central banks. There was also relatively strong interest in consultations at the CNB; 13 of these were held for 44 participants from the central banks of Albania, Armenia, Moldova, Serbia and Vietnam. CNB staff also provided expert assistance in the form of consultations at the recipient bank



and lectures at foreign technical assistance events organised by foreign partners. They also took part in IMF missions to third countries.

In 2009, the CNB was involved in joint EU-funded projects with other ESCB central banks. These included a banking supervision project for the central bank of Egypt and a project for the National Bank of Serbia relating to its preparations for future ESCB membership. Together with the Deutsche Bundesbank the CNB participated in a twinning-light project organised by the European Commission for the Central Bank of Bosnia and Herzegovina in the field of human resources management.

TECHNOLOGY AND SECURITY

Computing and communication systems

In the IS/IT area, the CNB continued to fulfil the strategic aims launched in previous years. It succeeded in further cutting investment and operating costs while extending and increasing the IS/IT technological level and providing an ever rising number of services.

A total of 23 projects were implemented at the CNB last year. The key projects supported activities mainly in the monetary and statistics area, financial market supervision, currency issuance and management, interbank payments and settlements, and the CNB's internal accounting and management processes. The other projects involved system environment upgrades, with an emphasis on higher computing power and accessibility to that power in business continuity planning, as well as rising IS/IT security requirements. The Information System Department also focused on improving external and internal electronic circulation of documents. Last year saw a turning point in the use of "business intelligence" tools, which are used to generate data and information outputs that can be used at various management levels. Virtualisation technology is an equally important element becoming prevalent in IS/IT. Each technology upgrade is focused primarily on reducing operating costs. One example of this was the replacement of the disk sub-system, which ensured sufficient capacity for the operation and development of the existing IS while cutting operating costs. As regards security, a unified system for managing users' electronic identities and IS access was completed and technology for safe access to classified documents was implemented.

The internal regulations for the IS/IT management system were simplified. This will facilitate more efficient project planning and management at the CNB. Commodity projects were introduced for the system environment (e.g. for purchase of servers,

client stations, etc.). These are aimed at making it easier to check whether the CNB's procedures are compliant with the Public Procurement Act.

Crisis management system

The CNB is a crisis management body under Act No. 240/2000 Coll., on Crisis Management. The position not only invests the bank with defined powers, but also makes it accountable for the area of activity delegated to it. The CNB demonstrates its preparedness for dealing with crisis situations in its key crisis management document, the CNB Crisis Plan.

As part of the testing of the implementing documentation of the Crisis Plan, the CNB continuously verified whether the operational plans of its organisational units were up to date. Selected units tested how the CNB's core functions are safeguarded in practice from the CNB's back-up centre. The CNB also conducted successful exercises in cooperation with the Czech Fire Rescue Service. The main purpose of these drills was to practice cooperation between specified CNB employees and fire-fighting units in the event of emergencies in CNB buildings (the Plzeň and Brno branches). All these exercises helped increase CNB employees' awareness of emergency procedures at the CNB and allowed them to practice evacuating buildings. They also meant that the CNB complied with the statutory duty to organise fire alarm training in its buildings. Members of the Fire Rescue Service became more familiar with specific features of the CNB's buildings and their environs. This, in turn, should make fire-fighting operations faster and more effective in the event of a real emergency.

Last year, the CNB also focused on updating the contingency plans for other critical financial market infrastructure entities. This infrastructure was created at the decision of the National Security Council and the Civil Emergency Planning Committee. The primary task of the CNB and other selected banks (critical financial market infrastructure entities) is to safeguard the provision of banking services, in particular currency circulation and payments, for individuals and legal entities in the event of an emergency, i.e. to safeguard the availability of banking services through their own branches and headquarters. Critical financial market infrastructure entities thus contribute to ensuring that the national economic and financial system is functional and that resources are available for dealing with emergencies and crises and for safeguarding the basic material needs of the people and the state at times of crisis.

THE CNB AND THE PUBLIC



EXTERNAL COMMUNICATIONS

The aim of our communication activities is to maintain and promote the CNB's reputation as a credible, open and generally respected institution both at home and abroad. The CNB has long been successful in maintaining good relations with the public and with specialists, represented in particular by specialised journalists and financial market analysts. Attention has also been focused on providing information about often highly specialised topics in a form that the general public can understand.

Last year, the CNB adopted the global standard in monetary policy communication and set a fixed time for announcing the Bank Board's interest rate decisions. Since the start of 2010, monetary policy decisions have been announced at 1 p.m. on the day of the Bank Board meeting. The press conference given by the CNB Governor, who explains the monetary policy decision, starts regularly at 2.30 p.m. The fixed publication time provides the public, and above all market participants and the media, with an anchor that eliminates the time uncertainty and potential speculation linked with the time of announcement of the Bank Board's decision on key interest rates.



The global financial and economic crisis has increased the need for communication by the main macroeconomic policy makers and financial market supervisors and regulators and the pressure to provide prompt responses to press agencies and other electronic and print media. The CNB repeatedly pointed out factual inaccuracies and misleading interpretations by foreign media and successfully influenced a change in the perception of the CEE region. These communication efforts were aimed at breaking the stereotypical view of the region as a homogeneous group and pointing out the often considerable differences in the economic condition and situation of financial sectors across the individual countries of the region.

The financial crisis was also reflected in issues relating to financial market regulation and supervision. The CNB was actively involved in the public debate about the European proposals for the establishment of new pan-European supervisory and regulatory agencies. Our communication relating to the publication of the Financial Stability Report 2008/2009 in mid-June 2009 met with a great response from specialists and the media. Close attention was paid to the banking sector stress test results which are an important part of the Financial Stability Report.

The CNB also accelerated the switch from communication through the traditional print and analogue media to the new, digital media. It decided to stop printing four of its regular publications (the Annual Report, the Inflation Report, the Financial

Stability Report and the Financial Market Supervision Report). This made the CNB the first EU central bank to publish its flagship publications primarily in electronic form and to use on-line channels for their distribution.

The extension of our web calendar to include regular updates of public appearances by CNB Bank Board members was welcome by journalists and others. The use of video on the CNB website was tested with success at the end of 2009. Video recordings of the press conferences following the Bank Board's monetary policy meetings, which are held eight times a year, now complement the traditionally released audio recordings, used mainly by analysts and journalists who are unable to attend the press conference.

