

OFFICIAL INFORMATION OF THE CZECH NATIONAL BANK

of 29 March 2011

regarding the prudential rules for banks, credit unions and investment firms

Exposure of an Investment Firm – Exposure to Institutions

The Czech National Bank hereby provides information in relation to Article 180 and 181 of Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms, as amended by Decree No. 380/2010 Coll. (hereinafter the “Decree”):

I. Exposure Limits for Investment Firms' Exposures to Institutions

1. The Decree stipulates, with effect from 31 December 2010 in accordance with Directive 2009/111/EC (hereinafter “CRD II”), among other things stricter limits for some exposures of an investment firm that is not a bank (hereinafter an “investment firm”). The limit of 25% of the sum of the original and additional capital reduced by the deductible items (hereinafter the “capital”) hitherto applied to corporate exposures, is, with effect from 31 December 2010, also applied to the exposure of an investment firm to credit institutions and investment firms (hereinafter “institutions”), recognised stock exchanges or recognised clearing houses. In the case of exposures to these entities, under specific circumstances¹ the 25% capital limit may be replaced by an internally determined exposure limit to an entity or an economically connected group of entities in accordance with risk concentration management. Such an internally determined limit must not be higher than EUR 150 million and at the same time must not be higher than 100% of the capital of the investment firm.
2. The tightening of the rules for exposures to institutions, recognised stock exchanges or clearing houses is a consequence of the abrogation of certain CRD II provisions according to which it was possible to fully or partially exclude such exposures from the exposure limits².
3. Decree No. 380/2010 Coll., in accordance with CRD II, mitigates the potential negative consequences of a rapid reduction in the above exposures. It contains an interim provision, according to which an investment firm may, until the end of 2012, apply the existing large exposure rules to exposures to an entity that is a credit institution, an investment firm from a Member State, a recognised investment firm from a third country, a recognised stock exchange or recognised clearing house, if these exposures arose before 31 December 2009.

¹ The amount of 25% of the capital of an investment firm reduced by the deductible items is less than EUR 150 million.

² On the basis of these provisions in the Czech Republic prior to 31 December 2010, investment firms were permitted to exclude 100% of the value of exposures to institutions with residual maturities of up to 1 year, 80% of the value of exposures to institutions with residual maturities of 1 to 3 years, 50% of the value of exposures to institutions with residual maturities over 3 years and exposures to recognised stock exchanges and recognised clearing houses with maturities of up to 1 year.

II. Financial Means of Customers Entrusted to Investment Firms

4. When evaluating whether the exposure of an investment firm to a credit institution also includes the financial means of a customer entrusted to the investment firm, the accounting approach is used as the basis for the purposes of compliance with the large exposure rules. If the accounting methods used by an investment firm are not in accordance with the international accounting standards governed by EU law (hereinafter only the “IFRS”), for the purpose of compliance with the large exposure rules instruments are treated according to the IFRS.³
5. The IFRS do not provide an explicit treatment of⁴ the reporting of the financial means of a customer entrusted to an investment firm. It is, therefore, necessary for an investment firm to assess whether the non-inclusion of financial means entrusted to it by a customer in its assets is in accordance with the IFRS, and this through the definition of assets and liabilities and the provisions governing the accounting treatment of financial instruments.
6. If, for the purposes of the large exposure rules⁵, an investment firm does not include financial means entrusted to it by a customer in its exposure to institutions, the Czech National Bank will not consider such an approach to be non-compliant with the IFRS if the following conditions are complied with:
 - a) only a customer who has been properly informed of this fact is exposed to the credit risk of the credit institution at which the financial means of the customer are deposited,
 - b) the customer receives interest on this deposit at the credit institution⁶ and
 - c) in the event of the failure of the institution, the customer does not have the right to require to be reimbursed by the investment firm for the financial means.
7. Setting clear rules in the contract between the investment firm and the customer can help the investment firm when demonstrating that the credit risk of the credit institution at which the customer’s financial means are deposited is fully borne by that customer, and, therefore, that the investment firm’s practice of not including these financial means in its exposure to institutions is justified.⁷
8. One of the elements of this set of rules is the management of customer financial means on so-called accounts with special treatment pursuant to the Act on Banks⁸.

Vice-Governor:

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³ A similar approach is employed for the purposes of capital adequacy.

⁴ The IFRS do not contain provisions that would expressly state whether the financial means of a customer entrusted to an investment firm are an asset of the investment firm or not.

⁵ Similarly for the purposes of capital adequacy.

⁶ Including the possibility of potentially netting them against the claims of the investment firm.

⁷ According to the IFRS, an investment firm would not report the financial means of a customer in its assets and the associated liability towards the customer.

⁸ Article 41f of the Act on Banks.

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