

# ANNUAL REPORT 2018



**CNB** CZECH  
NATIONAL  
BANK  
100 YEARS  
**Kč**





The graphic design of the CNB's Annual Report for 2018 was inspired by the visual concept for the celebrations of 100 years of the koruna. The CNB contributed to the celebrations with numerous activities. It held some events in 2018 and prepared others for 2019. The main symbol of the celebrations is a unique heavyweight CZK 100 million gold coin.

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# THE MANDATE OF THE CNB

- to maintain price stability,
  - to maintain financial stability and see to the sound operation of the financial system in the Czech Republic,
  - to issue banknotes and coins, manage the circulation of currency and administer clearing between banks,
  - to supervise the entities operating on the financial market.
- 
- Through *monetary policy* we seek to preserve price stability, i.e. low and stable inflation. Through *macroprudential policy* we foster financial stability and resilience of the financial system, which are necessary conditions for the maintenance of price stability. Through the joint action of monetary policy and macroprudential policy, we contribute to maintaining confidence in the value of the Czech koruna and safeguarding the stability of the macroeconomic environment.
  - By *supervising the financial market and creating prudential rules and rules of conduct towards clients* we protect the clients of persons and institutions carrying on business on the financial market.
  - By *managing the interbank payment system and issuing banknotes and coins* we ensure smooth payments and cash circulation.
  - As the *bank of the state*, we provide banking services to the state and the public sector.
  - In line with our primary objective, *we manage international reserves with professional care*.
  - We are a *part of the European System of Central Banks (ESCB)* and contribute to the fulfilment of its objectives and tasks.

## What we build on

### INDEPENDENCE

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

### OPENNESS AND CREDIBILITY

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 and their elected representatives regularly and openly about our objectives and their fulfilment and about our opinions, plans and predictions. This makes our actions comprehensible, predictable and therefore credible.

### PROFICIENCY

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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## 2018 AT A GLANCE

- Monetary policy operated in an environment of continued – albeit slower – growth of the domestic economy and strong tightness in the labour market. Domestic inflation fluctuated inside the tolerance band around the CNB's 2% target in the course of the year and was exactly at the target in the last two months of 2018.
- The CNB responded to the inflation pressures stemming from the domestic economy and import prices by raising monetary policy interest rates in a total of five steps.
- The domestic financial sector remained resilient to potential adverse shocks. Given an increase in cyclical risks, the CNB raised the countercyclical capital buffer rate twice. The CNB reacted to risks associated with house financing by imposing caps on two indicators used to assess mortgage loan applications: a debt-to-income (DTI) ratio of 9 and a debt service-to-income (DSTI) ratio of 45% were added to its macroprudential policy toolkit with effect from 1 October.
- In the first half of the year, the CNB completed the process of licensing non-bank consumer credit providers in the transition period between 1 December 2016 and 31 May 2018. Of the 108 providers that had previously carried on business under a trade licence, 84 applicants were granted a licence and 24 were refused.
- On 1 January, the CNB launched the Central Register of Accounts system. Banks, foreign banks operating in the Czech Republic and credit unions maintain records in this system for their clients by law.
- The President of the Czech Republic appointed Tomáš Holub and Aleš Michl as new members of the CNB Bank Board with effect from 1 December. At the same time, Bank Board members Marek Mora and Tomáš Nidetzký were appointed as new Deputy Governors, replacing Vladimír Tomšík and Mojmír Hampl, whose mandates ended on 30 November.
- The Bank Board approved a new organisational structure for the CNB's offices with effect from 1 January 2019. This decision transferred the CNB branches from direct supervision by the Bank Board to supervision by the Executive Director of the Cash Department. This organisational change also involved reallocating activities between some organisational units of the CNB.
- To further develop the interbank payment system, the CNB introduced the option of making instant payments at the end of the year. The instant payment system can be used by any payment service provider that is a CERTIS participant.
- As in previous years, the CNB in cooperation with the Ministry of Finance prepared the *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*. In this document, the two institutions jointly recommended that the Czech government should not set a target date for adopting the euro yet and thus should not attempt to enter the Exchange Rate Mechanism (ERM II) during 2019.





## GOVERNOR'S FOREWORD



Dear Readers,

In the economic area, 2018 was characterised by the continuation of certain trends established in previous years. The Czech economy expanded for the fifth consecutive year, although the growth slowed somewhat compared with 2017, especially in the second and third quarters. The economic slowdown was due to the gradual exhaustion of domestic sources of growth, in particular the available labour force, accompanied by slowing external demand. The overheating of the labour market peaked. This was reflected in a general shortage of skilled and unskilled labour, the highest-ever number of job vacancies, record-low unemployment (the lowest in the whole of Europe) and average nominal wage growth exceeding 8%.

The labour market situation, which was exceptionally favourable for employees, stimulated consumer sentiment. This was reflected in rapidly rising consumer demand. Alongside briskly increasing investment targeted at substituting technologically advanced production capital for scarce labour, consumer demand was the engine of domestic demand and economic

growth. Although the buoyant wage growth contributed to the long-running process of wage catch-up with advanced economies in 2018, it also weakened the price competitiveness of domestic producers and exporters, as it was not accompanied by corresponding growth in labour productivity. The labour market overheating thus generated some degree of internal imbalance in the Czech economy. This did not, however, translate into an external imbalance, so the balance of trade remained in substantial surplus. Nor did it have any adverse implications for inflation, which fluctuated around the CNB's target during the year and was exactly at the target in the last two months of 2018. In terms of the fulfilment of our inflation target, 2018 was one of the most successful years in the whole 20-year history of inflation targeting.

The monetary policy normalisation process that we started in summer 2017, a few months after we ended our exchange rate commitment, continued in 2018. This process involves abandoning the unconventional instruments we used following the financial crisis (to combat sustained low inflation or even deflation) and returning to the use of interest rates as our main monetary policy instrument. While in 2017 we increased our policy interest rates two times, in 2018 we did so a total of five times. This gradually brought us closer to what we regard as the long-run neutral interest rate level, i.e. the level that neither slows nor stimulates the economy.

Admittedly, in reaching the two-week repo rate level of 1.75% in November we were aided by a weaker-than-expected exchange rate of the koruna. Global financial market investors withdrew

their capital into assets and countries seen as less risky, so the expected scenario of sustained exchange rate appreciation did not materialise. We responded by tightening the interest rate component of the monetary conditions. The large foreign exchange positions that investors had opened while the exchange rate commitment was in place were another factor that probably prevented the koruna from firming at the expected rate. In any case, our interest rates diverged increasingly from the euro area level during 2018, generating uncertainty with regard to potential sharp exchange rate movements. Such movements ultimately did not occur, so the exchange rate developments during the year can be labelled as slightly surprising but unusually calm overall.

As in previous years, the domestic financial sector remained highly resilient to potential shocks in 2018. Our regular macro stress tests demonstrated that the financial institutions we supervise would be able to withstand even very adverse economic developments comparable, for example, to the 2008 financial crisis. Given the continued shift of the domestic financial cycle into the growth phase and the related gradual increase in cyclical risks, we raised the countercyclical capital buffer rate twice: to 1.5% in May with effect from 1 July 2019 and to 1.75% in November with effect from 1 January 2020. We reacted to potential risks associated with house financing by imposing caps on two indicators used to assess applications for mortgage loans for owner-occupied housing: a debt-to-income (DTI) ratio of 9 and a debt service-to-income (DSTI) ratio of 45% were added to our macroprudential policy toolkit with effect from 1 October 2018.

As regards macroprudential policy, though, I regret to say that despite our best efforts we did not succeed in getting these tools converted from the “soft” form of mere recommendations into a legally enforceable form. If we are to continue to bear full responsibility for the stability of the financial sector in the future, it is vital that the corresponding legal conditions – in particular effective enforceability of our instruments – are put in place. Sustained economic prosperity is of course a fine thing, but no one should be lulled into mistakenly thinking it will last forever. It is a rather paradoxical but well-proven truth that the seeds of financial crises are sown in good times, when alertness to accumulating risks is weakened. As the supreme supervisory authority, we deem it essential to be equipped well in advance with the legal powers we need to supervise the financial market responsibly and safeguard its stability.

In 2018, we celebrated 100 years since the establishment of Czechoslovakia. The CNB contributed to the celebrations with its numismatic activities, among other things. We issued a gold CZK 10,000 coin and special circulating CZK 20 coins bearing portraits of the country's founding fathers – Tomáš Garrigue Masaryk, Milan Rastislav Štefánik and Edvard Beneš. The circulating coins met with particularly strong interest from the public and received heavy media coverage.

To sum up, I am pleased to say that 2018 was a successful year for both the Czech economy and the central bank. This Annual Report covers the CNB's most important activities and describes how it performed its key functions. It provides an overview of the material, operational, organisational and personnel measures taken by the CNB. I believe that we succeeded in further strengthening the credibility we have long enjoyed with the Czech public.



Jiří Rusnok  
Governor



## Heavyweight gold coin “100 years of the koruna”

The symbol of the celebrations of 100 years of the koruna is a unique heavyweight CZK 100 million gold coin. The coin, made of pure gold and weighing 130 kg, was issued by the Czech National Bank as a single piece on the occasion of the 100th anniversary of the koruna and related events. It is 535 mm in diameter and 48 mm thick. This makes it the largest gold coin in Europe and the second largest in the world. However, the amount of gold used to make it is less than that needed to produce a single issue of gold coins, which the CNB issues two to three times a year.

The coin was designed by Czech sculptor and medal maker Vladimír Oppl. Oppl also designed the Czech 20-koruna coins (1993, 2000, 2018 and 2019) and the 50-heller coin (1993). His New Town of Prague gold coin from the Charles IV set received an award for the world's best gold coin in 1999. He also designed the badge of the Order of Tomáš Garrigue Masaryk.







# 1

THE BANK  
BOARD

# 1. THE BANK BOARD

The Bank Board is the supreme governing body of the CNB. It has seven members: the Governor, two Deputy Governors and four other members. Bank Board members are appointed and recalled by the President of the Czech Republic. They are appointed for a term of six years. No one may hold the position of Bank Board member more than twice.

Membership of the Bank Board is incompatible with the position of member of a legislative body, member of the Government or member of the governing, supervisory or inspection bodies of other banks or commercial undertakings, and the performance of any independent gainful occupation, except for management of own assets and scientific, literary, journalistic, artistic and pedagogical activities. Membership of the Bank Board is incompatible with any activity which might cause any conflict of interest between the performance of this activity and membership of the Bank Board.

In line with the CNB's primary objective, namely to maintain price stability, and in line with the task of maintaining financial stability, the Bank Board sets monetary and macroprudential policy and the instruments for implementing those policies. It decides on fundamental monetary and macroprudential policy measures and lays down principles for CNB transactions. In addition, it decides on key measures relating to financial market supervision, potential resolution on the financial market and cash and non-cash money circulation. It sets the CNB's overall development strategy and rules for the CNB's involvement in the activities of the EU, the European System of Central Banks (ESCB) and the European Systemic Risk Board (ESRB) and for its cooperation with international financial institutions. It decides on the bank's organisational structure and the powers and responsibilities of its organisational units. It also approves the CNB's budget and financial management principles.

The Governor, or, in his absence, a Deputy Governor nominated by him, chairs the meetings of the Bank Board. The Bank Board acts by a simple majority of the votes cast. In the event of a tie, the chairperson has the casting vote.

Tomáš Holub and Aleš Michl were appointed as new members of the CNB Bank Board with effect from 1 December 2018. At the same time, Bank Board members Marek Mora and Tomáš Nidetzky were appointed as new Deputy Governors, replacing Vladimír Tomšík and Mojmír Hampl, whose mandates ended on 30 November 2018.



**The Bank Board as of 31 December 2018**

Back: Oldřich Dědek, Aleš Michl, Tomáš Nidetzký, Vojtěch Benda, Tomáš Holub  
Front: Marek Mora, Jiří Rusnok



## Obverse side of the heavyweight coin

The relief on the obverse side of the heavyweight coin commemorates the birth of the Czechoslovak currency with a stamp dating from 1919, while the present is represented by the CNB logo. Shields bearing heraldic animals from the large national coat-of-arms can be found in the upper part of the coin field. The Czech lion is in the middle, with the Moravian eagle to the left and the Silesian eagle to the right. The motif of the reverse side of the 1921 Czechoslovak 50-heller coin, two bundles of grain wrapped in ribbon, is shown below the lower part of the logo. The shields bearing heraldic animals and the bundles of grain are connected from the left and the right with linden leaves to form a circular composition.





# 2

THE CNB  
IN 2018

## 2. THE CNB IN 2018

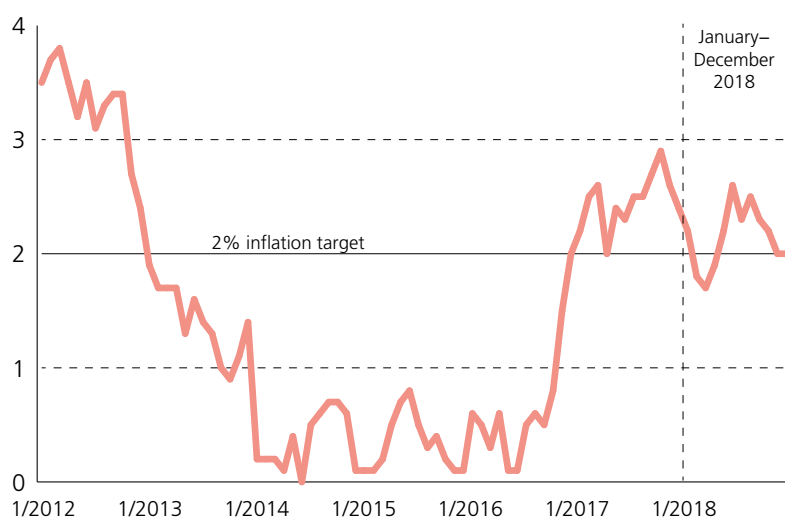
### MONETARY POLICY AND ECONOMIC DEVELOPMENTS

The primary objective of monetary policy is to maintain price stability. Since January 1998, i.e. for more than 20 years, the CNB has been achieving this under an inflation targeting regime in which it keeps inflation close to a declared target. Since 2010, the target has been set in the form of 2% year-on-year growth in the consumer price index with a tolerance band of  $\pm 1$  percentage point. This target is in line with the practice of advanced economies.

In 2018, monetary policy operated in an environment of continued – albeit slower – growth of the domestic economy and strong tightness in the labour market. Record-low unemployment and the highest number of job vacancies in history were reflected in a further acceleration in wage growth. The buoyant wage growth coupled with continued growth of the real economy resulted in strong domestic inflation pressures. At the same time, import prices turned inflationary again, reflecting growth in foreign prices as well as the koruna exchange rate, which mostly followed a weakening trend during the year. Domestic inflation fluctuated inside the tolerance band around the CNB's 2% target in the course of the year and was exactly at the target in the last two months of 2018.

The CNB responded to the inflation pressures stemming from the domestic economy and import prices by raising monetary policy interest rates in a total of five steps. Following the exit from the exchange rate commitment in April 2017, the exchange rate of the koruna was influenced solely by market factors and the CNB did not intervene in the market in 2018. The koruna weakened last year as a result of adverse global developments.

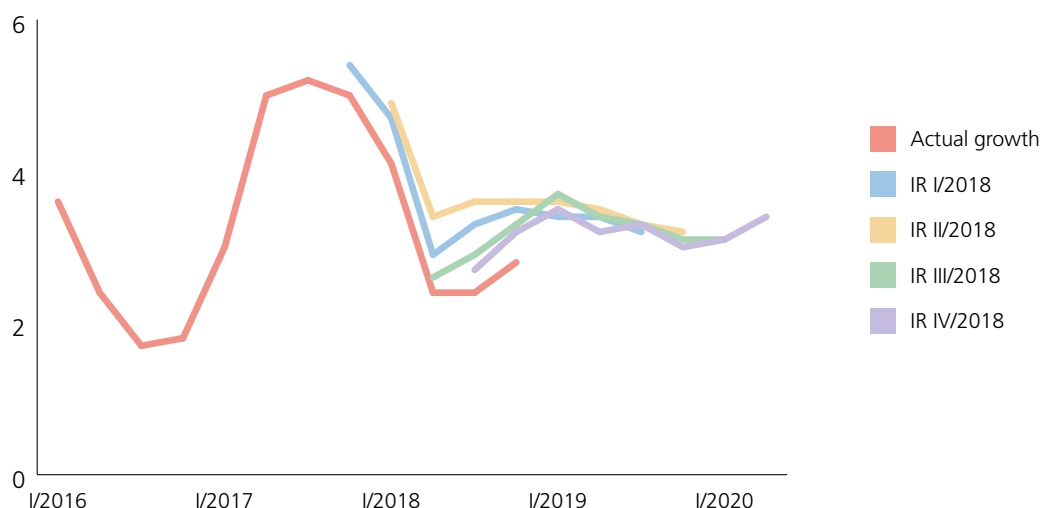
#### Fulfilment of the inflation target (in %)



The key input to the Bank Board's decision-making is the forecast of future economic developments drawn up by the Monetary Department. The forecasts are published together with a description and assessment of economic and monetary developments in the quarterly Inflation Reports (IRs), which are available on the CNB website (*Monetary policy > Inflation reports*).

The forecasts published in the first half of the year indicated that economic growth would remain just above 3% in 2018–2020 despite a marked slowdown compared with 2017. The economy was expected to continue to be supported by rising external demand, robust consumption of Czech households (reflecting a rapid rise in their income and optimistic expectations) and generally strong domestic investment activity. Rising labour demand coupled with increasingly distinct labour shortages was expected to manifest itself in continued rapid wage growth, which was projected to slow gradually in the following years.

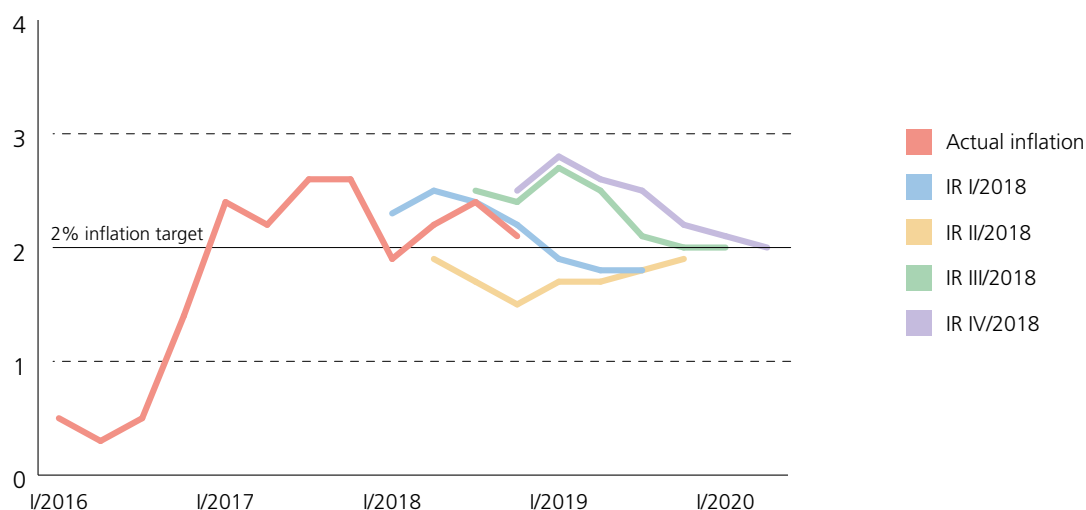
### GDP growth forecasts (in %)



According to the February and May forecasts, the domestic inflation pressures thus remained strong but would ease gradually. In 2018, this would be due to a strengthening anti-inflationary effect of import prices stemming from renewed appreciation of the koruna against the euro. According to the forecasts, this would be driven by an increasing interest rate differential vis-à-vis the euro area, asset purchases by the European Central Bank (ECB) and real convergence of the Czech economy to euro area countries. The anti-inflationary effect of import prices was expected to weaken in 2019 owing to a marked decrease in the pace of appreciation of the koruna as a result of an expected slowdown in external demand and the ECB's return to conventional monetary policy. At the same time, the one-off price factors that had increased inflation in the previous year were expected to fully disappear. The February and May forecasts thus expected inflation to be slightly below the 2% inflation target in 2019.

