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SM/00/158
Correction 1

August 9, 2000

To: Members of the Executive Board

From: The Secretary

Subject: **Czech Republic—Report on the Observance of Standards and Codes**

The following corrections have been made in SM/00/158 (7/12/00):

Page 4, Section D, first para., lines 4-6: for "this covers...for example."
read "this does not cover...EC directives."
second para., penultimate line: for "starting January 1,"
read "Conditional...starting January 1,"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

represents an overall cap.[4] Within a budgetary chapter, increases in individual spending lines (votes) may not exceed 10 percent, even if the overall chapter ceiling is observed. Across budgetary chapters, the government's discretion is limited to 5 percent additional spending, but only if equivalent savings are realized elsewhere.

- **Rules on government guarantees are tightened substantially.** Each individual guarantee must now be approved in a separate law, either at the time of the budget submission or separately.

- **All spending must be executed by institutions approved by law**. Past practice of establishing spending institutions by ministerial decree will be discontinued.

- **Budgetary presentation and monitoring will be made more transparent and accountable**. The presentation of the state budget must include a medium-term outlook covering two years beyond the budget under consideration.[5] Moreover, the quarterly reports to Parliament will become more timely and user-friendly, with a semiannual focus on budget deviations and proposed remedies. These reports must also cover the operations of the extrabudgetary funds.

- **The government can no longer operate on the basis of an unapproved budget.** Under current rules, the budget provisorium is the proposed budget, even if it has been rejected by Parliament. Under the new rules, the Czech practice will be brought in line with that in many other countries: the government will need to limit total monthly expenditure to 1/12 of the previous year's spending until the new budget is approved.

C. Transparency of Monetary and Financial Policies

In early 2000, there was a wave of bankruptcies in the credit union (kampelicka) sector, and a large number of credit unions were placed under forced administration. The guarantee fund maintained by the credit unions does not suffice to cover all insured deposits and the government has proposed to step in to indemnify all depositors 80 percent of their deposits, up to a maximum of CZK 100,000. The credit union sector is regulated by a separate

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[4] There are a few small, and well-defined exceptions. For example, if certain mandatory expenditures are running above expected levels (for example, unemployment benefits because of a higher-than-anticipated number of unemployed) then the government is not obliged to call for a halt in payments. Also, if expenditures are linked to precise additional financing such as EU funds, then they do not fall under the ceiling.

[5] However, the medium-term framework required by law can remain quite general; it does not require, for example, medium-term projections of individual spending items or even budgetary chapters, but only broad revenue and expenditure magnitudes.

legislative act, which assigns the responsibility of supervising to the *Office for Credit Union Supervision.*

D. Compliance with Basel Core Principles for Effective Banking Supervision

A new regulation was issued in July 1999 regarding **consolidated supervision**, stipulating that from April 2000 the capital adequacy ratio (CAR) on credit risk and large exposure limits should be calculated both on a solo and a consolidated basis (only once a year on a consolidated basis). However, this does not cover cases where the bank is a subsidiary of a nonbank holding company, as required by EC directives.[6] This would require an amendment of the *Act on Banks*, which is under consideration.

The CNB has introduced a requirement for a capital charge for **market risk**, designed to contribute to the effective supervision of off-balance-sheet transactions. This is assessed on a solo basis, however. The CNB is considering extending it to a consolidated basis by 2002/03. The CNB has also introduced a market value accounting standard for the derivative transactions of banks starting in January 2000 in accordance with the international accounting standards. Conditional upon the amendment of the Accounting Act (see below), starting January 1, 2001, market value accounting will also be introduced for the securities portfolios held by banks.

E. Transparency and the Securities Market

Since the August 1999 report, a number of changes are now being made to the regulatory framework governing the securities market, with the overall objective of bringing Czech legal and regulatory practice closer to international standards and harmonizing Czech law with EU law.[7] All amendments listed below are due to enter into force on January 1, 2001.

The *Commercial Code* is being amended. Key elements of the amendment are: (i) a strengthening of minority shareholders' rights, including the disclosure requirements of large shareholdings and mandatory buy-outs in case of take-overs;[8] (ii) a clarification of other

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[6] Under the Agreement on Cooperation with the Ministry of Finance and the Securities Commission, the CNB has the possibility of acquiring information from other domestic financial market regulators and, under certain circumstances, the possibility of requiring on-site examinations; however, the Czech legal system hampers a full exchange of information.

[7] Draft laws have been submitted to Parliament and, in some cases, approved. Before entering into force, they must also be approved by the Senate and signed by the President.

[8] A buyer is required to make an offer to minority shareholders if its purchase results in a shareholding exceeding 40 percent of outstanding equity. This compares with levels of 25-30 percent in many other market economies.