The CNB website visit statistics, which record a daily average of 685,000 downloaded pages and 15,000 visits, reveal the growing importance of this on-line tool of central bank communication. In addition, following the examples of the Norwegian and U.S. central banks, the CNB opened a profile on the microblogging and social networking service Twitter, which provides the CNB with an alternative channel for contacting its foreign observers.

In its communication activity the central bank continued to deal with money topics, e.g. the issuance of new CZK 500 and 5,000 banknotes and the issuance of new commemorative coins, which started to meet with greater interest given the economic uncertainty during the crisis.

In 2009, preparations were launched for the CNB Open Day. This event will be held for the first time in four years on Saturday, 12 June 2010. Visitors will have a rare opportunity to talk directly with CNB Bank Board members and view otherwise inaccessible areas of the CNB.

Dealing with written, electronic and telephone enquiries and suggestions is regarded as a service for the public and emphasis is put on dealing with them quickly and on providing high-quality, accurate information. The public can contact the CNB by calling the Green Line on 800 160 170 or by e-mailing info@cnb.cz. The number of written submissions handled fell to 404 in 2009 (from 543 in 2008), while the number of e-mails dealt with rose to 3,303 (from 2,591 in 2008) and the number of Green Line calls answered increased to 3,222 (from 3,101 in 2008).

EXHIBITION

In 2009, the CNB Exhibition had a total of 14,678 visitors. More than 121,000 visitors passed through its doors between the date it first opened and the end of the above



calendar year. The largest number of visitors is recorded each year during term time. During the summer holidays, it depends mainly on special interest groups, tourists, families and individuals.

A visit to the exhibition has become part of the curriculum in schools specialising in economics and is being gradually integrated into the curricula of all schools in a new subject entitled "Financial literacy". Last year, the exhibition was visited by the first schools on the basis of a recommendation contained in the "Financial Literacy" textbook. Bookings of visits to the exhibition are thus very likely to increase. At present, visits are being taken a year and a half in advance.

The exhibition was not used only for visits to the permanent exhibition *People and Money*, but also as a venue for social events, official visits and press conferences (the issuance of the new CZK 500 and CZK 5,000 banknotes). It has also become popular with the media and was used as a location for TV shows such as *Víkend (Weekend)*, *Retro*, *Češi v krizi (Czechs in Crisis)* and *Paláce 1. republiky (Palaces of the 1st Republic)*.



The showcases in the part of the exhibition devoted to the present day are being updated; the last update was made in 2004. Naturally, the exhibits are being supplemented to include newly issued commemorative silver and gold coins and banknotes. The outdated and defective technology in the screening room was replaced in mid-2009. The *Golden Showcase*, in which visitors may weigh a real gold brick in their hands, has become a favourite place to end each visit. Further information is available in the *Exhibition* section of the CNB website.

SPECIAL LIBRARY

The primary mission of the CNB's special library is to provide both bank staff and outside specialists with information. To this end, the library offers lending, advisory, reference and bibliographic information and research services (searches for information from all available information sources). Its highly specialised collection and access to numerous electronic sources allow users to obtain information primarily in the fields of banking and economics in general, law and computer technology and to some extent in other areas as well.

The library maintains and provides access to more than 57,000 publications and 800 periodicals. In 2009, the library acquired 2,055 books, 1,688 study texts, research reports and annual reports and about 7,500 periodicals and other publications (bank

documents, brochures, etc.). The number of printed publications from central banks and important international institutions is decreasing every year as such documents become available in electronic form only. In 2009, the library continued to provide access to the Internet and to bibliographic, full-text and numerical databases. The library has 7,034 active readers, who borrowed 41,186 publications in all. The library is open 38 hours a week, Monday to Thursday from 9 a.m. to 5 p.m. and Friday from 9 a.m. to 3 p.m.

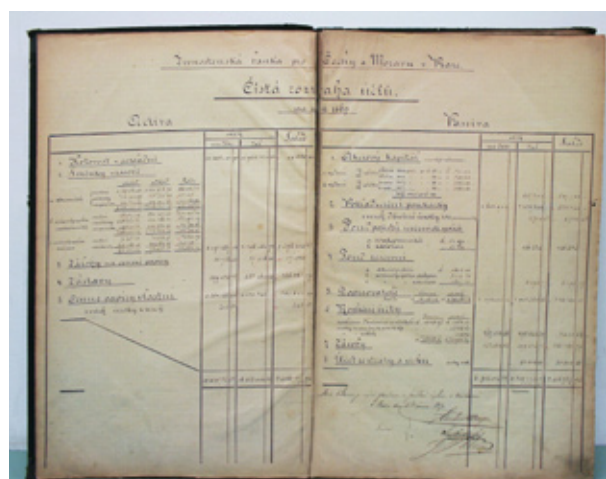
In line with the strategic plans for the further development of the library, a survey was conducted in May 2009 regarding the expansion of services. The results of the survey, which was presented in two variants (for internal and external users), revealed that users are satisfied with the scope and quality of the services provided. In 2010, attention will be paid mainly to creating an application enabling uniform searching in multiple databases simultaneously. In 2009, a long-term process to digitise the historical book collection was commenced. The first 50 titles have been made available in the library's local network. Following numerous user requests, an electronic version of the SBCS and CNB Bulletin for 1999–2000 was created and published on the CNB website together with metadata. In 2009, work continued on cataloguing unique collections (various historical publications of domestic and foreign banks and economic documents) and on making them available in the library's electronic catalogue.

All information can be obtained by visiting the library in person, by going to the *CNB special library* section of the CNB website, by directly accessing the online catalogue (<http://sd.ruk.cuni.cz/tinweb/cnbanka/k6>) or by e-mailing lib@cnb.cz.

CNB ARCHIVE

The Czech National Bank Archive is listed as one of the public specialised archives in Act No. 499/2004 Coll. Its primary mission is to care for the archive documents produced by the CNB and its legal predecessors. These documents, which form part of the National Archive Heritage, are professionally processed by CNB archivists so that they are available to the widest possible public. As part of the development of financial literacy, one of the long-term aims of the Archive is also to broaden awareness of continuity and discontinuity in the history of the Czech financial market. One of the results of this effort is a flagship CNB publication entitled *Central Banking in the Czech Lands*.