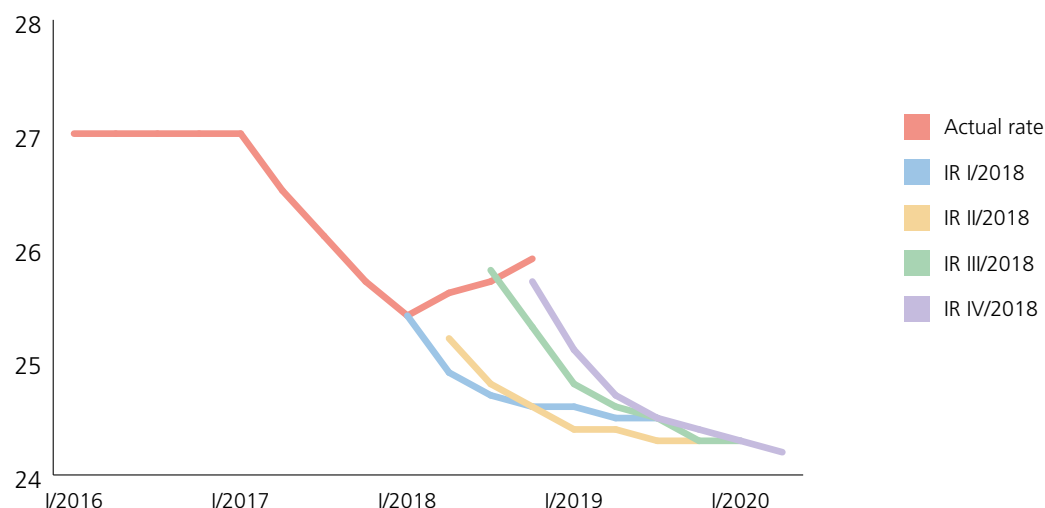
Following an increase in the key monetary policy interest rate of 25 basis points to 0.75% in February, the forecasts published in the first half of 2018 expected the CNB's interest rates not to continue rising towards their long-run neutral level until 2019. They viewed the still accommodative monetary policy of the ECB as a significant barrier to a faster increase in domestic interest rates. In this context, the forecasts assumed that the necessary monetary policy tightening would be delivered by a strengthening koruna.

## Inflation forecasts (in %)



However, this assumption did not materialise, as the koruna conversely started to weaken owing to an outflow of short-term capital from emerging economies in reaction to a deterioration in global market sentiment. The forecasts published in the second half of the year therefore expected import prices to turn inflationary again, reflecting growth in foreign prices in addition to depreciation of the koruna. The outlook for the domestic real economy saw no major changes, so the message of the forecast regarding persisting strong domestic inflation pressures did not change either. The inflation outlook thus shifted upwards and inflation was expected to approach the target from above as late as the end of 2019. It was expected to stay at the target during 2020. The forecasted decrease in inflation was underpinned by an expected easing of the inflation pressures owing to growth in interest rates, renewed appreciation of the koruna and a gradual slowdown in wage growth.

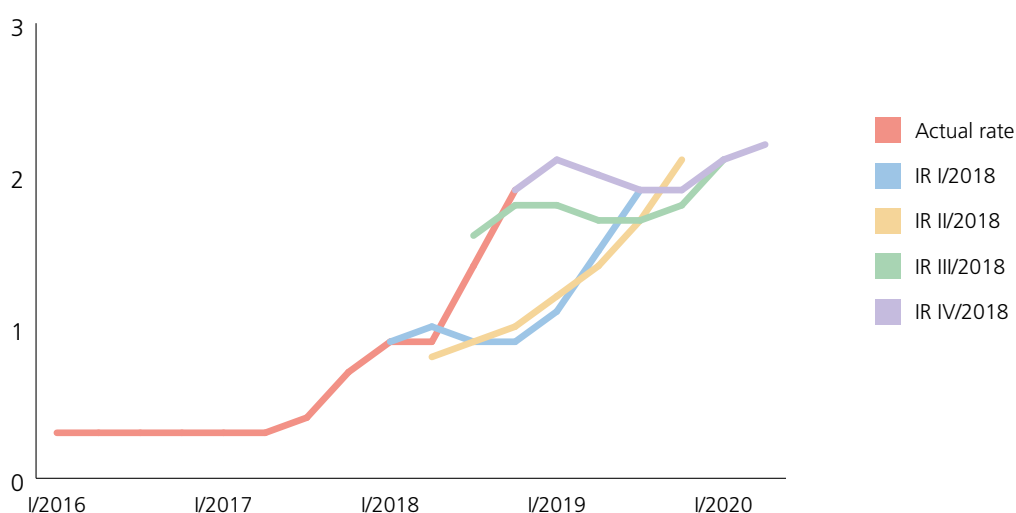
## Koruna-euro exchange rate forecasts





The increase in the overall inflation pressures called for tighter monetary policy. However, the weakening koruna was easing the monetary conditions. The forecasts published in the second half of the year therefore expected continued growth in interest rates until the end of 2018. In light of these factors, the Bank Board raised the key monetary policy interest rate four times starting at the end of June – by 25 basis points in each case – to 1.75% in early November. In the August and November forecasts, expected renewed appreciation of the koruna amid continued very accommodative monetary policy of the ECB led to broad stability of interest rates at an elevated level in 2019. According to these forecasts, a subsequent tightening of monetary policy by the ECB combined with a broadly stable koruna exchange rate would create room for further growth in domestic interest rates in 2020 towards their long-run neutral level (estimated at 3% for the 3M PRIBOR).

### 3M PRIBOR forecasts (in %)



The monetary policy decisions made in 2018 were subject to a number of risks and uncertainties stemming mainly from developments abroad. The main uncertainty was the duration of the global factors which had caused the koruna to depreciate. Growth in protectionist measures in global trade and the manner of the exit of the United Kingdom from the EU were additional sources of external uncertainty.

At the end of 2018, the CNB in cooperation with the Ministry of Finance prepared for the Government the regular *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*. The document again resulted in a recommendation not to set a target date for adopting the euro yet and thus not to attempt to enter the European exchange rate mechanism (ERM II) during 2019. This recommendation was based on a whole range of factors. The economic situation in the euro area was stabilised, but the level of development in the individual countries remained uneven and unresolved debt and structural problems persisted in a number of countries. The fiscal indiscipline of some member countries is a long-standing problem in the euro area. The preparedness of the Czech Republic to adopt the euro had improved further, although some shortcomings – especially the incomplete process of real economic convergence – persisted.

## FINANCIAL STABILITY

Maintaining financial stability and seeing to the sound operation of the financial system in the Czech Republic are among the central bank's important objectives. The CNB identifies, monitors and assesses risks jeopardising the stability of the financial system. By means of its power to set the relevant macroprudential tools, it prevents or mitigates these risks. In doing so, it creates macroprudential policy and contributes to the resilience of the financial system and the maintenance of financial stability. It provides information about the conduct of this policy on its website (*Financial stability > Macroprudential policy*).

The CNB informs the public about financial stability developments mainly in its Financial Stability Report. The CNB publishes this report in June on its website (*Financial stability > Financial stability reports*) and also provides information about the results of the analyses at a press conference given by the Governor and at a special seminar. In accordance with the law, it also submits the report to the Chamber of Deputies. The Financial Stability Report is an underlying document for the spring Bank Board meeting on financial stability issues. CNB experts prepare an update to it for a similar autumn meeting. The update is published in December in the publication *Risks to financial stability and their indicators*, also in the *Financial stability* section of the CNB website.

In 2018, the CNB Bank Board decided to make its meetings on financial stability issues closer in form to its monetary policy meetings, including the way it communicates meeting outcomes. Decisions on macroprudential tools and the related underlying documents will now be published in a similar time sequence as decisions on monetary policy interest rates. Minutes of the meetings on financial stability issues will also be published.

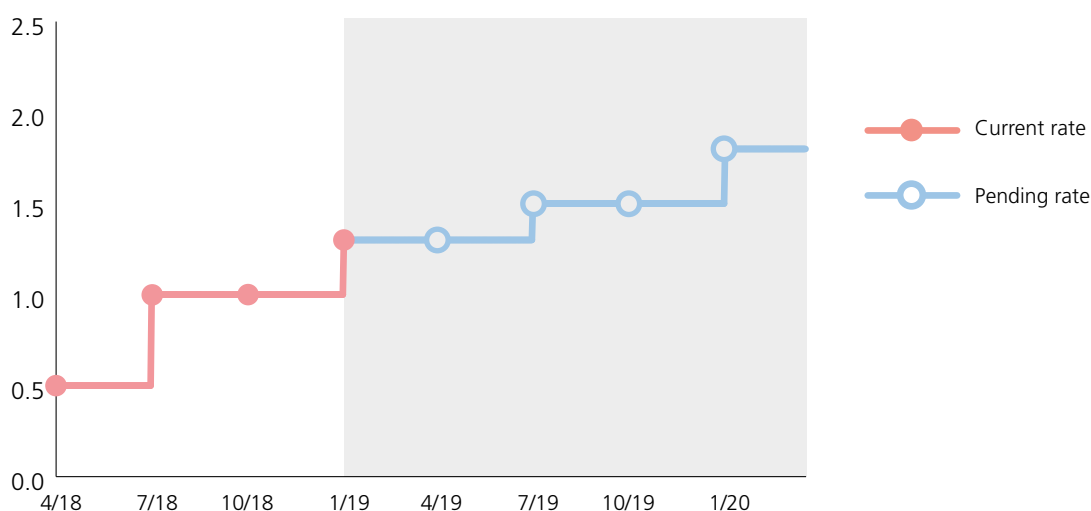
Both the aforementioned publications issued last year confirmed that the financial sector had maintained a high level of resilience to potential adverse shocks. Macro stress tests demonstrated the ability of the supervised financial institutions to withstand even very adverse economic developments (see the web page *Financial stability > Stress testing*). The results of supervisory stress tests of banks and insurance companies also confirmed high resilience.

As regards potential future sources of risks to financial stability, the CNB recorded a slight rise in risks associated with the business cycle. The CNB reacted to the continued shift of the domestic financial cycle into a growth phase by raising the countercyclical capital buffer rate. At its May meeting on financial stability issues, the Bank Board decided to increase this rate to 1.5% of banks' exposures in the Czech Republic with effect from 1 July 2019. At the November meeting, the Bank Board decided to raise the rate further to 1.75% with effect from 1 January 2020, due in part to the evolution of banking sector vulnerability indicators. In addition, the CNB confirmed during the year that five systemically important banks would be required to maintain a systemic risk buffer of 1–3% in the next two years.

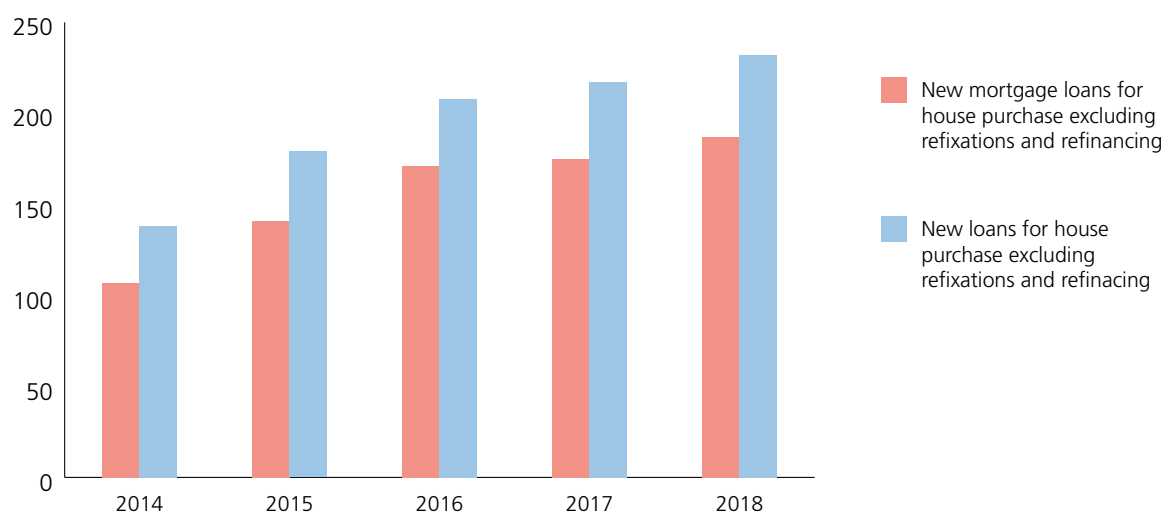
In recent years, the CNB has focused intensively on risks associated with the relationship between property prices and loans for house purchase. At its May meeting, the Bank Board agreed that there was no need to change the current loan-to-value (LTV) limits (an upper LTV limit of 90% and an aggregate limit of 15% for loans with LTVs of between 80% and 90%). It stated, however, that debtors were becoming more vulnerable due to growth in housing prices outpacing growth in income, so potential systemic risks were rising. It therefore decided that the CNB would impose caps on two indicators used to assess mortgage loan applications:

a DTI (debt-to-income) ratio of 9 and a DSTI (debt service-to-income) ratio of 45% were added to its macroprudential policy toolkit with effect from 1 October 2018. Furthermore, the CNB in cooperation with the Ministry of Finance drafted an amendment to the Act on the CNB which should, among other things, grant the CNB the power to set binding upper LTV, DTI and DSTI limits for all mortgage lenders. The amendment passed through the interdepartmental comments procedure without encountering any significant objections from the mandatory commenting departments.

### Current and pending countercyclical capital buffer rates in the Czech Republic (in % of total risk exposure)



### Genuinely new mortgage loans and loans for house purchase (annual totals in CZK billions)



## FINANCIAL MARKET SUPERVISION

In accordance with the law, the CNB supervises entities operating on the financial market and lays down rules for their business to safeguard the stability of the financial system. Besides systematic regulation and supervision, it also issues penalties for non-compliance with the rules. It is part of the European System of Financial Supervision (ESFS) and works in cooperation with the European Systemic Risk Board (ESRB) and the European Supervisory Authorities for the banking industry (EBA), insurance and occupational pensions (EIOPA) and securities and markets (ESMA). The CNB provides detailed information about its supervisory work in its annual Financial Market Supervision Report, which is available on its website (*Supervision, regulation > Aggregate information on the financial sector > Financial market supervision reports*).

### Financial market regulation

Last year, the CNB was actively involved in preparing Czech financial market laws and EU financial legislation, mainly in partnership with the Ministry of Finance. It prepared implementing decrees, issued a series of explanatory opinions and replied to questions from financial market participants on the application of regulatory requirements. A complete and up-to-date list of the CNB's decrees, provisions of a general nature, official information and opinions relating to the financial market can be found on its website (*Supervision, regulation > Legislation*).

At the start of 2018, work began on the resubmission of amendments to the Act on Banks, the Act on Credit Unions and the Recovery and Resolution Act, i.e. proposals which had been prepared earlier but the discussion of which had not been completed before the end of the previous parliamentary term. The amendment to the Resolution and Recovery Act, which only addressed minor technical issues, was resubmitted in unchanged form and was approved in 2018 with effect from 4 January 2019. The amendment to the Act on Banks and the Act on Credit Unions, which, in addition to technical changes, had originally contained, for example, rules for the conversion of banks into branches, was expanded to include a number of new topics and submitted to the government at the close of 2018. The new changes included amended rules for the language of documents submitted by regulated entities to the CNB outside administrative proceedings, a reduction in the duties applying to the convening of bank general meetings and greater stability of the legal regime for banks in court reviews of administrative decisions to revoke licences.

As regards capital market regulation, the CNB was involved in the preparation of an amendment to the Capital Market Undertakings Act linked among other things with changes in the area of management companies and investment funds and the intermediation of pension products. The main reason for the amendment is the need to adapt Czech law to the new EU Prospectus Regulation. However, it also changes the rules for recording telephone conversations concerning investment services, adds preparatory work to the list of activities regarded as investment services and contains provisions on mutual fund insolvency. At the same time, the CNB prepared another amendment to the Capital Market Undertakings Act aimed at transposing the EU Directive as regards the encouragement of long-term shareholder engagement. This amendment mainly affects issuers whose shares are traded on a European regulated market (i.e. listed companies) and also institutional investors and asset managers, on whom it imposes duties relating to the management of shares issued by listed companies.



An amendment to the Act on Bonds which, among other things, sets a new framework for covered bonds entered into force at the end of 2018. The CNB followed this up by issuing a new Decree on records of covered blocks.

A major change in the area of insurance regulation was the adoption of a new Act on Insurance and Reinsurance Distribution transposing the Insurance Distribution Directive (IDD) into Czech law. The main objective of the law, which took effect on 1 December 2018, is to enhance the transparency and quality of the insurance distribution market, which is burdened with a large number of registered entities. The law clarifies the requirements for the expertise of intermediaries and conduct towards clients, and in particular strengthens the provision of objective information to clients and prevents the sale of unsuitable products.

During 2018, the Czech Parliament also approved an amendment to the Act on Bureau-de-change Activity, which the CNB had initiated in 2016 on the basis of its supervisory practice. Based on suggestions made by the CNB, the amendment contains above all the right of a consumer to withdraw from (cancel) an exchange, consistent implementation of the single exchange rate list rule and the inclusion of most fees in the exchange rate. It was promulgated in the Collection of Laws in January 2019.

Together with the Financial Analytical Unit, the CNB began working at the end of the year on an amendment to the Act on Certain Measures against Money Laundering and the Act on the Central Register of Accounts in connection with the fifth amendment of the Anti-Money Laundering Directive (AML). The amendment, published in the Official Journal of the EU, aims to address virtual currencies and introduce national central account registers, among other things.

Given the growing pace of financial market innovation, the CNB on 1 October 2018 also established a unit focusing specifically on financial innovation. The unit's main aim is to improve the central bank's preparedness for changes on the financial market stemming from greater use of information technology and digitisation.

## European regulation

Intensive discussions on European financial market regulations continued in 2018 at the level of the European Commission, the EU Council and the European Parliament. The CNB prepared opinions on proposals for new legislation and commented on the instructions of the Ministry of Finance for EU Council meetings on an ongoing basis, and its representatives actively promoted the CNB's positions in EU committees and working groups.

Throughout the year, the CNB helped prepare opinions and comments on the European Commission's proposals to reduce risks in the banking sector discussed between the EU Council and the European Parliament. An amendment to the directive and regulation on capital requirements (CRD IV/CRR) enhances the proportionality principle in regulation, for example as regards supervisory reporting requirements and information disclosure, and introduces a binding leverage ratio and net stable funding ratio as part of the mandatory liquidity standard, among other things. The main aims of the proposed changes to the Bank Recovery and Resolution Directive (BRRD) are to harmonise the introduction of the moratorium on the fulfilment of banks' obligations and to implement the international standard for capital usable during bank resolution into the European legislation.

During 2018, the CNB was also involved in preparing opinions and comments on proposals for a directive and regulation on new prudential rules for investment firms and a new regulatory framework for covered bonds. The proposal regarding investment firms significantly lowers the regulatory burden on most firms, as only the largest systemically important investment firms would be subject to the regulatory framework for credit institutions. The proposed new framework for covered bonds introduces minimum harmonisation of the requirements applying to covered bond issuers and changes to supervision in this area.

As part of its work in the European Supervisory Authorities, the CNB also contributed to numerous other implementing measures, guidelines and explanatory opinions on the application of EU regulatory rules by both market participants and supervisory authorities. They included CRD IV/CRR, the directive and regulation on markets in financial instruments (MiFID/MiFIR), the European Market Infrastructure Regulation (EMIR) and the Central Securities Depository Regulation (CSDR).

