

OFFICIAL INFORMATION OF THE CZECH NATIONAL BANK

of 29 December 2010

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

Exposures Excluded from the Large Exposures of the Investment Portfolio

The Czech National Bank hereby provides the following information with regard to Article 180 (2) (c) and (d) of Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms, as amended (hereinafter the “Decree”):

I. Exposures Excluded from the Large Exposures of the Investment Portfolio pursuant to Article 180 (2) (c) of the Decree

1. The characteristics of the exposures excluded from the large exposures of the investment portfolio of a bank, credit union or an investment firm (hereinafter the “liable entity”) pursuant to Article 180 (2) (c) of the Decree are derived by the Czech National Bank from Item 22 of the Preamble of Directive 2009/111/EC (CRD II)¹.
2. The criteria for the exclusion of exposures from the large exposures of the investment portfolio are as follows:
 - a) type of service pursuant to paragraph 4 below;
 - b) client’s activity pursuant to paragraph 5 below; and
 - c) short-term exposure pursuant to paragraph 6 below.
3. The criteria pursuant to paragraph 2 above must be fulfilled simultaneously. Exclusion of exposures from the large exposures of the investment portfolio may not be limited to some counterparties only.

Type of service

4. The services that generate exposures excluded from the large exposures of the investment portfolio are as follows:
 - a) provision of money transmission services, including the execution of payment services, clearing and settlement in any currency and correspondence banking; and
 - b) clearing of financial instruments and settlement of transactions and custody services to clients involving incoming payments of incomes (e.g. interest or dividend payments), repayments of principals and other payments associated with financial instruments;

¹ “Since a loss arising from an exposure to a credit institution or an investment firm can be as severe as a loss arising from any other exposure, such exposures should be treated and reported in the same manner as any other exposures. However, an alternative quantitative limit has been introduced to alleviate the disproportionate impact of such an approach on smaller institutions. In addition, very short-term exposures related to money transmission including the execution of payment services, clearing, settlement and custody services to clients are exempt to facilitate the smooth functioning of financial markets and of the related infrastructure. Those services cover, for example, the execution of cash clearing and settlement and similar activities to facilitate settlement. The related exposures include exposures which might not be foreseeable and are therefore not under the full control of a credit institution, inter alia, balances on inter-bank accounts resulting from client payments, including credited or debited fees and interest, and other payments for client services, as well as collateral given or received.”

these may be exposures to clients, correspondents or persons active in the custody chain (in particular, to issuers and payment agents).

Client's activity

5. The client's activity may be direct (i.e., activity at the client's suggestion) or indirect (e.g. in the form of payments made or received by agents or contractual partners of clients – payments and collections, fees and interest, provision or withdrawal of cash collateral). However, this does not apply to any exposures arising from trading on own account. The following exposures shall be excluded:
 - a) exposures arising from the deferred income of financing funds; or
 - b) other exposures, namely:
 1. exposures arising from the unexpected income of funds and exposures arising from the unexpected receipt or provision of funds as a result of technical or external restrictions (e.g. moment during the day and market practice), providing that such exposures cannot be reduced with reasonable efforts before the end of the business day;
 2. exposures arising from cash collateral provided or received or from other financial operations with clients (e.g. collateral transferred for the purpose of participating in a regulated financial market or for the purpose of repurchase transactions); and
 3. exposures arising on the same day as a consequence of exposure diversification; for example, a liable entity may redeposit parts of excluded exposures with other banks or make repurchase transactions with other banks, as a result of which the liable entity is unable due to technical or external restrictions (e.g. moment during the day and market practice) to diversify the exposures in a manner that the subsequent exposures are below the limit; the excluded exposures shall meet the following requirements:
 - i) the original exposure fell under subparagraph a) or b) (1) above;
 - ii) the diversified exposures arose solely from the institution's effort to reduce the risk associated with a counterparty by diversifying a part of the original exposure into one or more counterparties; and
 - iii) the credit institution with which the diversified exposures are deposited must have been given a credit rating by a rating agency that corresponds to credit quality of level 3 or better according to the rules for the risk weighting of exposures to institutions (the standardised approach to the calculation of the credit risk capital requirement).

Short-term exposure

6. The criterion for an exposure to be recognised as a short-term exposure shall be deemed fulfilled, if an exposure falls below the limit by the end of the next business day after its creation. It is expected that an exposure shall be reduced below the limit without undue delay. An exposure to a counterparty at the end of a day may be a consequence of different activities of many clients during the day. Therefore, if the limit is exceeded on consecutive days, it does not have to mean that such exposures are not subject to exclusion. Cash collateral pursuant to paragraph 5 (b) (2) above shall be excluded from large exposures, provided that it does not have to be held for any fixed or minimum period exceeding the next business day.

7. The liable entity shall put in place procedures and control mechanisms to ensure that the aforementioned requirements are met. In particular, the liable entity must be able to demonstrate that the requirement that the excluded exposures arose from clients' activities has been met.

II. Exposures Excluded from the Large Exposures of the Investment Portfolio pursuant to Article 180 (2) (d) of the Decree

8. The criteria for the exclusion of exposures from the large exposures of the investment portfolio are as follows:
 - a) type of service pursuant to paragraph 10 below;
 - b) service provider pursuant to paragraph 11 below; and
 - c) short-term exposure pursuant to paragraph 12 below.
9. The criteria pursuant to paragraph 8 above must be fulfilled simultaneously.

Type of service

10. The large exposures of the investment portfolio shall not include exposures to persons that provide money transmission services, including the execution of payment services, clearing and settlement in any currency and correspondence banking. Such exposures shall be excluded regardless of their origin (for example, they may result from operations with financial instruments, payments for purchases, smooth transfers between accounts) and their method of payment (payment in cash, clearing of cheques, collection, etc.).

Service provider

11. The large exposures of the investment portfolio shall not include exposures to providers of the services pursuant to paragraph 10 above. Such a service provider does not have to be a payment institution under the EU directive on payment services. The services pursuant to paragraph 10 above do not have to be the core services provided by the service provider. However, providers of the services pursuant to paragraph 10 above must in any case be subject to regulation and supervision in a Member State of the European Union or to regulations equivalent to the legislation of the European Union.

Short-term exposure

12. The criterion for an exposure to be recognised as a short-term exposure shall be deemed fulfilled, if an exposure falls below the limit by the end of the given business day (intraday exposure). It is expected that an exposure shall be reduced below the limit without undue delay.

III. Final Provisions

13. The liable entity shall apply procedures and control mechanisms to ensure the fulfilment of the criteria pursuant to Sections I and II above.
14. Within the meaning of Article 9 of the Decree, the *Implementation Guidelines on Article 106 (2) (c) and (d) of Directive 2006/48/EC Recast* issued by the Committee of European Banking Supervisors (CEBS) in July 2010 (www.c-ebs.org) are considered by the Czech

National Bank to rank among the acknowledged standards for the purposes of determining the value of underlying exposures for the purposes of large exposures.

15. This Official Information shall be followed from 31 December 2010.

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