At the end of 2009, the CNB Archive had 57 archive collections containing archive documents dating from 1819–1998. To study them, researchers can use archive



tools in book form as well as electronic search tools in the VadeMeCum application. This application currently allows researchers to search in 178,574 records (another 55,538 records relate to personnel files of former employees of the CNB's legal predecessors).

In 2009, the CNB Archive's research room was visited by 39 researchers, who spent 149 research days there. The most studied topics are general issues of Czechoslovak monetary policy and banknote printing in 1918–1950. Other topics studied include important personalities in Czechoslovak banking and general economic developments in the Czech lands and developments in the regional money market. An important part of research room's work is extensive consulting activity provided to all researchers. The research room is open all year subject to prior consultation.

Background research is an important area of the Archive's work. The most frequent topics in 2009 were the historical exchange rates of the Czechoslovak currency and the history of Czech and Central European banking. Property issues are another important area of work.

The CNB Archive also offers educational visits, mainly for university students. Four such visits were organised for visitors from the Czech Republic and abroad in 2009. Some documents from the CNB Archive were also made available to the public as part of the *Republic* exhibition organised by the National Museum in 2008–2009.

The CNB Archive is a member of the European Association for Banking and Financial History (EABH) and since 2009 has also been represented in its statutory bodies (Academic Advisory Council). It is also involved in the activities of the EABH's Corporate Culture Memory Task Force, which aims to protect the archive heritage of European financial market institutions.

Anyone interested in studying in the CNB Archive or in obtaining historical economic information should visit the *Archive* section of the CNB website or e-mail archiv@cnb.cz.

CONGRESS CENTRE

The CNB Congress Centre is a venue for meetings between the CNB's top management and representatives of central banks of other states, deputies and senators of the Parliament of the Czech Republic, financial market representatives, trade unions, financial analysts and journalists. The CNB's specialised units hold conferences, lectures, presentations, insurance intermediaries' examinations and



press conferences there. One of the most important events of the first half of 2009 was undoubtedly the business lunch held by the CNB Governor as part of an informal ECOFIN meeting under the Czech EU Presidency. The Congress Centre also hosted working meetings of the committees and working groups of the European Central Bank and the European System of Central Banks. In the second half of the year, the Congress Centre played host to the international conference *20 Years of Banking and Financial Reform in the Czech Republic* in cooperation with the University of Economics in Prague and the international seminar *Introducing Counter-cyclicality into Prudential Regulation; Its Role in Basel II* in cooperation with Columbia University.

The spaces of the Congress Centre are not only used by the CNB, but are also rented out to organisations such as state institutions, economic universities, the Liberal Institute, the Czech Banking Association, benevolent societies such as Junior Achievement, and corporations. These organisations use the Large and Small Halls as a venue for domestic and international conferences and seminars, training events to foster financial literacy, presentations and social events. For instance, the traditional Forecasting Dinner, organised by the Czech CFA Society, and the European Banking and Financial Forum were held there in the first half of the year. The Czech Statistical Office, in partnership with the University of Economics and the CNB, organised the international conference *Statistics – Investment in Future II* at the Congress Centre at the start of the second half of the year.

The Congress Centre is used not only for conferences and seminars, but also for cultural events. In 2009, the Large Congress Hall hosted 13 classical music concerts, for example the *Jan Palach in Memoriam* concert, the opening concert of the 50th International Frederyk Chopin Festival, a Czech Chamber Philharmonic concert and Prague Spring International Music Festival concerts. In the summer months, a charity concert given by violinist Pavel Šporcl in aid of those affected by the summer floods and one of the concerts of the *Dvořák's Prague* summer festival were held there. The music year concluded with a *Young Czech Talents* concert in which promising young performers played pieces by the great composers.

A well-established tradition is that of hosting exhibitions of photographs in the foyer of the Congress Centre. CNB employees and guests had an opportunity to view the work of prominent Czech photographers as well as young student photographers. An exhibition entitled *Golden Collection – Part V*, comprising photographs lent by the National Museum of Photography in Jindřichův Hradec, focused on documentary in Czech photography. Another exhibition entitled *Digestive* showcased a selection of coursework by students of the Department of Advertising Photography, Faculty of Multimedia Communications, Tomáš Baťa



University in Zlín. The last exhibition, loosely related to the first, consisted of photographs by a young Czech traveller and photographer: *Světózor – A Travel Documentary* by Simona Boarová.

Further information is available on the CNB website (*About the CNB – Headquarters – Congress Centre*).

THE CNB AND ITS PEOPLE



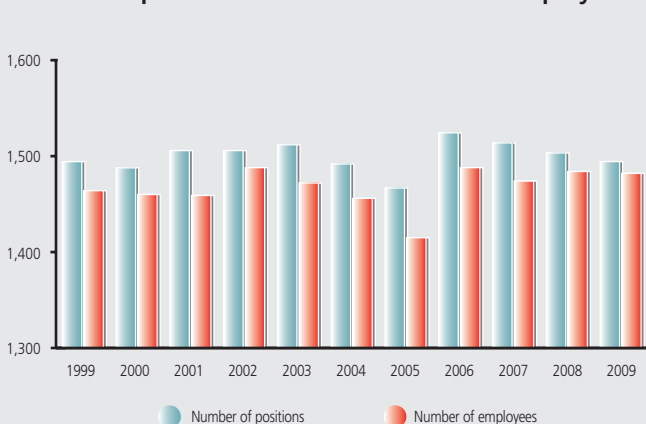
In the wake of the global economic crisis, human capital – the CNB’s workforce – is a reliable foundation enabling the CNB to fulfil its objectives and tasks successfully. Throughout its existence, the CNB has paid extraordinary attention to improving and developing its human resources. It strives above all to continuously enhance the quality of managerial work and devotes great care and adequate funds to ensuring the constant professional development of all CNB employees.

Number of positions and employees

As of 31 December 2009, the CNB had 1,482 employees, down by 2 from the end of 2008. In 2009, a total of 88 new employees were taken on and 90 persons terminated their employment, of whom 23 retired and 11 left as a result of organisational changes. The total labour turnover rate, including employees whose positions were eliminated due to organisational changes, was 6.1%. As of 31 December 2009, the average length of employment at the CNB was 12.9 years (compared to 12.5 years in 2008).

Although the CNB has greatly expanded its activities over the past decade, the maintenance of a constant number of positions demonstrates high efficiency in human resources work. The number of positions declined by 9 year on year to the 1999 level.