### **International cooperation on the financial market**

The CNB was also actively involved in the debate about the completion of the European banking union in 2018. In the area of reducing risks in the EU banking sector, the EU Council in May 2018 agreed on the extent of the mandate to negotiate the proposed banking package with the European Parliament. Following intense negotiations, the Council and the Parliament reached an agreement on a set of key measures contained in the proposal. The CNB supported maintaining the maximum of the compromise agreed in the EU Council, especially the prudential requirements and protection of the interests and powers of host supervisory authorities. As regards risk sharing measures, the CNB advocated that negotiations at the political level should only start after sufficient progress has been made with reducing risks. The EU Council continued to examine technical issues linked with the various possible configurations of the European Deposit Insurance Scheme. In December 2018, the EU Council adopted a political agreement to create a common backstop for the Single Resolution Fund (SRF) and a framework to give the European Stability Mechanism (ESM) stronger powers to prevent and manage financial crises, which was subsequently approved by the December Euro Summit.

The discussion of the European Commission's legislative proposals to change the regulations establishing the European Supervisory Authorities (ESAs) continued in 2018 in an EU Council working group. The CNB was actively involved in preparing the talks. As the CNB essentially considers the ESAs' current functioning to be satisfactory, it advocated only partial modifications to further streamline the authorities. It also opposed, among other things, unjustified centralisation of powers, the replacement of representatives of national supervisory authorities in the ESAs' governance structures by experts appointed by European institutions, and the transfer of financing of the ESAs' budget from national supervisory authorities to supervised entities. Although the Member States did not accept most of the elements of the European Commission's original draft and no agreement was reached in the EU Council during 2018, the pressure to find a compromise by the end of the European Parliament's current term will grow.

In 2018, the CNB was involved in nine supervisory colleges for European banking groups (acting as consolidating supervisory authority in one case). As in 2017, the colleges focused mainly on the assessment of the risk profiles of supervised entities and group recovery plans. In addition, the CNB cooperated in 13 supervisory colleges for European insurance groups. The discussions concentrated mainly on group internal models, compliance with the requirements of the directive on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and risk

assessments of supervised entities. Intensive cooperation with partner supervisory authorities in other countries remained a priority for the CNB.

### Licensing, approval and authorisation activities in the financial market area

As the financial market supervisory authority, the CNB issues authorisations (licences and registrations) to the majority of service providers on the financial market. It also issues other permissions or approvals, for example consents to the acquisition of qualifying holdings in regulated entities, approvals of securities prospectuses and approvals of the publication of takeover bids. In these cases, the CNB acts as an administrative authority. Most of these activities take the form of administrative proceedings.

#### Numbers of administrative licensing proceedings for selected categories of supervised entities

Categories of financial entities <sup>1)</sup>	No. of proceedings continuing from 2017	No. of proceedings opened in 2018	No. of proceedings closed in 2018	No. of supervised entities <sup>5)</sup>
Credit institutions	10	20	28	60
Insurance sector <sup>2)</sup>	2	10	8	48
Pension management companies and funds	1	7	8	44
Management companies and investment funds	23	62	65	412
Investment firms	16	11	15	79
Payment institutions and electronic money institutions	4	10	3	42
Processors of domestic banknotes and coins	0	0	0	5
Non-bank consumer credit providers <sup>3)</sup>	97	8	98	87
Securities issuers and market infrastructure	2	95	82	127
Accredited entities <sup>4)</sup>	4	32	32	41
Bureaux de change	6	51	41	999

1) Including branches of foreign companies.

2) Includes insurance and reinsurance companies and Czech Insurers' Bureau.

3) Includes both applications in the transition period and applications by entities entering the sector.

4) Accredited entities are entities accredited to organise examinations of supplementary pension savings, consumer credit and investment services distributors.

5) As of 31 December 2018.

In the first half of 2018, the CNB completed the process of licensing of non-bank consumer credit providers in the transition period between 1 December 2016 and 31 May 2018. Of the 108 providers that had previously carried on business under a trade licence, 84 applicants were granted a licence and 24 were refused due to failure to meet the licensing conditions or withdrawals of the application. In addition, the CNB assessed applicants that had not taken advantage of the transition period.

In the area of testing financial market expertise, the CNB on 1 June 2018 published a set of examination questions pursuant to the Capital Market Undertakings Act. Unified sets of questions, which the CNB publishes for individual laws in the financial market area, are used by accredited entities for examinations of financial services providers and intermediaries. Examination questions pursuant to the Consumer Credit Act were first published in 2017. A set of questions pursuant to the Insurance and Reinsurance Intermediation Act will be published in 2019.

The transition period for consumer credit distributors, during which such entities had to pass professional examinations, ended on 30 November 2018 (24 months after the entry into effect of the Consumer Credit Act). From the date of effect of the law until the end of 2018, accredited entities examined more than 66,000 consumer credit distributors with an average pass rate of over 69%.

A new Payment System Act entered into effect in January 2018. It introduced numerous new duties for existing holders of authorisation to provide payment services and enabled the establishment of new types of entities. This led to growth in the CNB's authorisation activities.

Two new banks entered the Czech market in 2018. In October 2018, the CNB granted a banking licence to China-based Bank of Communications. At the end of the year, it also decided to grant a banking licence to the credit union Moravský peněžní ústav.

Securities of 20 issuers were newly admitted to trading on a regulated market during 2018. By contrast, securities of 10 issuers were excluded from trading. Six of them were shares excluded at the decision of the issuer and four were bonds excluded because of due or early repayment.

In the market infrastructure area, the first licence to operate an organised trading system and the first licence to operate as a benchmark administrator were granted in 2018 – to 42 Financial Services, a.s. and Czech Financial Benchmark Facility, s.r.o. respectively. The latter took over the administration of the PRIBOR interbank rate. The same as a year earlier, there were three multilateral trading facility operators and two operators of settlement systems with settlement finality on the financial market. The number of regulated market operators decreased to two (Burza cenných papírů Praha, a.s. and RM-Systém, česká burza cenných papírů, a.s.) after POWER EXCHANGE CENTRAL EUROPE, a.s., ended its activities as a regulated market operator. There is still one central depository (Centrální depozitář cenných papírů a.s.), which in 2018 received an authorisation from the CNB under the Central Securities Depository Regulation (CSDR) as a condition for continuing its activities.

In addition to the entities listed in the table, the CNB supervises tens of thousands of other entities, mostly intermediaries of financial products such as insurance, consumer credit and investment services. The CNB publishes lists of regulated and registered supervised entities in the *Supervision, regulation > Lists and registers* section of its website. At the end of 2018, the CNB was supervising 162,790 insurance intermediaries, 215 investment intermediaries, 17,901 tied agents under the Capital Market Undertakings Act, 283 consumer credit intermediaries, 15,087 tied agents under the Consumer Credit Act and many other types of financial entities.

## Financial market supervision

In its supervisory work, the CNB continuously monitored the activity and financial performance of individual financial market entities and assessed the evolution of the market as a whole and its segments. Financial market supervision in the areas of prudence, conduct of business, consumer protection and AML/CFT took the form of both off-site surveillance and on-site inspections. Conducting comprehensive assessments of the risk profiles of supervised entities is also an integral part of CNB supervision.

The CNB's supervision of credit institutions was concentrated on the credit portfolio quality, capital adequacy, liquidity and overall performance of banks and their consolidated groups. The CNB also regularly assessed the quality of resolution plans. Supervisors paid increasing attention to retail loans. The aim in this area was, on the one hand, to send a signal to credit institutions about the importance of maintaining high credit standards and, on the other, to detect risks on the retail market, monitor developments and check the actual situation on an ongoing basis during on-site inspections in banks. Supervisors also addressed the issue of information systems and information technology, especially as regards cyber risks and outsourcing risks. In the conduct of business area, the CNB examined compliance with rules of conduct relating to the provision of payment and investment services, communication with clients and procedures for entering into and terminating contractual relationships.

Stress testing of banks, which is performed annually, is an integral part of macroprudential supervision. The aggregated results of these stress tests confirmed the good resilience of domestic banks. Their capital adequacy ratio stayed above the regulatory minimum by a sufficient margin even in an adverse scenario.

Prudential supervision of insurance companies is based mainly on regularly assessing the financial condition and solvency situation of the supervised insurance companies, assessing compliance with control system requirements and overseeing compliance with the requirements for regulatory reporting and information disclosure. In life insurance, supervisors continued to verify the compliance of insurance companies' approaches to setting technical provisions with the Solvency II requirements and the overall quality of asset and liability management. In non-life insurance, the CNB paid the greatest attention to systems for managing premium sufficiency in vehicle liability insurance. The CNB has also long put great emphasis on approving internal models for determining capital requirements under the Solvency II regulatory regime and on subsequent supervision of those models.

As regards professional care in insurance companies, the CNB focused on checking external distribution network quality control and procedures for terminating insurance policies with clients, for handling complaints and for claims and loss adjustment. Supervision also covers consumer protection, in particular when offering and promoting insurance products. Supervisors also monitored the preparedness of insurance companies for the new regulatory requirements laid down in the regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs).

The CNB conducted its own stress tests in 2017, which covered most domestic insurance companies. The aggregated results proved that the sector as a whole is sufficiently capitalised and able to absorb major changes in risk factors.



Pension management companies (PMCs) and the transformed and participation funds managed by them represent another major sector. The CNB assessed their compliance with regulatory requirements, especially fulfilment of the capital adequacy requirements by PMCs, and evaluated their capital positions and capital management. Supervisors also monitored compliance with the rules for the management of transformed and participation funds' assets and follow-up control mechanisms.

The provision of consumer credit was affected in the first half of 2018 by the transition period for assessing applications for non-bank consumer credit provider licences and the CNB decided which entities could continue to operate on this market. The CNB also conducted on-site inspections in accredited entities and found shortcomings in the evaluation of examination questions, the organisation of professional examinations and compliance with information duties imposed on accredited entities by the Consumer Credit Act. Based on the shortcomings identified, the central bank imposed penalties and some accredited entities left the market. Supervisors paid increased attention to 47 complaints from consumers about unauthorised consumer credit provision. In this connection, the CNB published public notices on its website regarding internet offers of consumer credit made by untrustworthy entities. The CNB investigated 299 complaints from the public regarding the provision of consumer credit.

The CNB's off-site surveillance in the capital market area focused mainly on the requirements laid down in an amendment to the Capital Market Undertakings Act, including sector-wide surveys focusing on compliance with new duties. The CNB's on-site inspections dealt, among other things, with the offering of debt instruments and related compliance with professional care by the supervised entities. The CNB investigated 98 capital market-related complaints from the public, most of which concerned foreign investment firms.

The CNB's off-site surveillance dealt primarily with verifying whether individual providers were compliant with the authorisation conditions and the conditions for carrying on business laid down in the new Payment System Act effective since January 2018. The CNB received 66 complaints from the public about the activities of non-bank payment service providers in 2018.

CNB supervision of bureaux de change was focused primarily on compliance with the duties to clients and with anti-money-laundering and anti-terrorist financing measures. On-site inspections mainly examined bureaux de change operating in Prague and other tourist areas. The CNB received 338 complaints from the public about the activities of bureaux de change.

Following the introduction of an amendment to the Capital Market Undertakings Act and new legislation on insurance distribution, on-site inspections in the area of distribution of financial products focused more on compliance with the new requirements. The CNB also opened on-site inspections in consumer credit intermediaries to an increased extent in 2018. In the area of off-site surveillance, it conducted a questionnaire survey to obtain information about the products of supervised distributors and about compliance with the AML/CFT duties. The CNB dealt with a total of 301 complaints from the public about the activities of financial product distributors. Members of the public most often pointed to the conclusion of disadvantageous insurance, insufficient compliance with disclosure duties and the carrying on of business without relevant authorisation.

## Enforcement

As regards the enforcement area in 2018, CNB mainly investigated petitions for the opening of administrative proceedings. It made decisions on the opening of administrative proceedings or the deferral of cases, and conducted first-instance administrative proceedings, within which it imposed fines and remedial measures, revoked licences and cancelled registrations. In addition to conducting administrative proceedings with supervised entities, the CNB conducted administrative proceedings with entities that provide financial services without having the relevant licence in financial market sectors where the law enables penalties to be imposed for the carrying on of unauthorised business. Final decisions in the CNB supervision area for which publication is prescribed by law are published on the CNB website (*Supervision, regulation > Conduct of supervision > Final administrative decisions*). Sanctions imposed on insurance intermediaries are entered in the Register of Insurance Intermediaries.

### Statistics on administrative penalty proceedings

Area of imposition of penalty	No. of proceedings continuing from 2017	No. of proceedings opened in 2018	No. of proceedings closed in 2018	Total fines imposed (in CZK thousands)
Supervision of credit institutions	0	10	4	3,000
Supervision of insurance companies	6	33	34	2,250
Capital market supervision	18	32	31	10,195
Violation of the Act on Bureau-de-change Activity	9	21	25	2,400
Consumer protection	2	0	1	2,800
Payment system	2	69	50	1,800
Circulation of banknotes and coins	2	10	9	1,295
Act on the CNB	0	1	1	500
Consumer credit	2	21	17	4,475
Anti-money laundering/ counter-terrorist financing measures	0	3	3	550
Financial market supervision, total	41	200	175	29,265

## RESOLUTION PROCEDURES

In 2018, the CNB's activities in the resolution of banks, credit unions and some investment firms were based again on two principles: that resolution-related costs should be borne not by the state but by private individuals (primarily the institution's shareholders and creditors), and that resolution should only be applied in the public interest. Banks are unique in that they provide certain critical functions that are crucial to the national economy (accepting deposits, providing loans and so on) and to the stability of the financial system. Uninterrupted provision of these critical functions can therefore be in the public interest.

In 2018, the CNB worked in the area of resolution with banks themselves, for which it plans resolution procedures, and with foreign institutions such as the Single Resolution Board (SRB) and the European Banking Authority (EBA). The CNB also continued to work in partnership with the Ministry of Finance and the Financial Market Guarantee System on further elaborating resolution procedures and instruments (such as a bridging institution), which will be refined and finalised in the future.

The CNB published a general approach to setting the minimum requirement for own funds and eligible liabilities (MREL) in 2018. By publishing this policy, the CNB has transparently informed banks and investors which general principles it will apply and how it will proceed in individual administrative proceedings to stipulate the MREL for banks. In the event of resolution, the CNB will be able to write down the MREL or convert it to cover losses and to renew capital so that the bank concerned remains viable and continues to provide critical functions.

Right at the end of the year, an amendment to the Insolvency Act was published which introduces a new type of liabilities ("senior non-preferred liabilities") into Czech law. The CNB expects banks to be able to use such liabilities to comply with the MREL. If the CNB were to use its powers in relation to these liabilities in the event of resolution, it would apply the principle of no creditor ending up worse off than under the procedure set out in the Insolvency Act.

Cooperation between the CNB and the SRB was focused on further refining planning documents. The SRB has prescribed an MREL on a consolidated level for some cross-border banks with a centralised resolution strategy whose subsidiaries carry on business in the Czech Republic. In the period ahead, the resolution authorities will focus on the division of this requirement among individual subsidiaries.

## CURRENCY AND PAYMENTS

### Currency in circulation

Under the Act on the CNB, the central bank has the exclusive right to put banknotes and coins (including commemorative banknotes and coins) into circulation and to manage the circulation of currency.

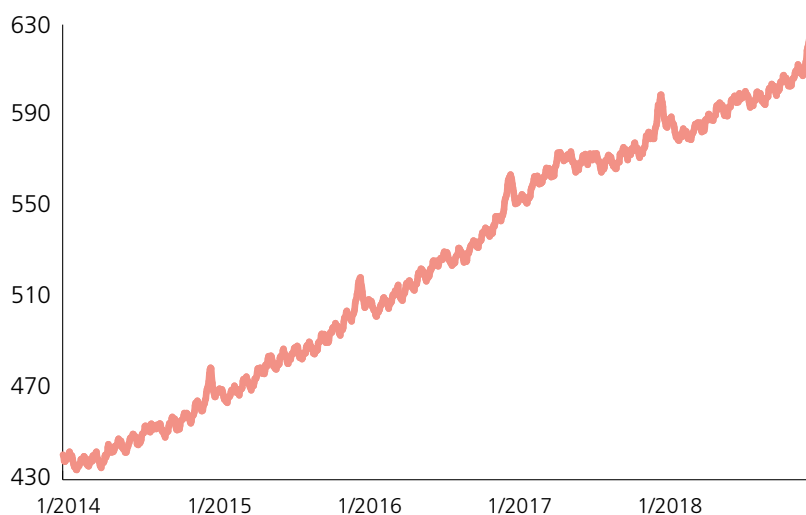
The value of currency in circulation rose by CZK 24.8 billion in 2018 and broke through CZK 600 billion in July. As of 31 December 2018, it amounted to CZK 618.6 billion. Currency in circulation increased by 4.2% in 2018 compared to 31 December 2017. Following a gradual increase in previous years, the ratio of currency in circulation to GDP is currently fluctuating between 11.5% and 12%. In 2018, the figure was 11.6%.

CZK 2,000 banknotes accounted for almost 42% of the value of currency in circulation. CZK 5,000, CZK 2,000 and CZK 1,000 banknotes together accounted for more than 90% of the value of currency in circulation.

The numbers of banknotes and coins in circulation rose by 13.7 million and 107.5 million respectively in 2018. In all, 95.2 million banknotes, 126.2 million circulating coins (including those for annual sets), 79,600 commemorative silver coins and 32,300 gold coins were produced. These banknotes and coins (including gold and silver commemorative coins) cost the CNB a total of CZK 503.9 million to produce.

The CNB destroyed 72.7 million banknotes evaluated as unfit for recirculation due to wear or damage. Only 3.5 million coins accepted from circulation were rejected as unfit for further circulation. The significantly lower number of unfit coins than unfit banknotes is due mainly to the material used, which makes coins more resistant to wear and tear.

**Currency in circulation – 1 January 2014 to 31 December 2018**  
(in CZK billions)





## Structure of banknotes and coins in circulation as of 31 December 2018

Denomination	CZK millions	Percentage of total	Millions of pieces	Percentage of total
CZK 5,000	158,833.3	25.7%	31.8	6.7%
CZK 2,000	258,480.8	41.8%	129.2	27.3%
CZK 1,000	141,176.1	22.8%	141.2	29.8%
CZK 500	22,073.8	3.6%	44.1	9.3%
CZK 200	12,917.3	2.1%	64.6	13.6%
CZK 100	6,329.6	1.0%	63.3	13.3%
<b>Banknotes, total</b>	<b>599,811.0</b>	<b>97.0%</b>	<b>474.2</b>	<b>100.0%</b>
CZK 50	6,866.6	1.1%	137.3	7.0%
CZK 20	4,215.1	0.7%	210.8	10.7%
CZK 10	2,377.7	0.4%	237.8	12.1%
CZK 5	1,399.7	0.2%	279.9	14.2%
CZK 2	997.7	0.2%	498.9	25.4%
CZK 1	301.1	0.1%	601.2	30.6%
<b>Coins, total</b>	<b>16,458.0</b>	<b>2.6%</b>	<b>1,965.9</b>	<b>100.0%</b>
Precious metal coins	2,360.5	0.4%	2.7	100.0%
<b>TOTAL</b>	<b>618,629.5</b>	<b>100.0%</b>	<b>2,442.8</b>	

Cash turnover at the CNB's cash offices amounted to CZK 1,366.3 billion in 2018, down by CZK 25.9 billion (1.9% in relative terms) from a year earlier. The CNB's cash offices received 684.4 million banknotes and 388.4 million coins from circulation and issued 698.1 million banknotes and 495.6 million coins.

The CNB put new versions of the CZK 100 and CZK 200 banknotes into circulation in September 2018. Although the general appearance of these banknotes was unchanged at first glance, the new notes have enhanced protection against counterfeiting and are easier to process by machine.

The CNB put new precious metal coins into circulation in 2018: three CZK 200 commemorative silver coins, one CZK 500 commemorative silver coin, two CZK 5,000 commemorative gold coins and one CZK 10,000 commemorative gold coin to mark the 100th anniversary of the founding of the republic. It also issued a limited run of CZK 20 coins bearing portraits of three personalities of the Czechoslovak state – Tomáš Garrigue Masaryk, Milan Rastislav Štefánik and Edvard Beneš.



In 2018, the CNB continued to work to protect Czech banknotes and coins against counterfeiting and alteration and succeeded in doing so as regards the occurrence of counterfeits. The downward trend in the number of counterfeits observed since 2015 continued. A total of 1,011 counterfeit and altered Czech banknotes and coins were seized in 2018, a decrease of 307 compared to 2017. Of this number, 984 were counterfeit banknotes, eight were counterfeit coins and 19 were altered banknotes and coins. The CZK 1,000 note was the most counterfeited denomination (647 counterfeits). The total value of the counterfeit and altered banknotes and coins seized was CZK 1.2 million (as against CZK 1.4 million in 2017). As in previous years, most of the counterfeit Czech banknotes seized in 2018 were ink-jet printed (895 counterfeits, or 90.96%) and were rated as poor quality imitations.

### Supervision of compliance with the Act on the Circulation of Banknotes and Coins

Cash circulation, together with the related rights and duties of the CNB, banks, legal entities and natural persons, is regulated by the Act on the Circulation of Banknotes and Coins. In 2018, the CNB opened a total of 12 inspections focusing on compliance with duties under this act:

- three inspections of banks, during which the CNB conducted on-site inspections in 44 branches and 18 cash-handling centres and tested 183 banknote processing machines and 36 deposit ATMs. It also conducted 159 mystery shopping inspections in banks focusing on the exchange of damaged banknotes,
- one inspection of a handler of domestic banknotes and coins, consisting of on-site inspections in eight cash-handling centres, where 30 pieces of banknote processing equipment were tested,
- one inspection of a non-bank operator of non-anonymous devices (deposit ATMs), during which the CNB tested 12 deposit ATMs in 12 branches,
- five inspections of operators of anonymous devices, of which four inspections of retail chains (33 self-service cash registers tested in nine shops) and one inspection of an operator of exchange machines (six exchange machines tested in six shops),
- two inspections of persons authorised by the CNB to organise special courses, during which two special courses and two lecturers were inspected.

Two inspections commenced in 2017 and 11 inspections commenced in 2018 had been completed as of 31 December 2018.

## Non-cash payments

In the area of non-cash payments, the CNB keeps the accounts of the state and operates systems for transferring interbank payments and settling short-term securities transactions. These transactions are executed through CERTIS (Czech Express Real-Time Interbank Gross Settlement System), the Short-Term Bond System (SKD) and the Automated Banking Operations (ABO) System.

The CERTIS system is used to maintain accounts of banks, the SKD system records bonds issued by the CNB and the Ministry of Finance and owned by banks, investment firms and other entities, and the ABO system maintains accounts of state organisational units and other state organisations and legal entities connected to the state budget.

### CERTIS – interbank payment system

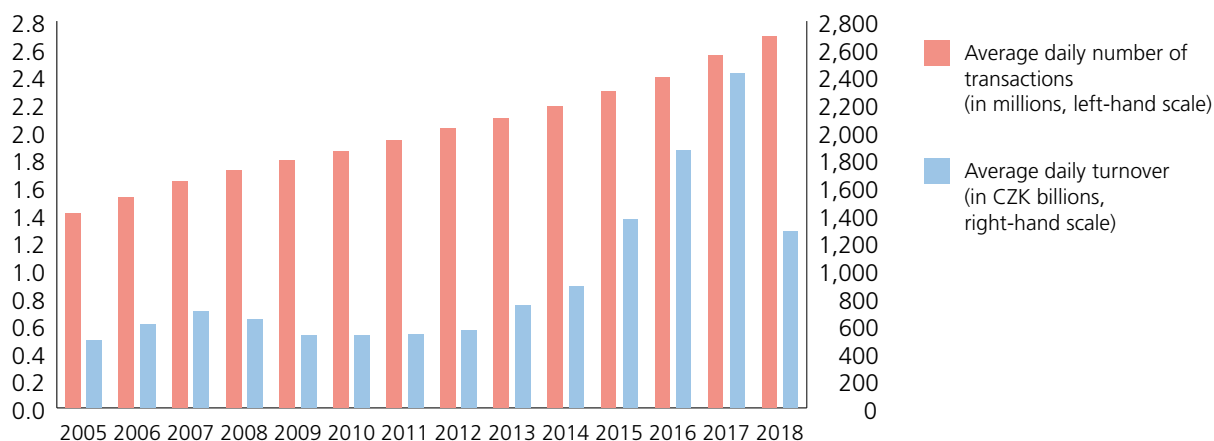
The CNB uses the CERTIS system to process interbank payments in the Czech Republic. Banks, credit unions and foreign bank branches are participants in this system. As of 1 December 2018, CERTIS had 47 direct participants with their own accounts and six third parties (for example, card payment clearing houses and securities clearing and settlement institutions).

CERTIS processed 672.8 million transactions in 2018 (up by 5.4% year on year) with a total value of CZK 319,028 billion (down by 47.3%). The decline in turnover is due to a change in the structure of monetary policy operations with banks after banks switched from overnight deposits with the CNB to deposits under two-week repo operations in response to interest rate increases. The fall in turnover is thus linked to the normalisation of monetary policy after the exit from the exchange rate commitment. Almost 2.7 million transactions were processed on average daily, with daily turnovers averaging CZK 1,276 billion.

To further develop the interbank payment system, the CNB introduced the option of making instant payments at the end of the year. The instant payment system can be used by any payment service provider that is a CERTIS participant.

The following chart shows the average daily number of transactions executed and the amount of funds transferred in CERTIS since 2005.

**CERTIS – average daily number of transactions and average daily turnover**  
(in millions of transactions and CZK billions)



## SKD – short-term securities settlement system

The CNB also operates the SKD system, which is a separate register of securities and a securities settlement system.

As of 31 December 2018, a total of 89 asset accounts – belonging to 56 clients (securities owners) and 11 custodians (securities managers) – were registered in SKD. The system records bonds issued by the CNB and government bonds with maturities of up to one year issued by the Ministry of Finance.

The securities recorded in SKD are used, among other things, as collateral for the intraday credit that the CNB extends to banks for smooth accounting purposes within CERTIS. The CNB also uses it for repo operations and the Ministry of Finance for daily liquidity management of the Single Treasury Account. On average, 115 transactions a day were processed in SKD in 2018. The average daily turnover was CZK 710 billion.

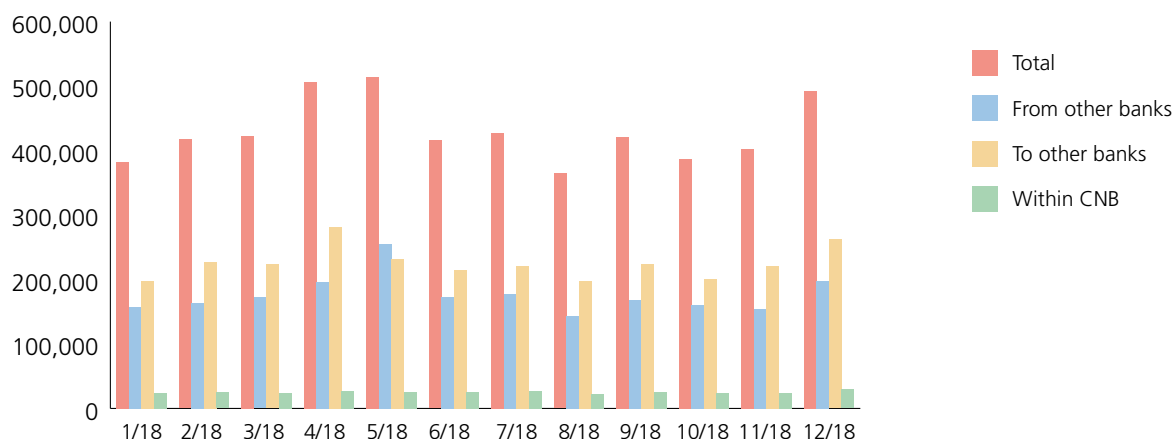
## ABO – the CNB's accounting and payment system

The CNB keeps its internal accounts and the accounts of its clients in the ABO system. At the end of 2018, it maintained 22,751 accounts, of which 3,246 were internal accounts, 3,329 CNB employee accounts and 16,176 accounts of legal entities. The vast majority of the accounts of legal entities – 15,575 – are Treasury accounts in the Czech currency and 229 Treasury accounts in the euro. In order to execute state budget payments, the ABO system is closely linked to the Integrated Treasury Information System operated by the Ministry of Finance. Detailed information about the set of clients and the involvement of the CNB in the Treasury accounts system is available in the section *The CNB as the bank of the state*.

Most clients use the CNB's internet banking to manage their accounts. In all, 15,831 users were registered in the system as of the end of 2018.

The following chart shows the average daily numbers of accounting transactions processed in each month of 2018. The ABO system processes more than 900,000 transactions a day on peak days. The total number of transactions increased by 4.8% and the number of client orders by 3.1% compared with 2017.

### ABO – average daily number of transactions





## Promotion of smooth and efficient payments and clearing

Another of the CNB's objectives under the Act on the CNB is to promote smooth and efficient payments and clearing and to contribute to the safety, soundness and efficiency of payment and settlement systems and to the development thereof (oversight). In 2018, the CNB performed an assessment of the important short-term bond registration and settlement system SKD. The assessment was based on the Principles for Financial Market Infrastructure published by the BIS Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) in 2012. The final assessment report provides information on the condition of the SKD system, mentioning, among other things, that the system is compliant with most of the Principles. It also states what risks are associated with securities settlement and what measures the CNB as the SKD operator has taken to prevent them.

## STATISTICS

The CNB compiles and publishes statistics for the needs of monetary policy, financial market supervision and financial stability, and also for the needs of the European Central Bank (ECB), Eurostat, the Czech Statistical Office and the public. These statistics are available in the *Statistics* section of the CNB website.

On 1 January 2018, in accordance with the Act on the Central Register of Accounts, the CNB launched an electronic system which registers the accounts maintained for clients by banks, foreign banks operating in the Czech Republic and credit unions (see the CNB website: *Statistics > Central Register of Accounts* – in Czech only). A total of 378,175 applications from eligible entities for information from this register were dealt with in 2018.

In 2018, the CNB continued to prepare a new central information system for data collection (SDAT) through which supervisory and statistical reporting data will be submitted to the CNB starting in 2020. In mid-2018, the CNB published the basic technical specification for the system and commenced broader support for the preparation of reporting agents' transition to the new system. The system's testing environment was launched at the end of the year.

In the area of macroeconomic statistics, the CNB started preparing to meet the ECB's new requirements relating to external statistics in 2018. The main changes consist in a more detailed sectoral and geographical breakdown and further support for the links between the balance of payments statistics (available on the CNB website: *Statistics > Balance of payments statistics*) and the national sectoral accounts. Government finance statistics reporting (see the CNB website: *Statistics > Government finance statistics*) to the ECB was also changed in 2018. The main aim of the change was greater harmonisation of data sources in all EU Member States. This will allow for closer data analyses and facilitate comparison of the annual and quarterly statistical data with the forecasts for the same variables, including a detailed view of government debt consolidation. The CNB's macroeconomic statistics are increasingly based on the available micro-databases. This enables it to respond flexibly to analytical needs and extends its options for monitoring the quality of macroeconomic statistics. In 2018, the CNB completed the

harmonisation of the financial accounts statistics (available on the CNB website: *Statistics > Financial accounts statistics*) with the annual national accounts statistics in the balance sheet area. There was significant progress in harmonising the financial accounts and the international investment position using joint procedures and EU-wide databases, especially in the area of debt securities and equities.

As regards monetary and financial statistics (see the CNB website: *Statistics > Monetary and financial statistics*), the CNB made methodological information for the preparation of new harmonised pension fund statistics available to reporting agents. At the request of the ECB, the CNB expanded its data reporting to include investment fund statistics for entities investing in transferable securities. The publication of statistics on banks' interest rates was expanded to include new indicators relating to euro-denominated loans and deposits. The CNB also newly published selected balance of payments statistics, in particular information about payment cards, numbers of accounts, terminals and sent payments. In 2018, the CNB continued to work with the ECB on a revision to the payment statistics regulation by getting involved in the assessment of the costs of the proposed collection items. As regards microdata statistics, the CNB continued to work with the Czech Banking Association on the preparation of the AnaCredit project. Contrary to the original assumptions, the CNB moved the data collection commencement date from September 2018 to June 2019. The shift was forced by changes to the conditions for the involvement of non-euro area countries in the ECB's project and also by the difficulty of developing IT systems on the part of the CNB and the reporting agents. As for the Central Credit Register, the CNB completed the modernisation of the system by developing new output formats for bank users in 2018.

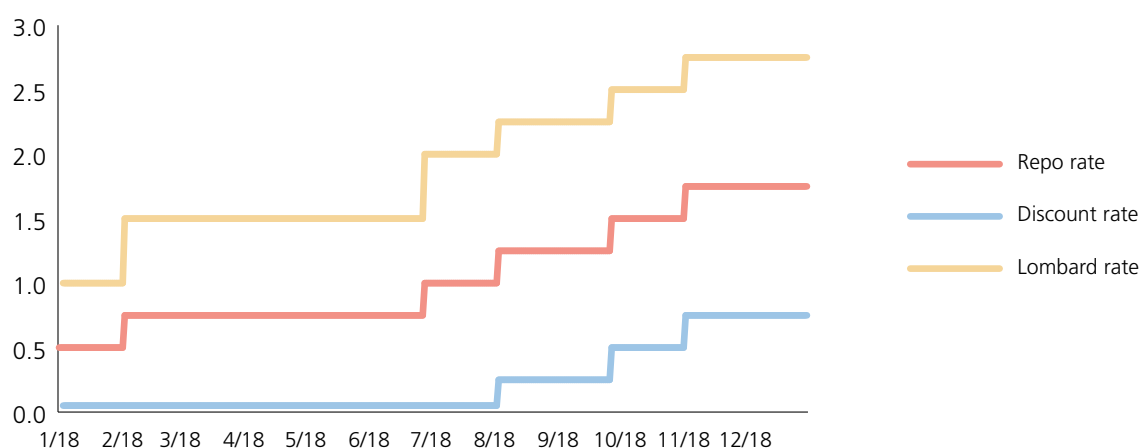
There were continued major changes in methodology and the scope of reporting in the area of supervisory statistics (see the CNB website: *Statistics > Supervisory statistics*). Besides changes to the methodology relating to credit institutions due to European requirements, the key projects included continued implementation of the new form of reporting in the capital market area and the data quality assessment. The CNB continued to raise data quality by developing analytical tools and creating new validation rules in the area of insurance companies and pension management companies. The CNB was also actively involved, through its representatives, in the work of the European Supervisory Authorities in individual working groups, especially in preparing methodologies and forms of reporting and in enhancing data quality.

The CNB introduced changes to the information system for registration and licensing activities in accordance with the new Act Insurance and Reinsurance Distribution. Following these legislative changes, the CNB added new lists of regulated and registered entities to its website (*Supervision, regulation > Lists and registers*).

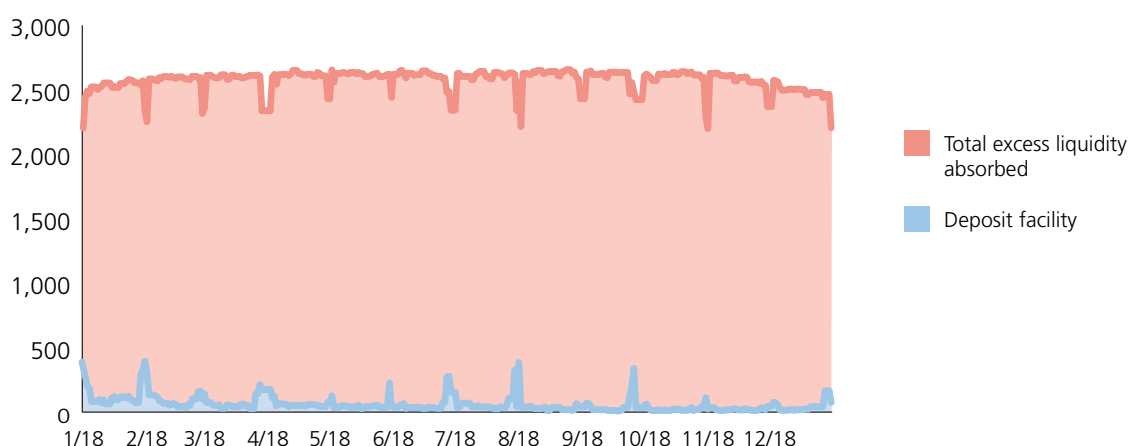
## FINANCIAL MARKET OPERATIONS

In 2018, the CNB's main monetary policy instruments included interest rate operations (repo operations and automatic facilities). The Bank Board sets three interest rates: the repo rate, the discount rate and the Lombard rate. The main monetary policy rate is the two-week (2W) repo rate. The discount and Lombard rates provide the floor and ceiling respectively for short-term interest rates on the money market. The CNB increased the repo rate and the Lombard rate five times in 2018, in February, June, August, September and November. At the end of 2018, the repo rate stood at 1.75% and the Lombard rate at 2.75%. The CNB raised the discount rate three times: in August, September and November. The discount rate stood at 0.75% at the end of 2018. With these rate adjustments, the CNB returned the gap between the discount rate and the repo rate to the standard level of 100 basis points. The CNB also sets the reserve requirement, which, however, is not one of the main monetary policy instruments in the inflation-targeting regime and was not changed in 2018.

**The CNB's interest rates**  
(in %)



**Excess liquidity**  
(in CZK billions)



In addition to two-week repo operations, the CNB uses two automatic facilities – the marginal lending facility and the deposit facility – to implement monetary policy. Under the lending facility, the CNB lends funds to banks overnight in the form of a repo operation at the Lombard rate. The deposit facility gives banks the option of depositing surplus liquidity that they cannot place on the interbank market with the CNB overnight at the discount rate.

The total average amount of excess liquidity absorbed was CZK 2,574 billion. Of this, the CNB absorbed 2.4% on average through the deposit facility and 97.6% through repo operations. Banks made use of liquidity-providing repo operations and the lending facility only in exceptional cases.

In collateral exchanges with banks, the CNB usually exchanged securities settled in the Central Securities Depository for securities settled in the Short-term Bond System (SKD). These operations were used not to affect the banking sector's excess liquidity, but to provide liquid securities to banks, for instance for obtaining intraday credit.

The CNB's toolkit still contains extraordinary two-week liquidity-providing repo operations and foreign exchange swaps. The CNB launched them in October 2008 as a result of the outbreak of the financial crisis and their existence is important for the stability of the domestic financial market. Although banks did not use these instruments actively in 2018, the CNB considers it appropriate to keep them available.

In the managed float exchange rate regime, the central bank reserves the option of intervening in the foreign exchange market if necessary. However, the CNB did not intervene in the foreign exchange market in 2018. Information about the CNB's foreign exchange trading is available on its website (*Financial markets > Foreign exchange market information > CNB Foreign Exchange Trading*).

## International reserves management

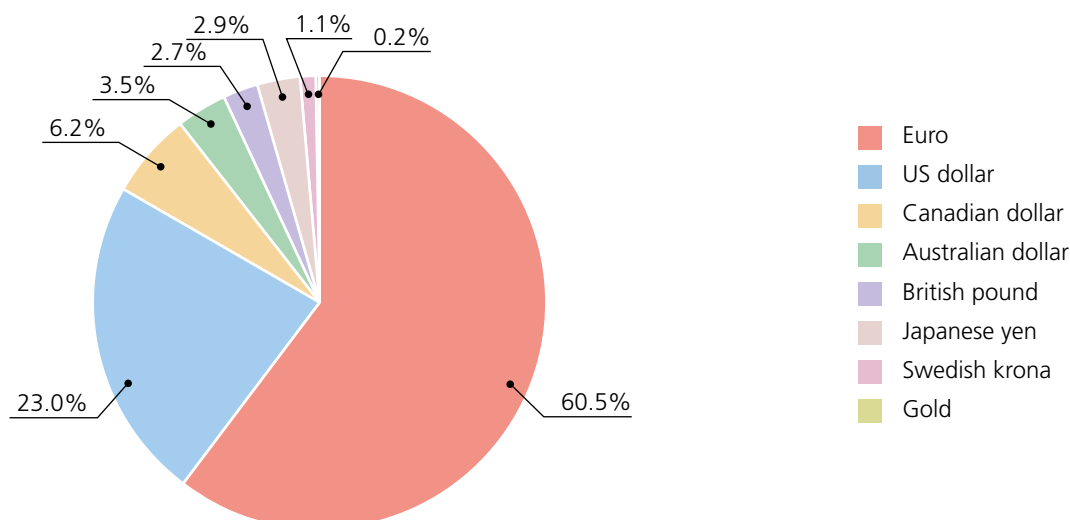
The CNB manages its international reserves, which are made up of foreign assets in selected convertible currencies. These assets are used mainly to support the CNB's independent monetary policy-making and as a source of foreign exchange liquidity for CNB clients. At the end of 2018, the reserves totalled CZK 3,202 billion, equivalent to EUR 124.5 billion or USD 142.5 billion. International reserves form the bulk of the CNB's assets – they accounted for more than 98% of the CNB's total assets at the end of 2018. The size and structure of the reserves are published regularly in the Financial markets section of the CNB website.