Number of positions and actual number of employees



Recruitment and selection of employees

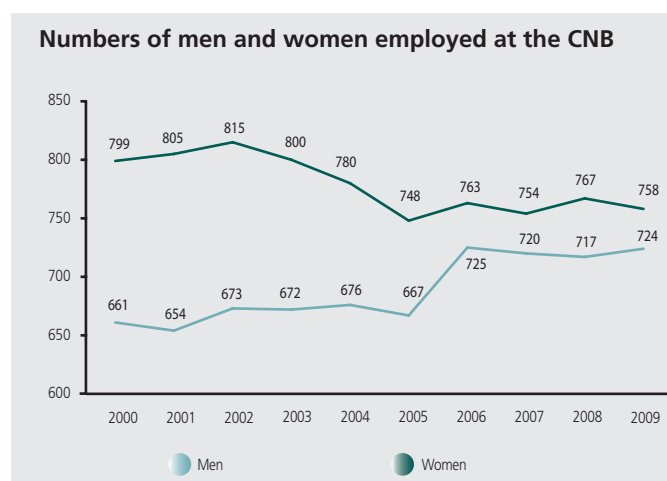
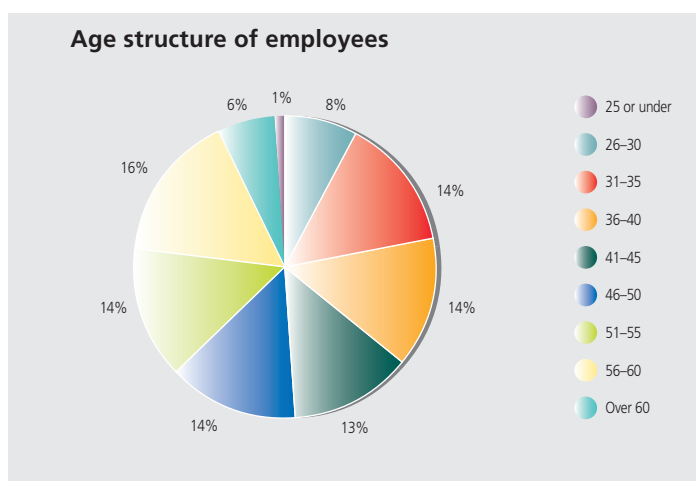
It is crucial for quality performance of the CNB’s tasks going forward that the CNB seeks and recruits high-quality staff who will responsibly perform tasks in their field of work and will be extraordinarily motivated to perform at the highest level. The 13 most important positions were filled on the basis of external selection procedures in which 880 persons submitted applications. Vacancies are advertised internally on the CNB intranet and externally on the CNB website, on internet job sites and in the daily press. The CNB also finds new staff by directly approaching selected students in their final years at university. In order to select applicants of the highest quality and to use funds effectively, the CNB also maintains a database of applicants, who are contacted if a vacancy arises and invited to participate in the selection process.

Structure of employees in terms of education, age and ratio of men to women

The CNB is an equal opportunity employer, as its employee structure shows. The nature of the CNB's objectives and tasks reflects the percentages of employees in individual education categories: university graduates made up 49% of the total CNB workforce, while employees with higher vocational training or secondary school education ending with a school leaving exam (including vocational training ending with a school leaving exam) accounted for 39% and employees with vocational training without a school leaving exam or with basic education recorded a 12% share.

The changes in the CNB's age structure were minimal compared to 2008. All age groups are evenly represented. This ensures that working teams have optimal composition and the bank does not face risks arising from generational turnover. The average age of the CNB's workforce as of 31 December 2009 was 44.8 years (compared to 44.5 years in 2008).

The representation of men and women is balanced, too. At the end of 2009, the ratio of men to women was approximately 49:51.



Incentive system

The salary system and the two-phase staff appraisal system linked to performance-related bonuses are the main pillars for influencing employee performance. Regular feedback provided by managers within working teams is another integral part of the incentive system. Managers – as salary administrators of their divisions and departments – are motivated within the system to assess the workload, composition and number of members of the team.

Personnel expenses totalled CZK 1,214 million in 2009, up by 4.8% on a year earlier. A total of CZK 871 million was paid in salaries, i.e. 5.9% more than in 2008. The average monthly wage was CZK 48,766. The average annual wage increased by 5.0%. Statutory insurance payments amounted to CZK 285 million. Other social costs totalled CZK 25 million. The bulk of these expenses (CZK 19 million) were life insurance and pension scheme contributions provided to employees.

The salaries of Bank Board members were as follows:		
	Gross salary in CZK ¹⁾	Net salary in CZK ²⁾
Zdeněk Tůma	4,585,269	3,761,646
Mojmír Hampl	3,779,185	3,076,474
Miroslav Singer	3,802,881	3,089,496
Robert Holman	3,171,992	2,553,240
Pavel Řežábek	3,207,796	2,569,434
Vladimír Tomšík	3,183,472	2,523,918
Eva Zamrazilová	3,195,476	2,591,002
1) The gross salary comprises the basic wage, wage refunds, performance-related bonuses and bonuses for working on non-working days.		
2) The net salary is the gross salary net of "capped" state health insurance contributions, social security contributions, state employment policy contributions and income tax and tax discounts for the taxpayer and dependent children.		

Professional development

Professional development is an integral part of effective human resource management. It encompasses specialised training, managerial training and language training. This includes training organised within the CNB, training provided by domestic external organisations (including university studies) and training provided in other countries. Spending on CNB employee training totalled CZK 34 million in 2009.

As for training abroad, cooperation between the CNB and partner central banks, the International Monetary Fund, the Joint Vienna Institute and the Financial Stability Institute played a major role. The most frequently used training events were seminars and workshops in the fields of financial stability, economic modelling and the financial markets. The CNB was actively involved in the education programme organised within the European System of Central Banks. There was a further increase in the number of financial market regulatory and supervisory staff attending seminars organised by the CEBS, CESR and CEIOPS. Extension of knowledge and experience in the form of consultations and short-term exchange study visits between central bank staff and financial market regulatory and supervisory institutions in the EU was an important element of specialised training.

Specialised courses focusing on enhancing skills in individual CNB business areas accounted for a large part of the internal training event structure. A major training project entitled *Development of corporate culture and soft skills of CNB staff* was launched. It is being financed by the European Social Fund within Operational Programme Prague Adaptability.

Short-term external training events organised in the form of seminars and workshops were requested by CNB staff in order to acquire information relating mainly to new legislation. Training of IT specialists also took the form of external training.