The market value of the international reserves recorded a year-on-year rise of CZK 73.2 billion in koruna terms. It was due mainly to exchange rate gains with a positive effect overall (+CZK 43.9 billion). The koruna depreciated against the two most strongly represented reserve currencies (the euro and the dollar) and the yen, while appreciating against the other reserve currencies (the Canadian dollar, the Australian dollar, the British pound and the Swedish krona). Other sources of growth included purchases of foreign currency from clients and foreign currency deposits (+CZK 43.3 billion). On the other hand, negative returns on portfolios fostered a decrease in the reserves (CZK -14.0 billion).

The shift of part of the euro assets into dollars continued in 2018. This process was started in 2017 in order to preserve the diversification role of the US dollar in the CNB's reserve portfolio after the percentage share of the euro in the currency structure of reserves had increased significantly due to foreign exchange interventions in euros. Sales of euros made in 2018 reduced the share of the euro in the international reserves by 5 percentage points to around 61%. The share of the US dollar in the international reserves conversely rose from 18% to 23%.



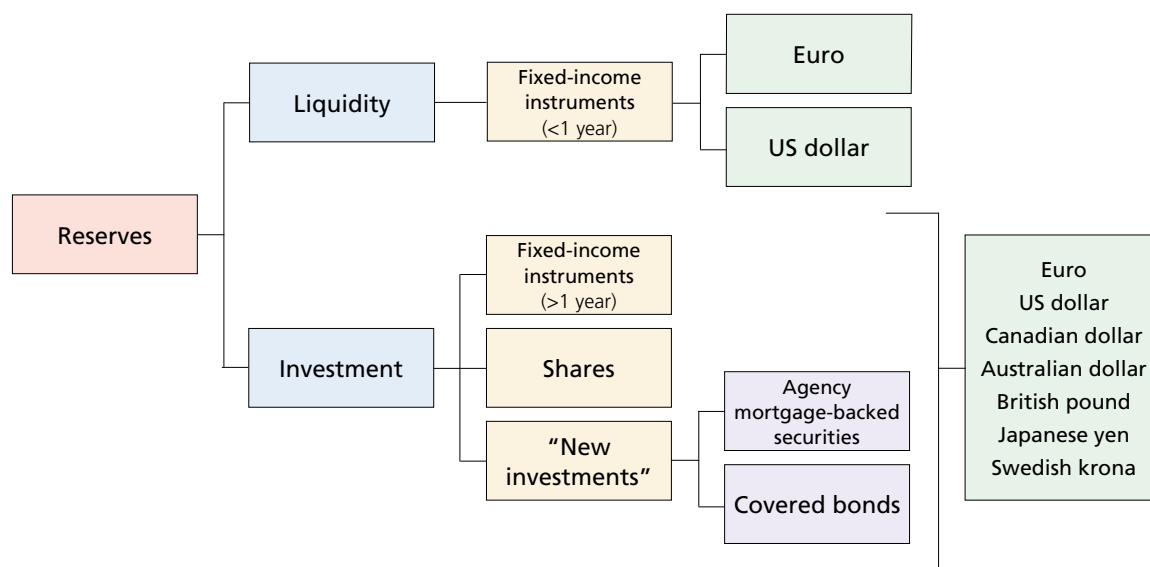
## Currency structure of the actively managed portfolio (net of liabilities) as of 31 December 2018



The CNB actively invests most of its international reserves in accordance with its reserves management principles. The principles take into account the function performed by the international reserves and pay due regard to security, liquidity and returns. The largest part of the reserve portfolio is invested in debt securities issued by governments of economically advanced countries, selected government-guaranteed bonds or bonds issued by top-rated multilateral institutions. Other instruments used for international reserves management include shares, repos, specific covered bonds, deposits with central banks, futures, and interest rate, currency and equity swaps. All creditor positions vis-à-vis private counterparties are backed by financial collateral.

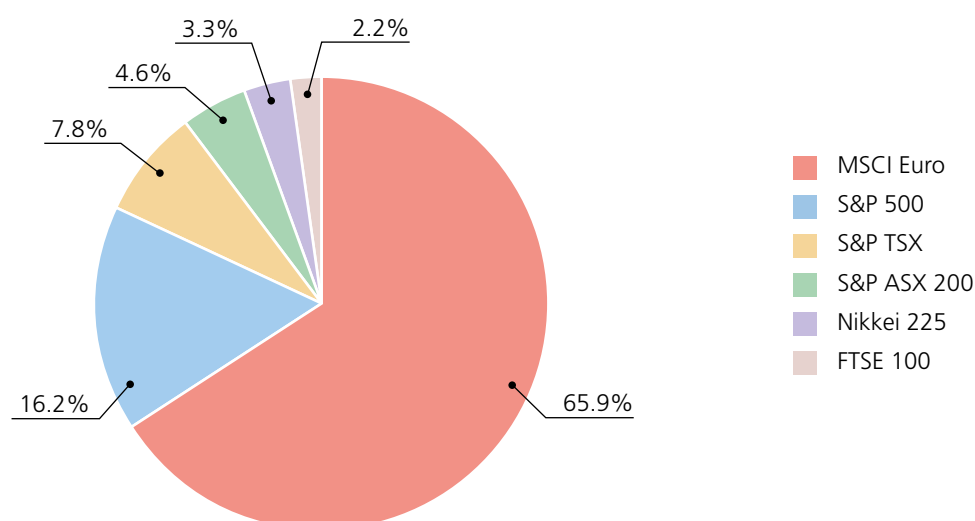
In response to the increase in the reserves in 2013–2017, the reserve portfolio was divided into two parts (tranches) which differ in investment horizon, risk parameters and expected returns. The ratio between the tranches is determined by the International Monetary Fund (IMF) methodology used for assessing international reserve adequacy. The liquidity tranche, which accounted for 48% of the reserves at the end of 2018, contains fixed-income investment instruments with a residual maturity of up to one year in euros and US dollars, which, if necessary, can easily be converted into money without any major risk of capital losses. The remaining 52% of the reserves made up the investment tranche. It contains financial instruments which bear higher risk (such as bonds with longer maturities and shares) but at the same time make it possible to generate higher returns in the longer run. In 2018, the CNB extended the range of investment instruments held in the investment tranche to include covered bonds of German banks and continued its preparations to include specific mortgage-backed securities guaranteed by selected US agencies.

## Internal division of the international reserves into the liquidity and investment tranches



Most of the international reserves are managed in internal portfolios made up of fixed-interest money and capital market instruments. The equity portfolios managed by BlackRock and State Street Global Advisors account for around 10% of the reserves and are invested on the following markets using the relevant benchmark indices: European (MSCI Euro), US (S&P 500), UK (FTSE 100), Japanese (Nikkei 225), Canadian (S&P TSX) and Australian (S&P ASX 200). Both companies that manage the CNB's equity portfolios follow the Global Investment Performance Standards.

## Structure of the equity portfolio as of 31 December 2018



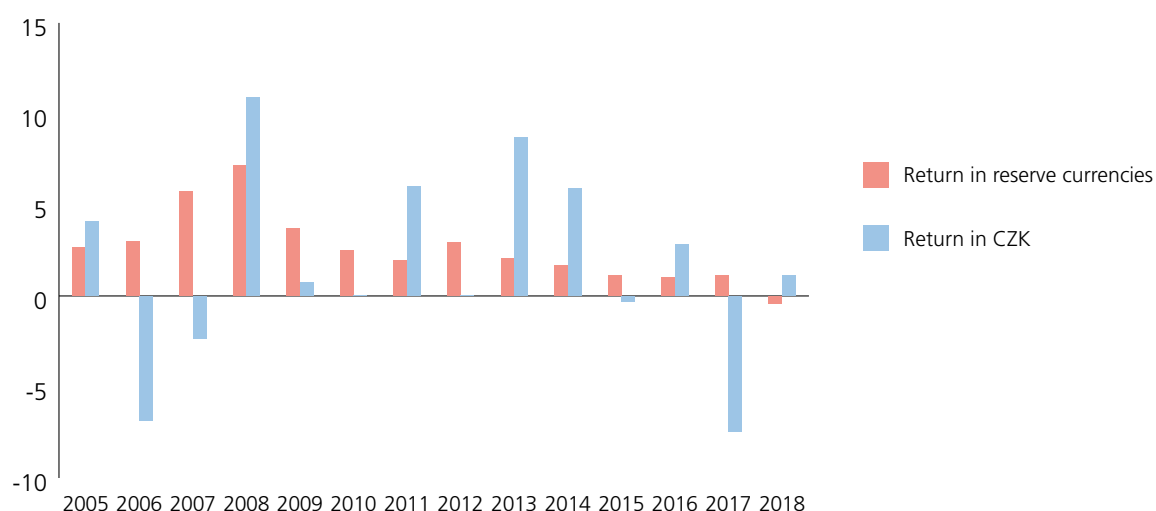
The liquidity and investment tranches recorded losses of 0.13% and 0.70% respectively in 2018 (in both cases, this is the weighted average of the rates of return on the individual portfolios measured in their own currencies). The liquidity tranche loss was in line with short-term interest rates and reflected the still very negative interest rates in the euro area and the gradually rising interest rates in the United States. The negative returns on the investment tranche were most of all due to equity portfolio losses resulting from temporary declines in stock indices in the fourth quarter of 2018. However, since its investment horizon is set at 3–5 years, the annual returns on this tranche provide very limited information about whether the investment parameters are configured correctly. The returns and losses on the portfolios of the two tranches (as measured in the portfolio currency) are given in the following table.

#### Returns and losses on the portfolios of the liquidity and investment tranches (in portfolio currencies)

Tranche	Euro	US dollar	Australian dollar	Canadian dollar	Swedish krona	Total
Liquidity	-0.47%	+1.66%	---	---	---	-0.13%
Investment	-2.77%	+0.06%	+3.56%	+1.17%	-0.03%	-0.70%

The total yield on the international reserves (the weighted average of the returns on the portfolios measured in their own currencies) was -0.43%. However, the depreciation of the koruna against the two main reserve currencies resulted in a positive koruna return of 1.10%, since a weakening of the koruna means revaluation of foreign currency items to a higher value (for example, one euro had an accounting value of CZK 25.540 at the end of 2017 and CZK 25.725 at the end of 2018).

#### Comparison of the total return on international reserves in 2018 with previous periods



Gold and the part of the claim on the IMF that has been paid or is maintained in a foreign currency make up a small part of the reserves. This non-koruna financial position vis-à-vis the IMF, as expressed in special drawing rights (SDR), amounted to SDR 878 million at the end of 2018, increasing by almost SDR 112 million during the year due to transactions with the IMF. SDR holdings remained almost unchanged. The zero drawdown of the bilateral loan to the IMF was unchanged as well. Part of the gold held by the CNB was used for coin production in 2018. The CNB thus had 8.8 tonnes of gold at the end of 2018.

## The CNB as the bank of the state

The Czech National Bank provides banking services for the state and the public sector under the Act on the Czech National Bank and the Act on Budgetary Rules, i.e. it maintains accounts and provides payment services and services relating to liquidity management of the Single Treasury Accounts. Other clients for which the CNB maintains accounts include state funds, subsidised organisations established by state organisational units, the Railway Transport Route Administration and health insurance companies. It also maintains accounts for another group of entities (such as regional authorities and public research institutions and universities) for the purposes of receiving subsidies from the state budget.

As of 31 December 2018, the CNB maintained 15,600 accounts for the state and the public sector. A total of 427,000 transactions took place on the Treasury accounts on average per day. Treasury clients now almost exclusively use internet banking.

## Support for Treasury liquidity management

The volume of the deposits on the government sector accounts can fluctuate widely, as it is affected by difficult-to-predict state budget revenues and expenditure (due, for example, to tax collection deadlines). However, the impact of this volatility on liquidity has been minimised by the introduction of the single treasury accounts.

There are two single accounts: koruna-denominated and euro-denominated. The koruna-denominated single treasury account includes, for example, state budget revenue and expenditure accounts, state financial assets and liabilities accounts, revenue and customs offices' accounts, state funds accounts and the National Fund accounts. The euro-denominated single treasury account includes above all the funds of the National Fund, euro debt service funds and foreign funds of state organisational units. The CNB is responsible for the daily consolidation of these accounts on the single accounts.

Virtually all the account balances of government entities are monitored and managed during the day so that current expenditures are covered and free funds are used effectively. The CNB invests any end-of-day surplus on these accounts on the financial market. Conversely, it covers any end-of-day shortfall by borrowing from banks. The CNB conducts these operations on behalf of the Ministry of Finance. The daily balances on the single treasury accounts are maintained at CZK 30 million and EUR 10 million, even though incoming and outgoing payments worth CZK 10–70 billion are settled every day.

The single treasury accounts system increases the amount of liquidity available for financing a state budget deficit and allows for effective planning of government bond issues. This lowers the refinancing risk of the state and generates budgetary savings by reducing debt servicing costs.

## Support for state debt financing

In the area of state debt management, the CNB carries out primary sales of both short-term and long-term government bonds for the Ministry of Finance and acts as administrator of the issues. In 2018, the CNB organised 29 auctions of T-bills, with sales totalling almost CZK 184 billion. The CNB also executed 55 auctions of government bonds totalling CZK 253.4 billion. As administrator, the CNB made coupon payments for government bonds and payments of principal on two maturing issues. It also organised coupon payments and repayments of principal for issues of government saving bonds.

## ECONOMIC AND FINANCIAL RESEARCH

Economic and financial research at the CNB helps create an analytical and knowledge base for monetary and macroprudential policy-making and also for the development of knowledge in the fields of macroeconomics and the financial markets. In the ECB's organisation structure, the Economic Research Division in the Monetary Department is responsible for economic research and the Financial Research Unit in the Financial Stability Department is responsible for financial research.

The CNB's research project outputs are presented primarily in two publication series: the CNB Working Paper Series (19 papers published in 2018) and the CNB Research and Policy Notes (one paper published in 2018). These internationally reviewed research papers cover a wide range of subjects, from empirical analyses of the real economy, through macroeconomic modelling, to financial stability. The CNB also published two issues of the Economic Research Bulletin presenting the research results in a comprehensible manner. The May issue was devoted to risk-sensitive capital regulation, while the November issue featured articles on interest-rate modelling. CNB economists published 15 articles in journals with a non-zero impact factor.

The CNB held its traditional Research Open Day in May. The speakers at the event included Oesterreichische Bank Governor Ewald Nowotny as guest of honour. On this occasion, the CNB Bank Board relaunched the awards for the best CNB research publication. In 2018, the award went to two papers: "An Exchange Rate Floor as an Instrument of Monetary Policy: An Ex-post Assessment of the Czech Experience" by Jan Brůha and Jaromír Tonner of the Monetary Department, and "Banks' Capital Surplus and the Impact of Additional Capital Requirements" by Simona Malovaná of the Financial Stability Department.





A seminar on the relationship between macroprudential policy and monetary policy was held in cooperation with the Czech Economic Society in September. This event was attended by CNB staff and members of the academic community. Two prominent speakers gave presentations. In the first session, Leonardo Gambacorta from the Bank for International Settlements (BIS) showed that macroprudential policy instruments are effective in stabilising the credit cycle and preventing undesirable risks to financial stability. In the second session, Mikael Juselius from the Bank of Finland demonstrated that monetary policy has a long-term impact on real economic output through its effect on the financial cycle, and that elements of financial stability should not be overlooked in the monetary policy debate.

In November, the CNB in partnership with the Czech Economic Society organised a seminar to mark 20 years of inflation targeting. The keynote speech was given by Andrew Filardo from the BIS. He emphasised that monetary policy had contributed to ensuring low and stable inflation in advanced countries in previous decades. The seminar was followed by a panel discussion, in which the panellists agreed that inflation targeting has proven successful but that monetary policy will face numerous challenges in the future.

Details on research publications, seminars and conferences, and other research activities can be found in the *Economic research* section of the CNB website.

## EUROPEAN AND INTERNATIONAL COOPERATION

### European Central Bank, European System of Central Banks and European Systemic Risk Board

The CNB is a member of the European System of Central Banks. This means that the CNB Governor and Deputy Governor attend – usually four times a year – the meetings of the General Council of the European Central Bank (ECB). The General Council is composed of the governors of all the central banks of the EU countries. In 2018, it dealt as usual with macroeconomic, fiscal, monetary and financial developments around the world, in the EU and in the euro area. Other topics discussed at the meetings included an assessment of compliance with the prohibition of monetary financing by member central banks, Brexit, the increasing trade policy tensions worldwide and their impacts, public finances, population ageing in the EU and vulnerabilities in emerging market economies.

CNB representatives were also actively involved in the work of the ESCB's 13 committees and numerous sub-committees and working groups. In 2018, the CNB assessed 100 written consultations of the ECB General Council on ECB documents and draft EU and Member State legislation. The CNB made comments on the content of the 2018 ECB Convergence Report and the ECB's draft opinions on the application of economic convergence provisions, an amendment to the regulation on the European Systemic Risk Board (ESRB), the European System of Financial Supervision, revisions to the rules relating to the European Securities and Markets Authority (ESMA), markets in financial instruments, the taking-up and pursuit of the business of insurance and reinsurance and the European Investment Stabilisation Function. The CNB also sent comments on the ECB's opinions on legislative proposals of EU Member States, specifically a draft Belgian royal decree organising the functioning of the central register of bank accounts and financial transactions and draft Croatian laws amending the Law on Hrvatska Narodna Banka and the Law on the State Audit Office.

The CNB Governor and a Deputy Governor also attended the meetings of the General Board of the ESRB, which dealt with the assessment of systemic risks in the EU and macroprudential policy instruments. In 2018, the ESRB at the level of the General Council addressed, among other things, the expansion of the application of macroprudential instruments to include insurance companies, dealt with risks relating to the residential and commercial real estate market and discussed measures associated with the high NPL ratios in some national banking sectors. A specific task was to monitor Brexit-related risks and measures. A key topic from the CNB's perspective was the second assessment of risks arising from growth in house prices and house purchase loans, which will probably result in selected countries being issued with warnings or recommendations in 2019.

CNB representatives were also involved in the ESRB Advisory Technical Committee and its working groups. In 2018, the CNB contributed mainly to the work of teams dealing with risks associated with property financing, the approaches of Member States to the setting of the countercyclical capital buffer and the cross-border impacts of macroprudential policy and the coordination of such policy in the EU. Cooperation in the area of financial stability also went on in the European Central Bank (ECB) via the Financial Stability Committee (FSC), in which the CNB is active primarily in providing data sources for financial stability analyses in the EU.

## Relations with EU Council, EU Committee

In most cases, the CNB does not take part directly in the meetings of the Council of the EU and its working and advisory bodies (exceptions include the EU Council's Economic and Financial Committee and informal meetings of the ECOFIN Council, for example). It therefore puts greater emphasis on being actively involved in preparing the positions of government representatives for relevant negotiations primarily through the EU Committee at both the working level and the government level and its ministerial coordination groups. The debate about further deepening the Economic and Monetary Union, completing the banking union and establishing a capital markets union continued in 2018. The talks focused on the reform of the European Stability Mechanism (ESM), where the changes will relate primarily to precautionary instruments, the introduction of the possibility of assessing the Member States' debt sustainability and the use of part of the ESM's funds as the common backstop for the Single Resolution Fund (SRF). As regards the banking union, the topics discussed were consistent with the EU Council's June 2016 conclusions about the plan for its completion. The establishment of a high-level working group was agreed with the aim of making progress in the talks about the establishment of a European Deposit Insurance Scheme.

The CNB was also active in formulating positions on proposals in the sustainable finance area. The talks about the multiannual financial framework for 2021–2027 and the related proposals for the establishment of a European Investment Stabilisation Function, a Reform Support Programme and a euro area budget also continued. The CNB also paid attention to the preparation of the EU's common positions for negotiations in the International Monetary Fund (IMF). The exit of the United Kingdom from the EU was also an intensively discussed topic here. CNB representatives dealt in detail with the potential impacts of Brexit, with an emphasis on impacts on the financial services sector.

Bulgaria took a big step towards adopting the euro in July 2018 when it announced its intention to join the European exchange rate mechanism (ERM II) in 2019 and undertook to simultaneously enter the banking union. In connection with this initiative, the CNB submitted to the EU Committee at the government level an information document containing a recommendation to take specific steps to clarify the ERM II entry conditions.

## International Monetary Fund

The CNB was actively involved in discussions about the international monetary and financial system. The CNB Governor, who represents the Czech Republic on the IMF Board of Governors, attended the yearly spring and annual meetings of the IMF and World Bank. He also took part in a meeting of the International Monetary and Financial Committee (IMFC), in which member countries of the IMF Executive Board are represented. The Central European and Eastern European constituency, of which the Czech Republic is a member, was represented by Michaela Erbenová in the Executive Board from 1 November 2016 until 31 October 2018.

The discussions about the fifteenth general review of quotas, which should be completed by the IMF's annual meeting in 2019 at the latest, continued in 2018. The review is focused on the sufficiency of the IMF's resources, the distribution of the quotas among its members and the formula used to calculate those quotas. Progress in the talks has so far been hindered by the reserved position of the USA, which has the biggest share of the voting rights.

One of the key topics under discussion concerned the conditions of the IMF's programmes for member states of monetary unions in the area of powers delegated to monetary union bodies. The interim surveillance review providing a basis for a comprehensive review planned for 2019 was also concluded. Other issues discussed included, for example, the role of special drawing rights (SDR) in the international monetary system, the IMF's role in the areas of technological innovation in the financial sector (FinTech) and anti-money laundering and the financing of terrorism, and the strengthening of macro-structural issues in IMF surveillance. The Executive Board approved financing for several countries experiencing balance of payments difficulties. The programme for Argentina of SDR 40.7 billion (1,277% of its member quota) – the largest in the IMF's history – is particularly worth mentioning.

A bilateral loan agreement of up to EUR 1.5 billion, signed between the CNB and the IMF in October 2017, took effect on 12 September 2018 after all domestic approval processes related to a state guarantee had been completed. However, this loan has not been drawn yet. The CNB continued to be involved as a creditor in providing assistance to IMF member countries in 2018.

The annual IMF Article IV mission to the Czech Republic took place in May 2018. From the CNB's perspective, the dominant issues were the real economy, the monetary policy stance, the inflation outlook and developments in the banking sector and the financial stability area. Recent trends in the development and management of foreign exchange reserves after the exit from the CNB's exchange rate commitment were discussed. The IMF supported a tightening of macroprudential policy and – given the rising household debt – recommended that additional measures be adopted to reduce households' financial vulnerability.

### **CNB activities in other international organisations**

The CNB Governor attended the regular meetings of central bank governors of the member countries of the Bank for International Settlements (BIS) and the meeting of the Central Bank Governors' Club of Central Asia, Black Sea Region and Balkan Countries. The CNB was also represented by a Deputy Governor at two meetings of the Basel Consultative Group, which is part of the Basel Committee on Banking Supervision, and at the 20th International Conference of Banking Supervisors in Abu Dhabi. Deputy Governor Mojmír Hampl co-chaired two meetings of the Regional Consultative Group for Europe of the Financial Stability Board (FSB) and attended the FSB Plenary Meeting in Basel as an observer. In 2018, the Regional Group discussed, among other issues, global risks to financial stability, interest rate benchmarks, market-based funding of the private sector, sustainable finance, crypto-assets and the effects of financial reforms on infrastructure finance. In addition, the CNB was represented at the meetings of a number of OECD working bodies, particularly the Economic Policy Committee and the Committee on Financial Markets. A CNB representative also attended the annual meeting of the European Bank for Reconstruction and Development (EBRD) in May 2018.

## Foreign technical assistance

A total of 19 events to provide technical assistance to foreign partners were held at the CNB in 2018. Six seminars were attended by 103 experts from 33 central banks, and 11 consultations took place for 45 participants from 12 central banks, mainly from Serbia, Uganda, Rwanda, Vietnam and Cambodia. CNB staff also provided technical assistance in cooperation with the IMF and participated in six ad hoc events in countries such as Belarus and Chile as part of IMF missions and programmes.





## Reverse side of the heavyweight coin

The reverse side of the design is dominated by a monumental Czech heraldic lion bearing a shield with the coat-of-arms of Slovakia. It is loosely based on the small national coat-of-arms of the Czechoslovak Republic, which was used – with a hiatus during the Protectorate – from 1920 to 1960. The motif of the reverse side of the first Czechoslovak 1-koruna coin, dating from 1922, is located below the lion. Written around the outer circle is the text in Czech “100 LET ČESKO-SLOVENSKÉ KORUNY” and the years “1919” and “2019”. The obverse side features the marks of the three companies that produced the coin, while the reverse side bears the signature of the author, OPPL.



The background of the entire page is a repeating pattern of the coat of arms of the Czech Republic. The coat of arms is circular, featuring a double eagle with a shield on its chest, holding a sword and a scepter. The shield is divided into three quarters. The text "REPUBLIKA ČESKÁ" is written around the top half of the circle, and "1918" is at the bottom. The pattern is rendered in a light, golden-yellow color on a darker golden-yellow background.

# 3

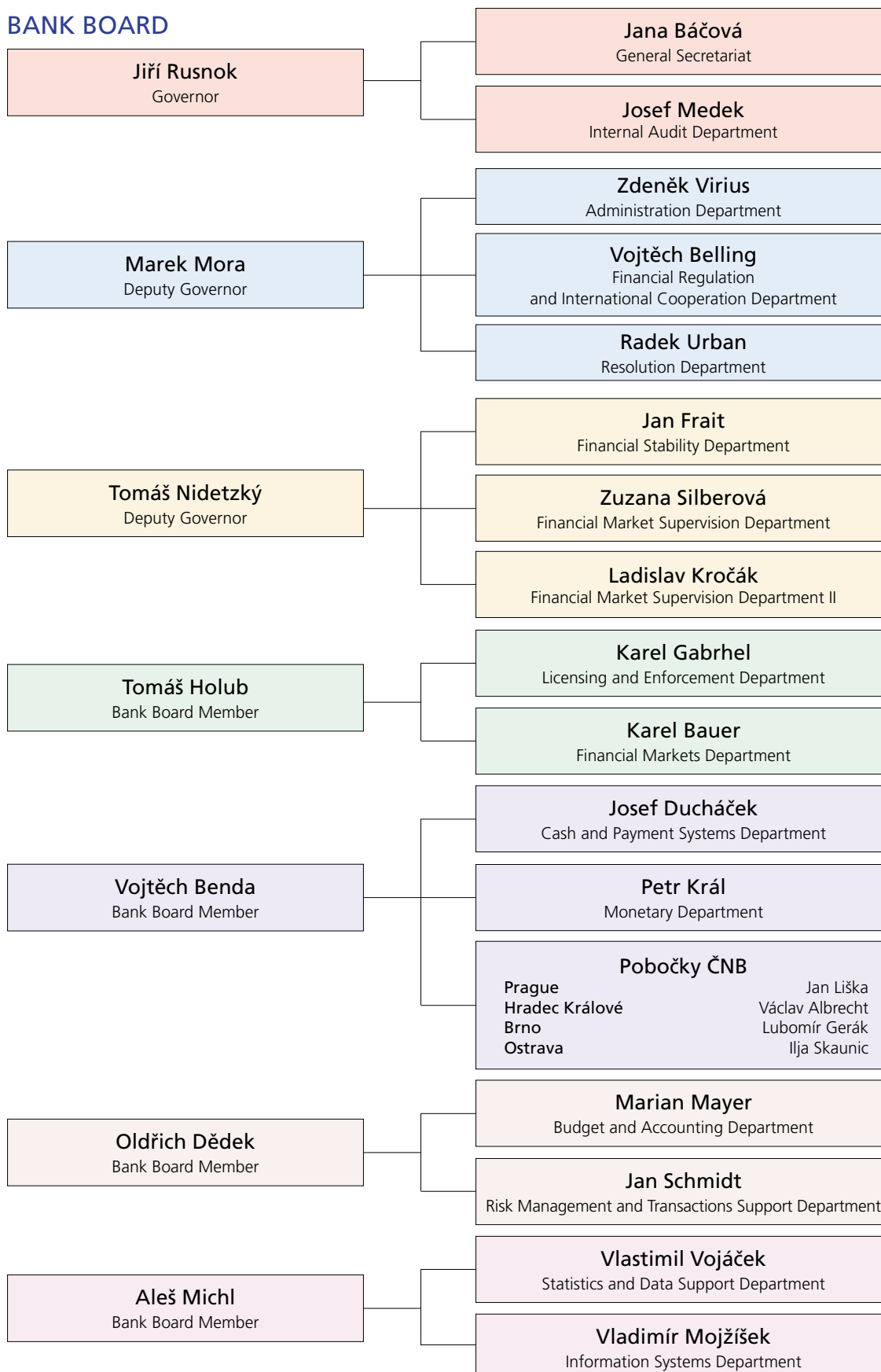
## MANAGEMENT AND ORGANISATION

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## 3. MANAGEMENT AND ORGANISATION

### ORGANISATIONAL CHART AS OF 31 DECEMBER 2018

#### BANK BOARD



The CNB has a two-tier management system. Fundamental decisions relating to the maintenance of price stability, which is the CNB's primary objective, the maintenance of financial stability and other tasks corresponding to the CNB's defined areas of competence are taken by the Bank Board. 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. The information about the CNB's branches and their executive directors contained in this part of the Annual Report describes the situation before 1 January 2019, when the branches were transferred from direct supervision by the Bank Board to supervision by the Executive Director of the Cash Department.

The CNB's organisational structure consists of a headquarters in Prague and four branches in Prague, Hradec Králové, Brno and Ostrava. In addition, the CNB is represented in České Budějovice, Plzeň and Ústí nad Labem by regional offices of its headquarters, where selected units of the Cash and Payment Systems Department (the Cash Department as from 1 January 2019), the Financial Market Supervision Department, the Licensing and Enforcement Department and the Financial Market Supervision Department II are located.

## **Bank Board**

The members of the Bank Board, in addition to collectively managing and deciding, oversee the activities performed by the CNB's organisational units according to a scheme defined by the Bank Board (see the organisational chart of the CNB as of 31 December 2018).

## **Executive directors of departments and branches**

These senior officers carry out the decisions taken by the Bank Board and are responsible – subject to the CNB's development strategy and plans for its individual areas of competence – for the performance of the activities of the units they manage (as defined in the Organisational Statute). The executive directors set targets and tasks for the staff under them and perform the employer's rights and duties under labour law in respect of those employees. Their powers and responsibilities relate not only to direct management activities, but also to methodological management activities in their competence, cooperation with other organisational units of the bank and with external partners in the Czech Republic and abroad, and to the submission of proposed solutions to issues of fundamental significance to the Bank Board.

## **Headquarters**

Departments, subdivided into divisions, are the organisational units of CNB headquarters. In their areas of competence defined in the CNB Organisational Statute, they are responsible for the implementation of the bank's main and ancillary activities and for methodological management within the headquarters and in respect of branches.

Coordination and advisory bodies – the Assets and Liabilities Management Committee, expert committees and project teams – are used to implement Bank Board decisions and perform activities that cover the areas of competence of more than one organisational unit and that depend on close and efficient cooperation between them.



As of the date of effect of the General Data Protection Regulation (GDPR), i.e. as of 25 May 2018, the CNB established the function of data protection officer as an independent authority helping to ensure that the CNB's activities comply with the legal rules in the area of personal data protection.

With effect from 1 October 2018, the CNB Bank Board decided to change the name of the Financial Market Regulation and International Cooperation Department to the Financial Regulation and International Cooperation Department. It also decided to transfer payment systems regulation and oversight of payment and settlement system operators, payment service providers and electronic money issuers from the Cash and Payment Systems Department to the Financial Regulation and International Cooperation Department.

With effect from 1 January 2019, the Bank Board approved a new organisational structure for the CNB's offices and decided to transfer and divide the related activities between the relevant organisational units of the CNB. The Cash and Payment Systems Department was renamed the Cash Department as part of this organisational change. The Cash Department took over activities in the area of money reserves management, money circulation and payments for CNB clients from the CNB's existing branches and the branches in Prague, Hradec Králové, Brno and Ostrava were subsumed into it. Management of the interbank settlement system CERTIS and the Short-term Bond System (SKD) was transferred from the Cash and Payment Systems Department to the Risk Management and Transactions Support Department and the payment services methodology was transferred to the Budget and Accounting Department. All the operational, technical, administrative and security activities previously performed by the CNB's branches were incorporated into the Administration Department.

## Branches

The main tasks of the CNB's branches include managing money reserves, maintaining accounts under the Act on Budgetary Rules and the accounts of other CNB clients falling within their fields of competence, and making payments for their clients.

# HUMAN RESOURCES

The CNB has paid extraordinary attention to staff development and recruitment throughout its history. It is a stable and attractive employer whose employees have the opportunity to contribute to the performance of unique tasks in a high-quality working environment.

## Recruitment and selection

According to a survey conducted by Universum, the CNB ranks among the three most attractive employers in the Czech Republic among students of economics. This status aids the CNB in its systematic search for qualified employees. Vacancies are advertised both internally on the

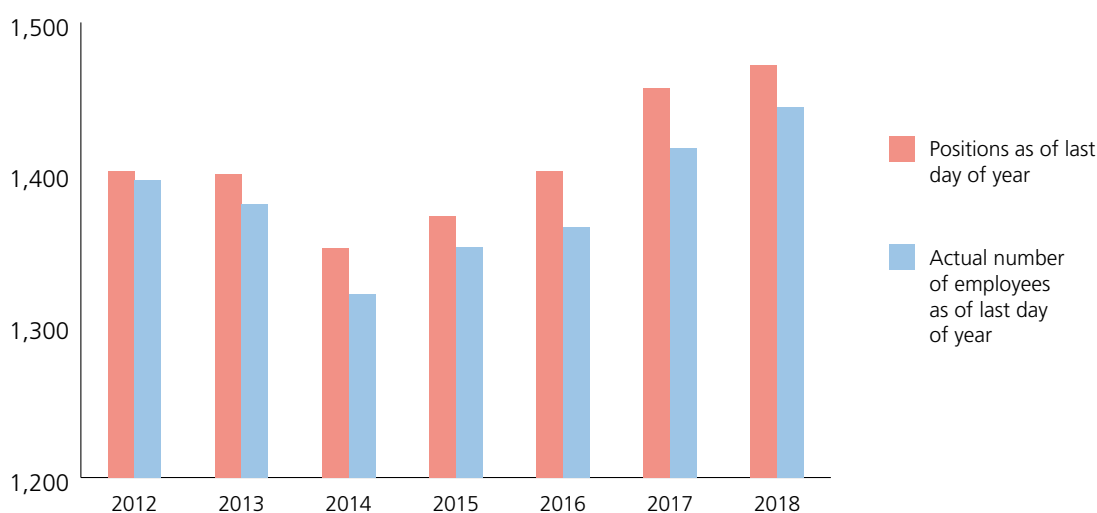


CNB intranet and externally on the CNB website and on internet job sites. The recruitment of new staff at the CNB usually involves several rounds, in which the necessary qualifications and expertise and personal attributes of applicants for jobs at the CNB are tested.

### Number of positions and employees

As in previous years, the CNB continued to enhance its capacity to perform its core activities, in particular financial market supervision, where it has acquired significant new competences in recent years. The number of systemised positions at the CNB thus increased to 1,457 as of 31 December 2018. A total of 1,444 employees were working at the CNB as of that date. During 2018, a total of 126 new employees were taken on and 121 employees terminated their employment at the CNB. The total staff turnover rate was thus 8.3% in 2018. The average length of employment at the CNB increased slightly year on year to 13.6 years.

### Number of employees and number of positions

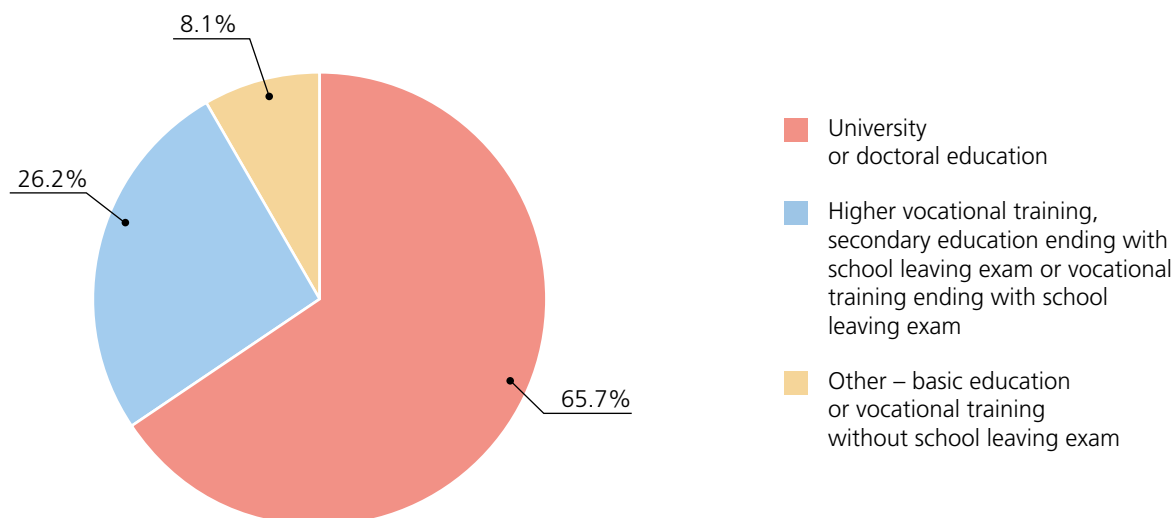


### Education, age and gender structure

The CNB embodies the values of diversity and offers equal opportunities to all employees regardless of gender, age, qualifications, nationality, religion or handicap. Its employee structure has thus long been balanced.

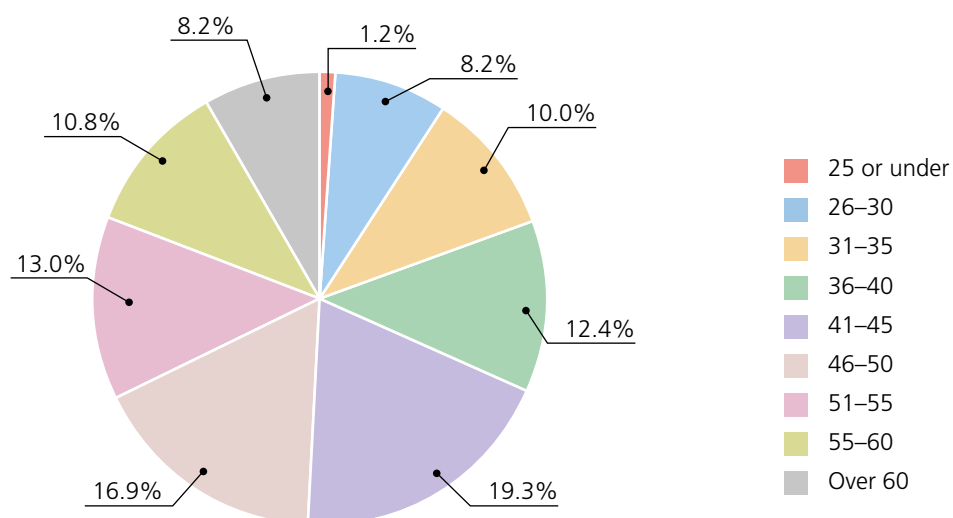
The structure of employees by education level saw no major changes compared with previous years. It is dominated by highly educated employees, reflecting the expertise required of CNB staff.