Language training at the CNB took the form of long-term or intensive tuition focusing mainly on enhancing knowledge of specialised terminology and communication skills. Regular complementary e-learning also continued in 2009. Selected seminars were offered to employees of other central banks as part of the ESCB's Open Training Activities.

The language skills requirements for managerial positions and specialised professions are met by all employees for which such requirements are prescribed (in many cases at a higher level than required). A total of 51% employees proved their language skills by passing standardised language examinations.

FINANCIAL REPORT



INDEPENDENT AUDITOR'S REPORT

To the Bank Board of Česká národní banka:

- I. We have audited the financial statements of Česká národní banka as at 31 December 2009 presented on the enclosed CD-ROM and our audit report dated 23 February 2010 stated the following:

"We have audited the accompanying financial statements of Česká národní banka, which comprise the balance sheet as at 31 December 2009, and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. For details of Česká národní banka, see Note 1 to the financial statements.

Management's Responsibility for the Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the Czech Republic. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors, International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

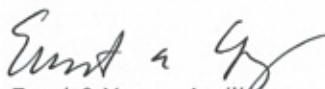
Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Česká národní banka as at 31 December 2009, and its financial performance for the year then ended in accordance with accounting principles generally accepted in the Czech Republic."

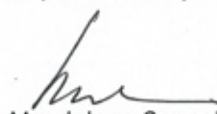
- II. We have also audited the consistency of the annual report with the financial statements described above. The management of Česká národní banka is responsible for the accuracy of the annual report. Our responsibility is to express, based on our audit, an opinion on the consistency of the annual report with the financial statements.

We conducted our audit in accordance with International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the information presented in the annual report that describes the facts reflected in the financial statements is consistent, in all material respect, with the financial statements. We have checked that the accounting information presented in the annual report in section 5 "Financial report" is consistent with that contained in the audited financial statements as at 31 December 2009. We believe that our audit provides a reasonable basis for our opinion.

Based on our audit, the accounting information presented in the annual report is consistent, in all material respects, with the above-mentioned financial statements.



Ernst & Young Audit, s.r.o.
License No. 401
Represented by Partner



Magdalena Soucek
Auditor, License No. 1291

23 February 2010
Prague, Czech Republic

FINANCIAL STATEMENTS

BALANCE SHEET			
in CZK millions		31 Dec. 2009	31 Dec. 2008
1.	Gold	782	796
2.	Receivables from the International Monetary Fund	47,665	24,707
3.	Receivables from abroad, including securities	733,233	707,739
3.1.	Deposits at foreign banks and financial institutions	15,784	2,478
3.2.	Loans provided to foreign banks	39,306	9,973
3.3.	Securities	678,035	695,132
3.4.	Other receivables from abroad	108	156
4.	Receivables from domestic banks	0	38,039
5.	Fixed assets	4,933	5,251
5.1.	Tangible fixed assets	4,892	5,223
5.2.	Intangible assets	41	28
6.	Other assets	7,336	7,863
6.1.	Other financial assets	3,043	3,006
6.2.	Receivables from former banks	0	0
6.3.	Other	4,293	4,857
TOTAL ASSETS		793,949	784,395
1.	Currency in circulation	387,276	399,248
2.	Liabilities to the International Monetary Fund	42,658	21,008
3.	Liabilities abroad	2,413	2,838
3.1.	Loans from foreign banks	0	1,582
3.2.	Other liabilities abroad	2,413	1,256
4.	Liabilities to domestic banks	380,964	307,883
4.1.	Bank monetary reserves	37,367	31,741
4.2.	Loans received	331,810	193,567
4.3.	Other liabilities to banks	11,787	82,575
5.	Liabilities to clients	107,836	178,592
5.1.	Liabilities to the state	103,595	175,423
5.2.	Other liabilities to clients	4,241	3,169
6.	Provisions	211	222
7.	Share capital	1,400	1,400
8.	Funds	8,050	8,046
9.	Revaluation reserve	6,633	26,925
10.	Accumulated losses from previous periods	(170,555)	(199,640)
11.	Profit for the period	18,454	29,128
12.	Other liabilities	8,609	8,745
TOTAL LIABILITIES AND EQUITY		793,949	784,395

OFF BALANCE SHEET			
in CZK millions		31 Dec. 2009	31 Dec. 2008
1.	Guarantees issued	161,359	161,432
2.	Receivables from spot, term and option transactions	150,594	91,187
3.	Liabilities from spot, term and option transactions	151,028	91,166
4.	Guarantees received	156,952	156,954
5.	Collateral received	82,697	62,238
6.	Values taken into custody and values in own custody	684	925

INCOME STATEMENT			
in CZK million		31 Dec. 2009	31 Dec. 2008
1.	Interest income and similar income	18,303	26,109
1.1.	Interest from fixed income securities	18,057	24,891
1.2.	Other	246	1,218
2.	Interest expense and similar expense	(6,630)	(16,836)
3.	Income from shares and other interests	601	139
4.	Fee and commission income	320	465
5.	Fee and commission expense	(73)	(48)
6.	Gains less losses from financial operations	8,037	21,445
6.1.	Net foreign exchange gains / (losses) and foreign exchange spread	(17,001)	20,602
6.2.	Other	25,038	843
7.	Other operating income	694	299
7.1.	Income from money issue	256	86
7.2.	Other	438	213
8.	Other operating expense	(893)	(432)
8.1.	Expenses for production of notes and coins	(538)	(342)
8.2.	Other	(355)	(90)
9.	Administration expense	(1,628)	(1,582)
9.1.	Personnel expenses	(1,215)	(1,159)
9.1.1.	Wages and salaries	(871)	(822)
9.1.2.	Social and health security	(285)	(276)
9.1.3.	Training and other expenses	(59)	(61)
9.2.	Other administration expenses	(413)	(423)
10.	Depreciation and amortisation of fixed assets	(405)	(433)
11.	Reversal of provisions for receivables and guarantees, income from receivables already written off	153	1,110
12.	Write offs, additions and utilisation of provisions for receivables and guarantees	(25)	(1,108)
13.	Profit for the period	18,454	29,128

The full version of the financial statements of the Czech National Bank as of 31 December 2009, including the notes thereto, are available on the CNB website (About the CNB – Performance – Financial statements) and on the attached CD-ROM.