### Employee structure by highest level of education attained as of 31 December 2018 (shares in %)



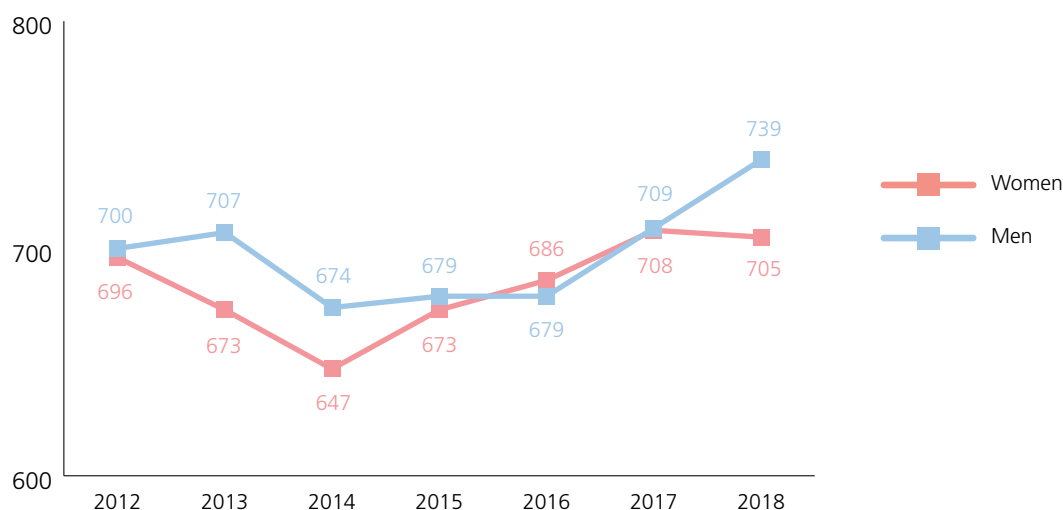
The CNB has an even and stable staff age distribution. Employees aged 41–45 account for the largest share (19%). The diverse age composition of working teams ensures that those teams function properly and smoothly absorb changes stemming from generational turnover. The average age of the CNB's employees increased slightly in 2018 compared with 2017 – by around five months to 45 years and five months.

### Age structure of employees as of 31 December 2018 (shares in %)



The CNB also has quite balanced shares of men and women in its workforce. The following chart shows that the balance shifted slightly last year compared with 2017 due to staff turnover, with men outnumbering women by 34.

**Numbers of men and women employed at the CNB as of 31 December 2018**



### Incentive system

The CNB's comprehensive remuneration system and appraisal system are key tools for raising the quality and performance of its staff. The wage system significantly helps the CNB to attract high-quality job applicants on the one hand and to motivate, stabilise and develop its existing workforce on the other. The staff appraisal system is used to evaluate the employee's performance in the previous period and to set his or her main goals and development activities for the next half-year. Performance appraisal naturally adds value by supporting staff motivation and identifying talent in the workforce.

Personnel expenses, which comprise wage costs, including temporary sick leave payments, obligatory insurance contributions and other social expenses (pension insurance, health care and food allowances), training expenses and employee benefits, amounted to CZK 1,685 million in 2018, up by about 13.4% on a year earlier.

Under the Act on the CNB, the central bank has been publishing information on the wages of all Bank Board members since 2004.

## Salaries of Bank Board members in 2018 (in CZK)

	Gross salary <sup>1)</sup>	Net salary <sup>2)</sup>
Jiří Rusnok	5,520,582	3,961,170
Marek Mora	3,774,214	2,701,159
Tomáš Nidetzký	3,790,271	2,747,353
Oldřich Dědek	3,643,414	2,614,887
Vojtěch Benda	3,745,797	2,715,268
Tomáš Holub <sup>3)</sup>	232,437	173,640
Aleš Michl <sup>3)</sup>	235,100	166,928
Mojmír Hampl <sup>4)</sup>	4,501,000	3,260,143
Vladimír Tomšík <sup>4)</sup>	5,475,474	3,903,774

1) The gross salary comprises the basic wage, performance-related bonuses and compensation for salary pursuant to the Labour Code.

2) The net salary is the gross salary net of state health insurance contributions, social security contributions, state employment policy contributions, income tax and solidarity tax and tax discounts for the taxpayer and tax discounts for dependent children for those Bank Board members who applied for the discounts.

3) Tomáš Holub and Aleš Michl were appointed members of the Bank Board with effect from 1 December 2018.

4) Mojmír Hampl and Vladimír Tomšík terminated their employment at the CNB as of 31 December 2018.

## Staff training

Staff training is one of the CNB's priorities, as it helps to enhance its attractiveness as an employer. It encompasses a wide range of activities, from internal training organised at the CNB, through training provided by domestic external organisations, including university studies and language tuition, to training provided in other countries. The total direct costs (tuition fees excluding transport and accommodation costs) of CNB staff training amounted to CZK 14.3 million in 2018.

The CNB organised a wide range of training activities for its employees in 2018. Internal courses, seminars and workshops were run by CNB experts and external training agencies and qualified lecturers. Key elements included induction training for new staff and training programmes for employees to support their career growth. The CNB prepared an internal mobility project to promote professional development and raise staff motivation. The pilot version of this project primarily involved supervisory staff.

International seminars, workshops and consultations are a key element of professional development. Attendance at such events is interesting and useful for CNB experts mainly because it gives them an opportunity to exchange information and knowledge with colleagues from other central banks, supervisory authorities and other foreign institutions. The main topics of these training events were financial stability, monetary policy, economic modelling and

financial markets, the use of data in financial market supervision units, statistical analysis and technological innovation in the financial sector (FinTech). Besides central banks, the organisers included the International Monetary Fund (IMF), the Joint Vienna Institute (JVI), the Financial Stability Institute (FSI) and the Study Center Gerzensee.

In 2018, employees of CNB supervisory units also continued to attend seminars organised by the authorities responsible for supervising the individual sectors of the financial market in the EU – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). The CNB also contributed to organising supervisory training events under the European Supervisor Education initiative.

The CNB was also actively involved in preparing and organising courses. It hosted 14 international training events, attended by a total of 204 experts from other EU central banks, in 2018.





## Technical aspects of the production of the heavyweight coin

Making a heavyweight coin is not a standard mass production operation, but a unique project. Some processes therefore had to be tailored or newly created just for this project. The gold coin was produced for the CNB by the Czech Mint and its subcontractors. The winning plaster model was scanned to create a three-dimensional image. It was then modified and milled into a gold cylinder, cast by Swiss company Metalor Technologies. The "gold disc" prepared for the relief engraving was double the current weight (over 260 kg) and slightly larger in diameter than the milled coin. The coin relief was milled by the Vienna Mint. It was engraved and polished into its final form by the Czech Mint in Jablonec nad Nisou. The surface treatment of the coin took 550 hours to complete.



# 4.

## PUBLIC RELATIONS

## 4. PUBLIC RELATIONS

### COMMUNICATIONS

The CNB has long nurtured an identity as a unique, independent, prestigious and erudite institution that builds on expertise, transparency, stability, tradition and credibility. Its credibility was confirmed in 2018 by a public opinion poll conducted by the STEM agency between 1 and 8 February. According to the survey, three-quarters of the Czech population have confidence in the CNB. This makes it one of the most credible public institutions in the country.

Monetary policy – the instrument whereby the central bank performs its main task of maintaining price stability – continued to be one of the CNB's most communicated activities in 2018. Press conferences following the Bank Board's monetary policy meetings and quarterly meetings with analysts, where the CNB presents its new forecast, are broadcast live on the CNB website so as to shorten the communication path to experts and the general public as much as possible and to ensure equal access to information for anyone who wants it.

However, the topic that probably resounded the most both in the media and among the public in 2018 was the issuing of further mortgage lending recommendations for banks. The decision adopted by the CNB in May under its second main statutory mandate – to maintain financial stability – was aimed at preventing the mortgage market from overheating and averting any instability of the banking system with deferred effect as from October. The objective of the central bank's communications was to explain to the public that the new rules were intended not to deprive people of the chance to own property, but to ward off potential mortgage default problems on the banking market, as such problems could trigger a financial and debt crisis similar to the one the global economy experienced after 2008.

The CNB's primary communication objectives are transparency and clarity. They hinge on its ability to conduct a debate not only with financial market participants, analysts and banks and the other financial institutions that the central bank supervises, but also with the general public. The CNB tailors its tools and forms of communication to the target group it is addressing. It primarily uses media releases published on its website and on its official Twitter, Facebook, YouTube and LinkedIn feeds. The CNB communicates not only through numerous interviews and articles, which its representatives provide to the media, but also through its blog and vlog. In June 2018, the CNB published, among other things, a video on its website and social networks offering guidance to foreign visitors on how to change money safely. The video was aimed at drawing attention to the unfair practices used by some bureaux de change in tourist areas and at informing bureau de change clients of their rights and options for what to do if they think they have been cheated.

The CNB handled 2,369 telephone enquiries and 5,585 electronic submissions as part of its direct communication with the public in 2018, up by 23% and 14% respectively. It received a total of 942 written submissions in 2018, a similar number as a year earlier.





In addition, central bank representatives, headed by Governor Jiří Rusnok, made another two visits to Czech regions last year, where they held round-table debates with representatives of local firms. These meetings took place in Liberec and Olomouc.

In 2018, the CNB also contributed to celebrations of the 100th anniversary of the establishment of the Czechoslovak Republic by issuing a unique gold CZK 10,000 coin and special circulating CZK 20 coins bearing portraits of the country's founding fathers – Tomáš Garrigue Masaryk, Milan Rastislav Štefánik and Edvard Beneš. These met with exceptionally strong interest from both the public and the media.

The CNB also continued to prepare for the 100th anniversary of the introduction of the Czechoslovak koruna, which falls in 2019. In November 2018, it launched a communication campaign for this anniversary at a press conference given by the Governor, who presented the events planned to accompany the celebrations and the banknotes and coins to be issued to mark the occasion, including the symbol of the celebrations – a heavyweight CZK 100,000,000 coin made of pure gold. In the autumn, the CNB shot a short film documenting the production of this, the second-largest gold coin in the world. In connection with the celebrations of the 100th anniversary of the creation of the Czechoslovak koruna, an hour-long documentary on the history of the koruna and monetary policy was made in co-production with Czech Television. The film was broadcast on Czech Television in spring 2019.

The celebrations were also accompanied by a competition for school pupils for the best design of a commemorative CZK 100 banknote, which the CNB announced jointly with the Ministry of Education, Youth and Sports in 2018. A lavishly illustrated book "100 years of the koruna", written by a team of authors headed by former Deputy Governor Vladimír Tomšík, was published at the end of last year.

The CNB continued to work with the Money on the Run (Peníze na útěku) website to support financial education. The site offers easy-to-understand advice and guidance to the public on how to create and manage a personal and family budget. The CNB also prepared an upgrade

of the highly rated Czech Money (České peníze) app, which focuses on the security features of Czech banknotes. New versions of the CZK 100 and CZK 200 banknotes with updated security features were added to the app.

The CNB was involved in the second annual Economics Olympics in 2018. This event, organised by the Institute of Economic Education, was held under the official auspices of the then Deputy Governor Mojmír Hampl. As part of the competition, the CNB presented the “CNB Award” for the best essay on a given topic, written by the Olympics’ ten finalists. These essays were judged by the CNB’s experts and published on its website, where the public could also vote on the best one. The winner of the “CNB Award” in 2018 was Jaroslav Kodoušek from Božena Němcová academic secondary school in Hradec Králové.

The CNB supported the tenth edition of the competition for secondary school pupils for the best essay on financial literacy. The competition is organised by the School of Business Administration of the Silesian University in partnership with the CNB and the town of Karviná. Of the 104 essays entered in the competition, this time on the topic *Cryptocurrencies and financial literacy – how do they go together?*, the jury chose that written by Jakub Zima of the academic secondary school in Broumov as the best. Another two academic round tables were held in the CNB’s Ostrava and Hradec Králové branches, where Bank Board members debated with university students from the relevant regions about topical issues relating to the central bank.

## PROVISION OF INFORMATION UNDER ACT NO. 106/1999 COLL., ON FREEDOM OF INFORMATION

The CNB provides information pursuant to Act No. 106/1999 Coll., on Freedom of Information, as amended (hereinafter the “Act”) by way of disclosure on the internet, primarily at [www.cnb.cz](http://www.cnb.cz), or to applicants on the basis of applications. The following text gives details on applications for information under the Act in 2018.

1. Number of applications for information under the Act: 71
2. Number of decisions refusing an application: 6
3. Number of appeals submitted against decisions: 3
4. Court judgements relating to the CNB in the area of provision of information:
  - Judgement of the Municipal Court in Prague of 23 February 2018, ref. no. 5 A 175/2014-37-41 – the court overturned the CNB’s decision dismissing an application for the provision of documents, copies of all documents and information content that the CNB had provided about the applicant to capital market supervisory authorities of other EU Member States. The matter was returned to the CNB for further proceedings. The CNB filed a cassation appeal and an application for suspensive effect of the appeal. In a resolution of the Supreme Administrative Court of 3 May 2018, ref. no. 10 As 118/2018-47, the court granted suspensive effect to the cassation appeal. Judgement of the Municipal Court in Prague, ref. no. 5 A 175/2014-37-41, overturned judgement of the Supreme Administrative Court of 28 November 2018, ref. no. 10 As 118/2018-53, on the basis of the CNB’s cassation appeal and returned the matter to the CNB for further proceedings.

5. Number of exclusive licences granted, including justification of the need 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: 4
  - The complaints contested the CNB's action in dealing with applications consisting in an objection that in its reply the obliged entity had not provided the complainants with all the requested information it should have provided by law. The applicants also disagreed with how their complaints had been dealt with under Article 6 and objected to unlawful practices of the CNB. The CNB dealt with all complaints in the same manner under the procedure laid down in Article 16a(5) of the Act and issued a decision refusing or partly refusing the application.
7. Other information relating to application of the Act:
  - The number of applications received decreased from 79 in 2017 to 71 in 2018.
  - The applications pertained to a broad range of information. A significant proportion of the queries concerned the CNB's supervisory work in all financial market segments, including licensing and enforcement activities. Other applications related to statistics and the circulation of banknotes and coins.

## CONGRESS CENTRE

The Congress Centre, located in the listed building of the former Commodity Exchange, was extended in 2017. One of the primary objectives in 2018 was to incorporate the new spaces into the Congress Centre's activities as much as possible. The extension has undoubtedly made the Centre more attractive not only for internal purposes, but also to outsiders. The new halls are multifunctional and can be used as a venue for large conferences, as meeting rooms or as additional training rooms in the Commodity Exchange building.

In 2018, the Congress Centre was used as a venue for meetings between the CNB's top management and representatives of other central banks, financial market and trade union representatives and analysts and journalists. The CNB's specialised units held conferences, committee and working group meetings of the European Central Bank (ECB), lectures, presentations, seminars, quarterly insurance intermediaries' examinations and various training sessions there. Thanks to its flexible spaces and modern technology, the Congress Centre is one of Prague's most popular venues. External partners organised 55 professional and social events there in 2018. The Congress Centre's clients include public and private institutions – both domestic and foreign – from various fields of activity.

More information is available in the *Congress Centre* section of the CNB website.



## EXHIBITION

The CNB's People and Money exhibition is a publicly accessible exhibition that aims to present the history of money and monetary developments in the Czech lands to the general public. The permanent exhibition is located at the CNB's Prague headquarters (in a former strong room) and also at the CNB's Brno branch, where its content is focused on the specificities of this subject in Moravia. The thematic focus of both parts of the exhibition is complemented by exhibitions of the works of Jiří Hrcuba, a major Czech medal and glass maker, who designed, among other things, the current CZK 5 coin and numerous commemorative coins. Anyone interested in visiting the exhibition should visit the *CNB exhibition* section of the CNB website, where they can also find a registration form for a guided tour.

The Prague exhibition, which has been running since 2002, welcomed its 250,000th visitor in April 2018. The Brno exhibition was visited by 3,870 persons in 2018. Since it opened in 2006, it has welcomed 8,494 visitors.



## SPECIAL LIBRARY

The primary mission of the CNB's special library is to provide CNB staff and outside specialists with lending, advisory, reference, bibliographic and research services. Its highly specialised collection and access to numerous electronic sources allow users to obtain information in the fields of economics and banking, law and computer technology and to some extent in other areas as well. The library provides readers with access to more than 83,000 publications and 700 periodicals, a large number of research reports and annual reports, and other publications.

The library uses a Verbis information system with a Portaro search engine for all library and lending processes. The system offers user-friendly search of relevant documents, including the option of creating and managing user accounts via a web interface. Readers can connect to the internet via both a wired connection and a secure wireless network. The library is located on the first floor of the Hypšman extension of the Commodity Exchange, Senovážné náměstí 29, Prague 1. It is open Monday to Thursday from 9 a.m. to 5 p.m. and Friday from 9 a.m. to 3 p.m. Information about the library, including the electronic catalogue and contacts, is available in the *CNB special library* section of the CNB website.

## ARCHIVE

The CNB Archive cares for the archive documents produced by the CNB and its legal predecessors. It currently contains 65 archive collections totalling 6,366 linear metres and offering a unique view of the political, economic, social and cultural history of the Czech lands and Central Europe. The CNB Archive's research room is open to the public all year round.

In connection with the 100th anniversary of the Czechoslovak Republic, the CNB Archive prepared an exhibition "The establishment of Czechoslovakia in the Czech National Bank's archive documents", which took place in the small foyer of the CNB's Prague headquarters from October to November 2018. The exhibition presented archive documents recording the preparations for the establishment of the independent state and the first moments of its existence. On this occasion, the draft Constitution of the future independent state of September 2018 – known as the Political Law – was presented to the public for the first time ever. The CNB Archive was also heavily involved in the preparation of a unique book to mark the 100th anniversary of the koruna, written by a team of authors headed by Deputy Governor Vladimír Tomšík (*100 years of the koruna*).

Anyone interested in obtaining information from, or studying in, the CNB Archive should visit the *About the CNB > Archive of the CNB* section of the CNB website or e-mail [archiv@cnb.cz](mailto:archiv@cnb.cz).

## Runner-up designs of the heavyweight gold coin

The CNB announced a competition for the design of the heavyweight coin, which 14 designers entered. The artists faced a technically very challenging task, as the creation of designs with an outer diameter of 57 cm and a coin field diameter of 50 cm was unprecedented in Czech coinage.

In addition to the winning design by Vladimír Oppl, two other designs advanced into the third round of the competition. Second prize was awarded to the design by Marie Šeborová featuring a composition of land emblems of the Czechoslovak Republic on the obverse side and the division of history into six periods, each characterised by the central bank's emblem (logo) in that period and a typical coin of the time. Third prize went to the design by Jakub Orava for a monumental depiction of the theme and a distinctive motif of the royal crown taken from the current CZK 1 coin.



The background of the entire page is a repeating pattern of embossed Czech Republic 100 Kč coins. The coins are arranged in a staggered grid, with each coin featuring the national coat of arms and the text 'REPUBLIKA ČESKÁ' and '100 Kč'.

# 5.

FINANCIAL  
REPORT



## 5. FINANCIAL REPORT

**Deloitte.**

Deloitte Audit s.r.o.  
Nile House  
Karolínská 654/2  
186 00 Prague 8 - Karlín  
Czech Republic

Tel: +420 246 042 500  
Fax: +420 246 042 555  
DeloitteCZ@deloitteCE.com  
www.deloitte.cz

Registered by the Municipal Court  
in Prague, Section C, File 24349  
ID. No.: 49620592  
Tax ID. No.: CZ49620592

### INDEPENDENT AUDITOR'S REPORT

#### To the Bank Board of the Czech National Bank

Having its registered office at: Na Příkopě 28, 115 03 Prague 1

##### Opinion

We have audited the accompanying financial statements of the Czech National Bank prepared on the basis of accounting regulations applicable in the Czech Republic, which comprise the balance sheet as at 31 December 2018, and the income statement and statement of changes in equity for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the assets and liabilities of the Czech National Bank as at 31 December 2018, and of its expenses and income and its profit or loss for the year then ended in accordance with accounting regulations applicable in the Czech Republic.

##### Basis for Opinion

We conducted our audit in accordance with the Act on Auditors and Auditing Standards of the Chamber of Auditors of the Czech Republic, which are International Standards on Auditing (ISAs), as amended by the related application guidelines. Our responsibilities under this law and regulation are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Czech National Bank in accordance with the Act on Auditors and the Code of Ethics adopted by the Chamber of Auditors of the Czech Republic and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

##### Other Information in the Annual Report

In compliance with Section 2(b) of the Act on Auditors, the other information comprises the information included in the Annual Report other than the financial statements and auditor's report thereon. The Bank Board of the Czech National Bank is responsible for the other information.

Our opinion on the financial statements does not cover the other information. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law or regulation, in particular, whether the other information complies with law or regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and
- The other information is prepared in compliance with applicable law or regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Czech National Bank obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.



### Responsibilities of the Bank Board of the Czech National Bank for the Financial Statements

The Bank Board of the Czech National Bank is responsible for the preparation and fair presentation of the financial statements in accordance with accounting regulations applicable in the Czech Republic and for such internal control as the Bank Board of the Czech National Bank determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Bank Board of the Czech National Bank is responsible for assessing the Czech National Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Bank Board of the Czech National Bank either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

### Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the above law or regulation, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Czech National Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Bank Board of the Czech National Bank.
- Conclude on the appropriateness of the Bank Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Czech National Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Czech National Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Bank Board of the Czech National Bank regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

In Prague on 22 March 2019

Audit firm:

Deloitte Audit s.r.o.  
registration no. 079



Statutory auditor:

Diana Rádl Rogerová  
registration no. 2045



# FINANCIAL STATEMENTS

BALANCE SHEET		31 December 2018 CZK million	31 December 2017 CZK million
<b>1. Gold</b>		<b>546</b>	<b>602</b>
<b>2. Receivables from the International Monetary Fund</b>		<b>82,840</b>	<b>81,008</b>
<b>3. Receivables from abroad, including securities</b>		<b>3,167,269</b>	<b>3,120,494</b>
3.1. Deposits at foreign banks and financial institutions		1,279,864	1,323,050
3.2. Securities		1,835,353	1,764,109
3.3. Other receivables from abroad		52,052	33,335
<b>4. Receivables from domestic banks</b>		<b>0</b>	<b>0</b>
<b>5. Fixed assets</b>		<b>3,237</b>	<b>3,308</b>
5.1. Tangible fixed assets		3,096	3,228
5.2. Intangible fixed assets		141	80
<b>6. Other assets</b>		<b>6,741</b>	<b>6,729</b>
6.1. Other financial assets		4,496	4,302
6.2. Other		2,245	2,427
<b>TOTAL ASSETS</b>		<b>3,260,633</b>	<b>3,212,141</b>
<b>1. Notes and coins in circulation</b>		<b>618,629</b>	<b>593,854</b>
<b>2. Liabilities to the International Monetary Fund</b>		<b>79,643</b>	<b>81,282</b>
<b>3. Liabilities abroad</b>		<b>144,299</b>	<b>140,992</b>
3.1. Loans from foreign banks		0	27,248
3.2. Other liabilities abroad		144,299	113,744
<b>4. Liabilities to domestic banks</b>		<b>2,303,096</b>	<b>2,294,920</b>
4.1. Loans received		2,130,901	1,758,566
4.2. Bank monetary reserves		98,039	92,721
4.3. Other liabilities to banks		74,156	443,633
<b>5. Liabilities to the state and other public institutions</b>		<b>282,275</b>	<b>269,895</b>
<b>6. Other liabilities</b>		<b>14,255</b>	<b>14,759</b>
<b>7. Provisions</b>		<b>258</b>	<b>245</b>
<b>8. Revaluation reserve</b>		<b>3,893</b>	<b>3,699</b>
<b>9. Share capital</b>		<b>1,400</b>	<b>1,400</b>
<b>10. Funds</b>		<b>0</b>	<b>60,389</b>
<b>11. Accumulated losses from previous periods</b>		<b>-188 905</b>	<b>0</b>
<b>12. Net loss / profit for the period</b>		<b>1,790</b>	<b>-249 294</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>3,260,633</b>	<b>3,212,141</b>

Data for 2017 were adjusted due to a change in the accounting method (items 8, 10 and 12 on the liabilities side of the balance sheet).

OFF-BALANCE SHEET		31 December 2018 CZK million	31 December 2017 CZK million
<b>1.</b>	<b>Guarantees issued</b>	<b>1,062</b>	<b>1,049</b>
<b>2.</b>	<b>Issued loan commitments</b>	<b>38,588</b>	<b>0</b>
<b>3.</b>	<b>Receivables from spot, term and futures transactions</b>	<b>433,069</b>	<b>398,115</b>
<b>4.</b>	<b>Liabilities from spot, term and futures transactions</b>	<b>433,407</b>	<b>397,498</b>
<b>5.</b>	<b>Guarantees received</b>	<b>38,588</b>	<b>64,616</b>
<b>6.</b>	<b>Collateral received</b>	<b>61,093</b>	<b>40,602</b>

INCOME STATEMENT		31 December 2018 CZK million	31 December 2017 CZK million
<b>1.</b>	<b>Interest income and similar income</b>	<b>18,783</b>	<b>14,457</b>
1.1.	Interest from fixed income securities	18,132	13,864
1.2.	Other	651	593
<b>2.</b>	<b>Interest expense and similar expense</b>	<b>-36,805</b>	<b>-13,843</b>
<b>3.</b>	<b>Income from shares and other interests</b>	<b>7,499</b>	<b>6,764</b>
<b>4.</b>	<b>Fee and commission income</b>	<b>718</b>	<b>613</b>
<b>5.</b>	<b>Fee and commission expense</b>	<b>-170</b>	<b>-176</b>
<b>6.</b>	<b>Gains less losses from financial operations</b>	<b>13,871</b>	<b>-255,840</b>
6.1.	Net foreign exchange gains / losses and foreign exchange spread	43,131	-270,365
6.2.	Other	-29,260	14,525
<b>7.</b>	<b>Other operating income</b>	<b>659</b>	<b>1,367</b>
7.1.	Income from money issue	437	848
7.2.	Other	222	519
<b>8.</b>	<b>Other operating expense</b>	<b>-566</b>	<b>-579</b>
8.1.	Expenses for production of notes and coins	-508	-453
8.2.	Other	-58	-126
<b>9.</b>	<b>Administration expense</b>	<b>-2,040</b>	<b>-1,819</b>
9.1.	Personnel expenses	-1,692	-1,494
9.1.1.	Wages and salaries	-1,171	-1,056
9.1.2.	Social and health security	-387	-352
9.1.3.	Training and employee benefits	-134	-86
9.2.	Other administration expenses	-348	-325
<b>10.</b>	<b>Depreciation and amortisation of fixed assets</b>	<b>-246</b>	<b>-238</b>
<b>11.</b>	<b>Reversal of provisions for receivables and guarantees, income from receivables already written off</b>	<b>993</b>	<b>6</b>
<b>12.</b>	<b>Write offs, additions and utilisation of provisions for receivables and guarantees</b>	<b>-906</b>	<b>-6</b>
<b>13.</b>	<b>Net loss / profit for the period</b>	<b>1,790</b>	<b>-249,294</b>

Data for 2017 were adjusted due to a change in the accounting method (items 6, 6.2 and 13).

The full version of the CNB's financial statements as of 31 December 2018, including the notes thereto, is available in the *About the CNB > Performance > Financial statements* section of the CNB website and, in the case of the printed version of this Annual Report, on CD-ROM, if attached.

The income and expense structure used in the following text provides information according to the purpose of the bank's expenditure. By contrast, the standard financial statements give an overview of income and expenses with regard to type.

### The CNB's income and expenses in 2018 (in CZK millions)

	Expenses	Income	Net	Y-o-y change
Monetary area	155,916	159,894	3,978	251,964
Monetary policy-making	27,716	0	-27,716	-23,687
International reserves management	109,951	98,021	-11,930	-37,915
Valuation changes	17,300	59,562	42,262	313,243
Client operations	48	1,318	1,270	278
Other operations	901	993	92	45
Currency issuance and management	508	458	-50	-461
Operations	2,344	206	-2,138	-419
<b>Total</b>	<b>158,768</b>	<b>160,558</b>	<b>1,790</b>	<b>251,084</b>

CNB recorded a profit of CZK 1.8 billion in 2018. This result primarily reflected domestic monetary policy, which is in a phase of gradual normalisation.

The CNB has raised its two-week (2W) repo rate seven times since discontinuing its exchange rate commitment in April 2017. Five of those rate increases were made in 2018. Given the needs of domestic monetary policy, it has also increased its other key interest rates – the discount rate and the Lombard rate. The last change occurred on 2 November 2018, when the 2W repo rate reached 1.75% p.a., the discount rate 0.75% p.a. and the Lombard rate 2.75% p.a. The tightening of monetary conditions implemented through interest rates, combined with growth in the reserves allocated by commercial banks on the central bank's accounts while the exchange rate commitment was in place, significantly increased the expenses of open market operations. During the calendar year 2018, the CNB paid out interest totalling CZK 26.8 billion on open monetary operations. Given the higher remuneration, commercial banks deposited their excess liquidity mainly through liquidity-absorbing 2W repo operations. The CNB sterilised CZK 2,512 billion on average using this type of monetary instrument, at a cost of CZK 26.7 billion. Sterilisation through the deposit facility, which is remunerated at the discount rate, averaged CZK 61 billion and cost CZK 0.1 billion. The portfolio of monetary policy instruments also includes the minimum reserves of banks, foreign bank branches and credit unions. With an average reserve amount of CZK 80 billion, the CNB paid out interest totalling CZK 0.9 billion.

The appreciation of the domestic currency since the exit from the exchange rate commitment has been driven by real convergence of the Czech economy and a positive interest rate differential vis-à-vis the euro area, the latter being a result of Czech monetary policy returning to normal faster than that of the ECB. The koruna also strengthened slightly at the start of 2018 due to domestic factors. The change in this trend in the second quarter was related primarily to global factors, reflecting a shift in the view of economic and particularly monetary policy developments and the outlooks in the main world regions. The koruna remained in a weak position against the main reserve currencies until the end of 2018. The resulting exchange rate profit of CZK 42 billion stemmed mainly from unrealised exchange gains and losses arising as a result of exchange rate movements on foreign currency assets and liabilities held in the balance sheet until the end of the calendar year. The bulk of the unrealised exchange gains were generated by the main reserve currencies, i.e. the dollar and the euro, and also by yen-denominated assets.

The loss on international reserves management of CZK 11.9 billion can be considered exceptional. It is a result of a combination of low yields on fixed-interest instruments, which have long had negative yields on the euro area money market, and a fall on stock markets. Although less than 10% of the international reserves are allocated in shares, the CNB has benefited from the significant growth of these markets in recent years. This growth has gradually dwindled away, and the last quarter of 2018 saw a large wave of sell-offs accompanied by a drop in the stock indices of all major world markets. Stock portfolios recorded a total accounting loss of CZK 26.9 billion. The bond portfolios, in which the largest proportion of the CNB's international reserves is deposited, contributed net income of CZK 18.6 billion due to both the interest rate and capital components.

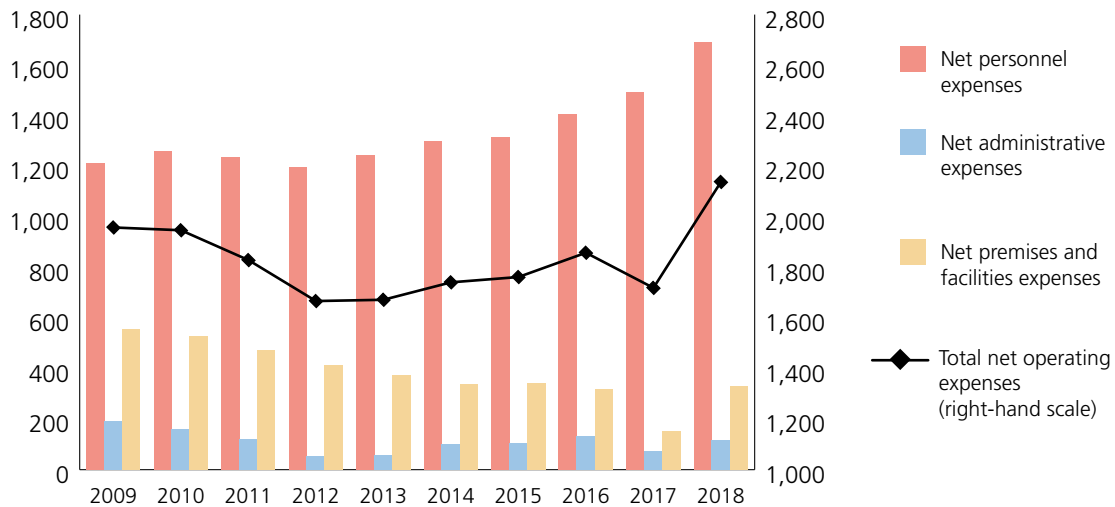
In October 2017, the CNB introduced the concept of international reserves tranching, which consists in dividing the reserves internally into two parts. At the end of 2018, the liquidity tranche accounted for 48% of the market value of reserves and the weighted average return on the liquidity portfolios in reserve currencies was -0.13% (see the table in the section *International reserves management*). The negative result was due to negative euro area interest rates, as most of the tranche is made up of a euro portfolio invested in deposits at central banks. The share of the investment tranche was 52% and the weighted average return on the portfolios was -0.70%. In this case, the negative outcome was due to the aforementioned drop in prices on stock markets, which was partially offset by the return on fixed-interest portfolios.

Another important, though less significant activity in terms of the impact on profit/loss is the area of banking services provided to the state and the public sector. This area has long had a positive effect on the CNB's performance. The fees charged for maintaining accounts and providing payment and other services are set with regard to the coverage of the investment and operating costs incurred by the CNB on these activities. The bulk of the income was due to conversions of funds on client accounts in 2018. In this regard, the most important client is the Ministry of Finance, which draws down EU funds and pays contributions to the European Commission's budget.

The CNB puts emphasis on efficient use of funds in all activities relating to its internal operations. Certain operational activities have long recorded declining or stable spending levels. The determining factor in terms of overall operating costs is wages. Together with the mandatory social and health insurance contributions, wages account for 66% of the CNB's total operating costs. The growth in wages is linked with the creation of new job positions, particularly in the area of financial market supervision, and simultaneously also reflects recent labour market developments. Both these factors also contributed to the year-on-year increase in operating costs in 2018. The growth in net operating costs of 24% was also due to a base effect reflecting one-off revenue from the sale of the CNB's loss-making guesthouse posted in 2017. Excluding this factor, the year-on-year growth would have been 14%.



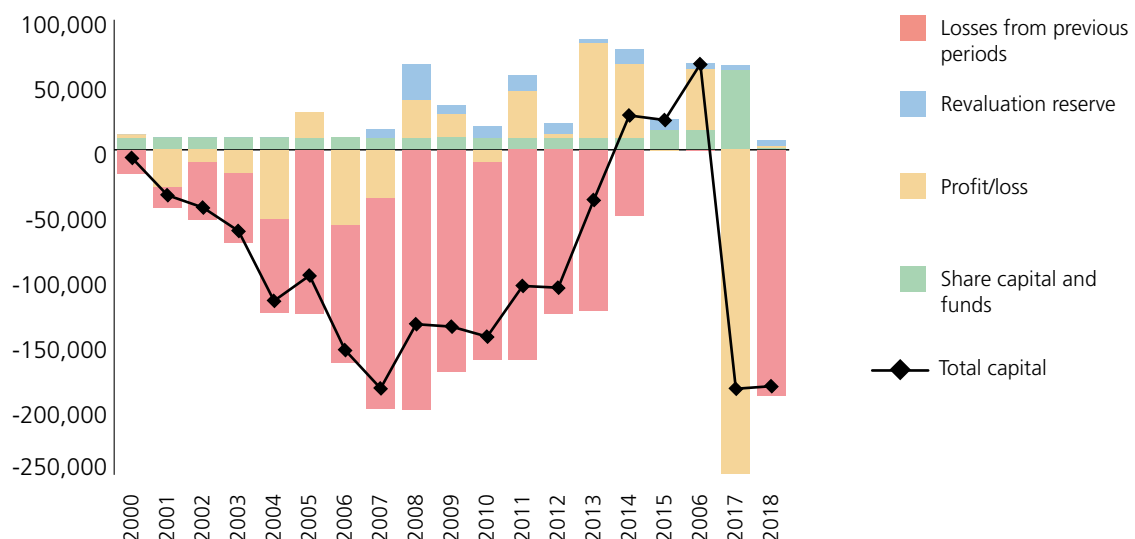
### The CNB's net operating expenses 2009–2018 (in CZK millions)



The CNB's capital attained a total negative value of CZK 181.8 billion at the end of 2018. In absolute terms, the value decreased year on year due to the profit recorded in 2018 and profit on the revaluation reserve arising from equity and member shares in international institutions (following a change in the accounting methodology, debt securities are measured at fair value against expense and income accounts). The change in the structure of capital was linked with the use of the reserve fund to cover accumulated accounting losses. The rest (CZK 188.9 billion) remains in the CNB's balance sheet as accumulated losses.

Although the CNB has long recorded negative capital, this has not affected the fulfilment of its statutory mandate in the area of maintaining price stability and performing its other tasks.

### The CNB's capital 2000–2018 (in CZK millions)



More comprehensive information about the CNB's performance in 2018 is available on the CNB website (*About the CNB > Performance > Financial Reports*).

## ABBREVIATIONS

ABO	Automated Banking Operations
AML	Anti-Money Laundering Directive
AnaCredit	Analytical Credit Datasets
BIS	Bank for International Settlements
BRRD	Bank Recovery and Resolution Directive
CERTIS	Czech Express Real Time Interbank Gross Settlement System
CNB	Czech National Bank
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSDR	Central Securities Depository Regulation
CZ	Czech Republic
CZK	Czech koruna
DSTI	debt service-to-income
DTI	debt-to-income
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN Council	EU Council in the composition of the ministers of economy and finance
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
ERM II	Exchange Rate Mechanism II
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	euro
FinTech	financial technology
FSB	Financial Stability Board

FSC	Financial Stability Committee
FSI	Financial Stability Institute
FTSE 100	benchmark index for the UK stock market
G20	Group of Twenty
GDP	gross domestic product
GDPR	General Data Protection Regulation
IDD	Insurance Distribution Directive
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commissions
IR	Inflation Report
JVI	Joint Vienna Institute
LTV	loan-to-value
MiFID II	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MREL	minimum requirement for own funds and eligible liabilities
MSCI Euro	benchmark index for the European stock market
Nikkei 225	benchmark index for the Japanese stock market
OECD	Organisation for Economic Cooperation and Development
PRIIPs	packaged retail investment products
S&P 500	benchmark index for the US stock market
S&P ASX 200	benchmark index for the Australian stock market
S&P TSX	benchmark index for the Canadian stock market
SDAT	the CNB's data collection system
SDR	special drawing rights
SEK	Swedish krona
SKD	Short-Term Bond System
Solvency II	directive on the taking-up and pursuit of the business of insurance and reinsurance
SRB	Single Resolution Board
SRF	Single Resolution Fund
USD	US dollar

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CZECH NATIONAL BANK  
Na Příkopě 28  
115 03 Praha 1  
CZECH REPUBLIC

**Contact:**

COMMUNICATIONS DIVISION  
GENERAL SECRETARIAT  
Tel.: +420 22441 3112  
Fax: +420 22441 2179

[www.cnb.cz](http://www.cnb.cz)

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