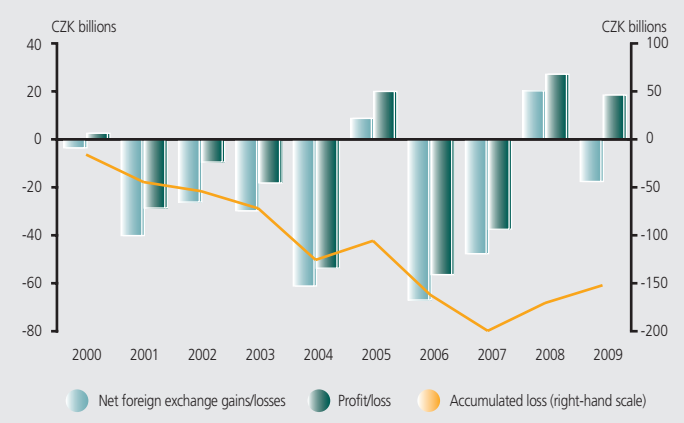
The structure of income and expenses used in the following text may differ in some cases from the structure of the standard financial statements, but the overall sum of CNB income and expenses is understandably the same. The difference in structure is due to the fact that from the perspective of the CNB's financial performance the individual income and expenses items are monitored and assessed according to purpose of expenses, which allows easier orientation as regards management of the core areas of activity ensuing from Act No. 6/1993 Coll., on the Czech National Bank (the income statement provides an overview of income and expenses primarily with regard to type). In the following review of income and expenses, the individual areas of the central bank's financial performance in 2009 are broken down according to the purpose of expenses, including the year-on-year change in net income for the individual items.

in CZK millions				
	expenses	income	net	y-o-y change
Monetary area	40,103	60,781	20,678	- 10,633
• monetary policy-making	6,146	59	- 6,087	8,724
• international reserves management	11,485	55,286	43,801	18,249
• valuation changes	21,662	4,106	- 17,556	- 37,770
• client operations	483	865	382	86
• other operations	327	465	138	78
Currency issuance and management	538	272	- 266	- 28
Operations	2,072	114	- 1,958	- 13
Total	42,713	61,167	18,454	- 10,674

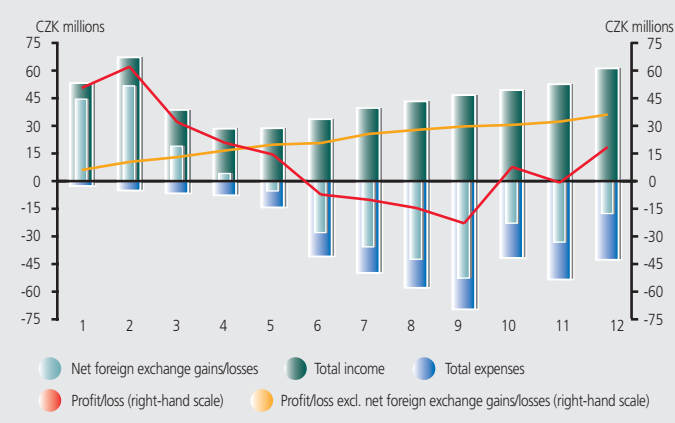
The CNB recorded a profit of CZK 18,454 million in 2009, despite exchange rate losses due to year-on-year appreciation of the domestic currency. The impact of valuation changes on the bank's performance was fully offset by international reserves management income. Profit was also positively affected by a slight decline in

average annual sterilisation of excess liquidity combined with a decrease in the repo rate during 2009. In line with financial management principles, the entire profit was used to cover accumulated losses from previous periods, which currently stand at CZK 152 billion.

The CNB's performance 2000–2009



The CNB's performance in 2009



The primary objective of the CNB is to maintain price stability. Monetary policy making is fully subordinated to this, regardless of the amount of expenses and income. Open market operations, conducted in the form of repo operations, and remuneration of banks' minimum reserve holdings generated a loss of CZK 6,087 million. In year-on-year terms the loss declined by 59% as a result of a decrease in interest rates during 2009 and a fall in the average annual excess liquidity that had to be sterilised. In 2009, the CNB sterilised CZK 348 million on average, representing a year-on-year decline of 5%. The CNB used the key two-week interest rate for its main monetary instrument, which takes the form of repo operations conducted as tenders. The CNB adjusted this rate four times in 2009. The two-week repo rate declined from its initial level of 2.25% p.a. to a historical low of 1% p.a. Interest expenses due to client operations totalled CZK 543 million.

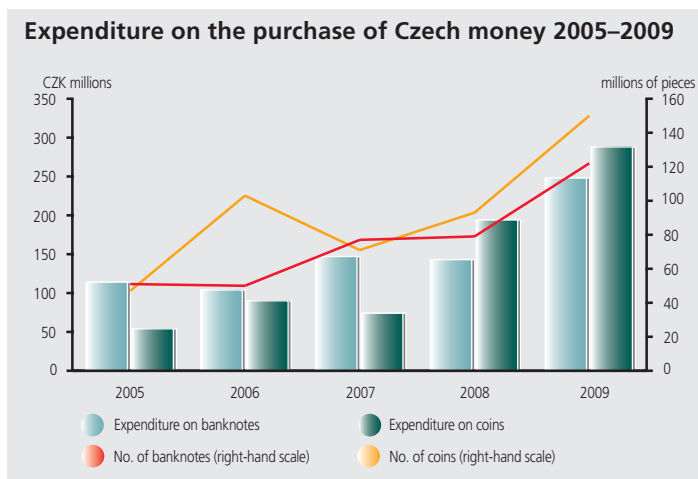
Monetary policy instruments also include automatic facilities, by means of which commercial banks were able to deposit or borrow liquidity overnight. However, both instruments were used to only a limited extent. From the end of 2008 and throughout 2009, the CNB allowed commercial banks to use a new type of non-standard reverse repo aimed at supporting banking sector liquidity and the smooth functioning of the government bond market. Owing to a lack of interest among domestic banks, this instrument was used with minimal frequency and the CNB recorded a claim against just one entity in this respect in its balance sheet at the end of 2009.

International reserves form the most important part of the CNB's assets. In euro terms, they stood at EUR 27,577 million at the end of 2009. The increase in the reserves in euro terms was fostered by external flows into the portfolios stemming mainly from foreign exchange transactions with CNB clients. Other important factors included an increase in the National Fund's foreign currency deposit and the return on the portfolios. By contrast, change in the euro-dollar exchange rate and sales of part of returns on individual portfolios fostered a decrease. The size of the international reserves has been above the level arising from monetary policy needs for several years now. The CNB is therefore adjusting the level by ongoing sales and thereby limiting the risk associated with the open foreign exchange position. The returns are being sold gradually and in small volumes to limit the impact on the koruna exchange rate.

Owing to the financial and economic crisis, the CNB implemented a series of measures in 2009 to reduce the financial risks associated with international reserves management. There was a need to address risks going beyond individual banks. With public budgets becoming increasingly indebted and guarantees to national financial systems rising, the financial condition of nations themselves was worsening. The measures adopted by the CNB and the formulation of the CNB's new credit policy were a commensurate response to these developments.

The return on the international reserves, measured as a weighted average of the returns in local currencies, was 3.72% p.a. in 2009. This is broadly in line with the long-term average. In absolute terms, international reserves management yielded the CNB net income of CZK 43,801 million. Owing to movements in prices on foreign markets, the market value of realisable bonds in the bank's portfolio increased at the end of 2008. Their subsequent sale in 2009 meant that the CNB recorded higher capital gains compared to the previous period. Significant income was also generated from the CNB's externally managed shares portfolio, since prices of individual shares contained in the stock indices in which the bank had invested rose from March 2009 onwards.

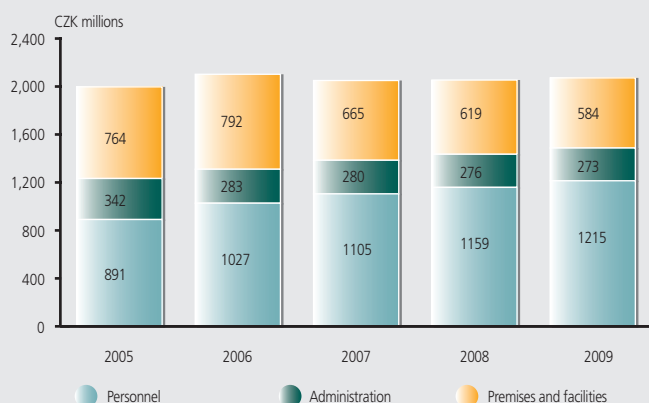
Owing to the CNB's high proportion of foreign exchange assets, the nominal exchange rate of the koruna has a significant effect on its performance. In this respect, 2009 was characterised by high volatility of the koruna's exchange rate against the main reserve currencies (the euro and the dollar) caused by movements of (often short-term) capital during the economic crisis. The domestic currency appreciated against both reserve currencies in year-on-year terms – from CZK 26.930 to CZK 26.465 against the euro and from CZK 19.346 to CZK 18.368 against the dollar. As regards the impact on the bank's performance, foreign exchange losses totalled CZK 17,556 million.



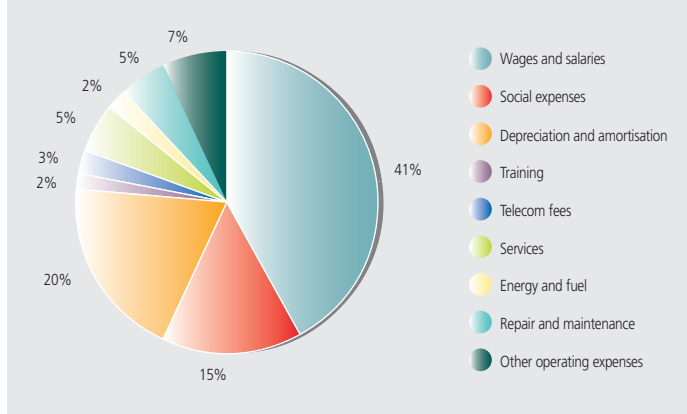
The amount of banknotes and coins purchased is based on the production plan for the relevant period. The CNB orders the required amount of Czech money from its suppliers in line with this plan. The year-on-year increase in currency issuance and management expenses was due to a rise in the number of banknotes and coins purchased, induced by the need to replenish low stocks of money, and also to the exchange of banknotes for notes with new security features. In 2009, the CNB purchased 122 million banknotes of various denominations from its suppliers, for which it paid CZK 248 million, and 150 million base metal coins and silver and gold commemorative coins at a total cost of CZK 288 million. Expenditure on the preparation of banknotes and coins totalled CZK 2 million. Owing to the completion of the project to upgrade Czech banknotes, no funds were spent on the protection of banknotes and coins.

Income in the area of currency issuance and management amounted to CZK 272 million (of which CNB received CZK 16 million in fees from banks for cash operations and banknote processing). Following the termination of the exchange period for invalid 10- and 20-heller coins on 31 October 2009, the CNB charged CZK 157 million to extraordinary income owing to the non-return of part of these coins from circulation. Sales of numismatic material (silver and gold commemorative coins) recorded a slight year-on-year increase to CZK 96 million.

Operating expenses 2005–2009



Structure of operating expenses in 2009



The CNB aims to spend efficiently in all its internal processes. It has long succeeded in maintaining stable operating expenses, despite performing a wider range of activities following the integration of financial market supervision, including consumer protection work. Rising wage costs have been so far offset by more efficient management of other areas of the bank's operations. The CNB recorded a total loss of CZK 1,958 million in the area of operations in 2009, up by just 0.7% compared to 2008.

In absolute terms, the CNB spent CZK 1,156 million on wage costs and statutory insurance payments. The increase in wage costs was due mainly to higher filling of vacancies during the year and to temporary sick leave compensation payments, which have been paid by the organisation since 1 January 2009. The average number of employees converted into full-time equivalents was 1,471, up by 0.8% on a year earlier. Other social costs and education of employees amounted to CZK 59 million.

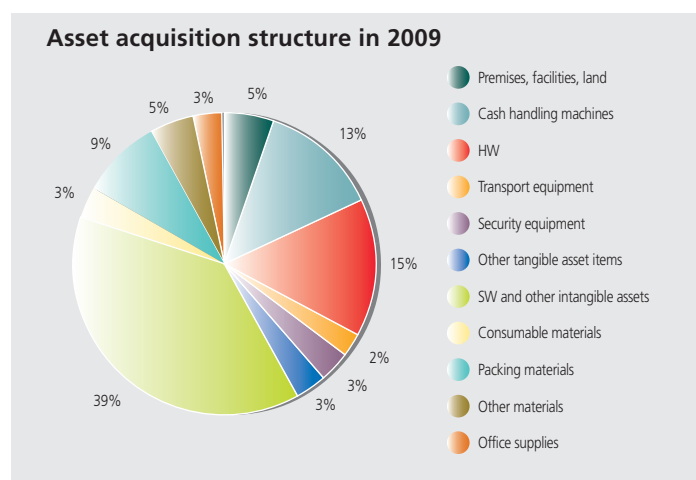
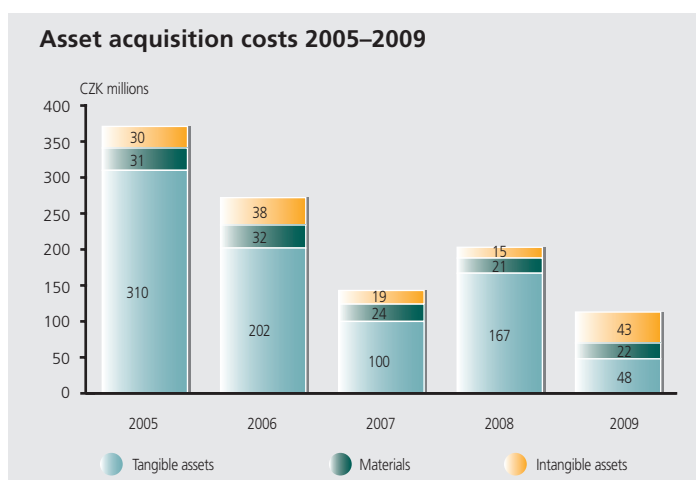
Administrative expenses totalled CZK 273 million. They declined by CZK 1,066 million compared to 2008, although the overall decline adjusted for write-offs of operating claims was CZK 3 million.¹⁸

Expenditure on the operation of premises and facilities was CZK 584 million, a year-on-year fall of CZK 35 million. This decrease was due to lower write-offs as a result of a higher rate of depreciation of the bank's tangible and intangible assets (especially computers, including software) and also to lower repair and maintenance expenses, particularly in the area of security equipment and information technology. Costs

¹⁸ In 2008, following the conclusion of bankruptcy proceedings against the bankrupt Pozemní stavby Zlín-Group, a. s., the CNB wrote off the remaining outstanding claims (mostly arising from assertion of contractual penalties) totalling CZK 1,057 million. Simultaneously, a provision fully covering the written-off claims was released to income, so the overall impact on the bank's performance was neutral.

were saved thanks to the selection of a new business partner and more favourable terms for the provision of maintenance services. Costs in other areas necessary for the operation of premises and equipment showed no major deviations from the previous year.

Operating income amounted to CZK 114 million. Fees levied during financial market supervision (especially administrative fees for the registration of insurance intermediaries) accounted for the largest part. Premises rental and restaurant service receipts were also reflected in the income.



Asset acquisition expenditure totalled CZK 113 million in 2009, the lowest level since the establishment of the CNB in 1993. CZK 48 million was spent on tangible assets, CZK 43 million on intangible assets and CZK 22 million on materials. Compared to 2008, asset acquisition expenditure declined by CZK 90 million, or 44%.

Unlike in previous years, when a periodical upgrade of banknote counting and processing equipment had been completed and rather expensive modifications and expansions of in-house technology had been made at CNB headquarters, no investment projects of this magnitude were implemented in 2009. Spending on tangible assets thus recorded a considerable year-on-year decline (of CZK 119 million). The spending in 2009 was mostly on the acquisition of hardware for IS development projects and necessary upgrades of existing hardware and also on necessary upgrades of banknote counting and processing equipment to enable processing of version 2009 banknotes.

By contrast, expenditure on intangible asset acquisition was higher than in 2008 (by CZK 28 million). A controlling and cost accounting software licence was purchased and software for the collection and processing of statistical data and information was upgraded. Software for enhanced security of access to the CNB's information technology and licences for software to be used with new and reconditioned disc arrays and servers were also purchased. In addition, upgrades and changes were made to information systems (e.g. for personnel work, for the registration of insurance intermediaries and for administration of documents and files).

Spending on the acquisition of operating materials and consumables in 2009 remained approximately the same as in the previous two years. Most (almost half) of the expenditure was on purchases of banknote and coin packing materials, followed by acquisition of office supplies, computer parts and consumables, maintenance materials and other operating materials.

PROVISION OF INFORMATION UNDER
ACT NO. 106/1999 COLL.



The Czech National Bank provides statutory information to applicants in writing on the basis of applications or by way of electronic disclosure, primarily at www.cnb.cz or on media servers.

The CNB's procedure for complying with the duties ensuing from Act No. 106/1999 Coll., on Freedom of Information, as amended (hereinafter the "Act"), and in particular its procedure for dealing with applications for information in compliance therewith, is internally regulated by Czech National Bank Directive No. 55 of 13 December 2002, on the communication of the Czech National Bank, as amended by Amendment No. 5 of 1 January 2009.

A) Information provided in 2009 on the basis of applications:

1. Number of applications for information submitted in compliance with the Act:
8
2. Number of decisions refusing an application:
3
3. Number of appeals submitted against decisions:
0
4. Transcript of the relevant parts of each court judgement concerning the examination of the legality of an obliged entity's decision refusing an application for information and an overview of all expenses incurred by the obliged entity in connection with court proceedings on rights and obligations under this Act, including its own staff expenses and legal representation costs:
0
5. Number of exclusive licences granted, including justification of the necessity to grant exclusive licences:
0
6. Number of complaints submitted under Article 16a, reasons for their submission and a brief description of the manner in which they were dealt with:
0
7. Other information relating to application of the Act:

Most written, e-mail and telephone applications for information received in 2009 concerned information whose provision went beyond the scope of the existing legislation. In 2009, the CNB answered 404 written and 3,303 e-mail enquiries from the public.

In 2009, the CNB received and examined one complaint against the procedure for dealing with the application for information.

B) Information provided by way of public disclosure:

The CNB publishes and continuously updates information in a manner allowing remote access and provides information pursuant to Articles 5(1) and 5(2) of the Act, which is placed on notice boards at CNB headquarters and branches, in locations accessible to the public, and also on the CNB website (www.cnb.cz/en). A wide range of other information on the activities and responsibilities of the CNB is also published on the state administration web portal.

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