
# Banking Regulation

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# Czech Republic

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## Introduction

At the end of January 2019, the Czech banking sector consisted of 24 banks, 25 foreign (from other EU states) bank branches, and one branch of a foreign bank from a non-EU state – Industrial and Commercial Bank of China Limited, Prague Branch (the "**banks**"). The structure of the Czech banking sector has long been broadly unchanged, stable and conservative. It still consists of four large banks, eight medium-sized banks and eight small banks, along with five building saving banks (in Czech, *stavební spořitelny*) and 25 foreign bank branches. The group of four largest Czech banks[1] remains the largest component of the Czech banking sector.

However, in October 2018, Moneta Money Bank (a Czech-based bank, listed on the Prague Stock Exchange; previously GE Money Bank) signed a memorandum of understanding to buy Air Bank (a retail bank belonging to PPF group – a privately held financial and investment group owned by a Czech billionaire Petr Kellner) and the Czech and Slovak operations of consumer finance provider Home Credit (which also belongs to the PPF group). The newly formed bank is to be named Air Bank and is supposed to be the second-largest consumer credit provider in the Czech Republic and the third-largest bank as regards the number of branches. This transaction remains to be approved by the general meeting of Moneta as well as by respective regulators (namely the CNB and the Antimonopoly Authority). However, in the latest news, Home Credit declined this transaction at the end of February 2019. The reason was a requirement of Moneta Money Bank to decrease the purchase price.

In the Czech Republic, the other type of credit institutions within the meaning of Article 4 par 1 (1) of the CRR[2] are credit cooperatives. A total of nine credit cooperatives were active in the Czech Republic at the end of January 2019. The Czech credit cooperatives are very small players in the Czech credit institution market. Following some substantial problems in the credit cooperatives segment in 2013 and 2014 resulting in several bankruptcies of credit cooperatives, the credit cooperative regulation is, with effect from 2015,[3] stricter than the regulation of banks. Further, there is pressure from the Czech regulator, as well as Czech legislation, for credit cooperatives to convert into banks. So far, only two credit cooperatives have successfully converted into banks.

In the last year, the CNB contributed to the implementation of the EU's rapidly changing regulations in the financial market area, and to changes in the regulatory framework in the Czech Republic. The CNB's activities in the area of new legislation included working not only with the Czech Ministry of Finance, but also with other state administration bodies (e.g. the Ministry for Regional Development, the Ministry of Justice and the Ministry of Industry and Trade). The CNB prepared proposals for decrees and issued a number of

explanatory opinions interpreting the application of regulatory requirements pertaining to financial market participants.

## Regulatory architecture: Overview of banking regulators and key regulations

Supervisory authorities

As mentioned above, in the Czech Republic there are two types of credit institutions within the meaning of the CRR – banks and credit cooperatives (in Czech, *spořitelní a úvěrová družstva*). There is also a group of building saving banks (in Czech, *stavební spořitelny*), which are allowed to manage building saving, a special saving product supported by the state. Czech banks and credit cooperatives are supervised by the Czech National Bank ("**CNB**"), the central bank and the sole financial services regulator of the Czech Republic.

Under the laws of the Czech Republic, the CNB is an independent authority established by Act No. 6/1993 Coll., on the Czech National Bank, as amended. This independence, confirmed also by the Czech constitution, allows the CNB to exercise its powers over supervised entities without any consultation with other Czech authorities.

Similar to other EU (EEA) Member States, the single European licence mechanism applies. Pursuant to the so-called "European passport" rule, banks established in an EU (EEA[4]) Member State can provide services in other EU (EEA) Member States under the licence issued by their home state regulator upon completing the notification procedure. The supervision over branches of other foreign banks benefiting from European passports operating in the Czech Republic is divided between the home state regulator and the host state regulator, provided that the powers of the host state regulator over a foreign EU branch are very limited (for more detail see Sec. 5a of Act No. 21/1992 Coll., on Banks, as amended, the "**Banking Act**").

The Czech Republic is not a member of the so-called European banking union. In response to the financial crisis, a deeper integration of the European banking system through a single supervisory mechanism and single resolution mechanism was pursued by the EU institutions. According to the Council Regulation (EU) No. 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, eurozone countries are automatically participating members in the Single Supervisory Mechanism ("**SSM**") system.

Other EU Member States can deliberately choose to participate in the SSM system by close cooperation with the European Central Bank. As a country outside the eurozone, the Czech Republic has decided not to participate in the SSM. As a second pillar of the banking union, the Single Resolution Mechanism Regulation (Regulation (EU) No. 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, "**SRM Regulation**") established the framework for the resolution of banks in EU participating countries. Consequently, the Czech Republic does not participate in the Single Resolution Mechanism ("**SRM**"), either.

The CNB is a designated resolution authority in the Czech Republic under the European Bank Recovery and Resolution Directive (Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, "**BRRD**") and is empowered to apply the resolution tools and the resolution powers. To exercise the powers separately from its other functions, the Resolution Department within the CNB has been established and shall serve as a first instance in case of administrative proceedings.

Despite the fact that the Czech Republic is not participating in the banking union, the CNB aims to supervise the financial market and its participants in accordance with international standards.

The CNB also cooperates with financial market supervisory authorities – namely the European Banking Authority ("**EBA**"),[5] the European Securities and Markets Authority ("**ESMA**") and European Insurance and Occupational Pensions Authority ("**EIOPA**") are of utmost importance. The CNB's cooperation with European supervisory authorities focuses, among others, on unifying supervisory procedures and laying down conditions for cooperation between home and host supervisors in the single European licence regime. In order to enhance cooperation and exchange of information, the CNB has entered into a number of bilateral and multilateral memoranda of understanding with other national supervisors and European authorities.

Besides the supervision of credit institutions, the CNB is also responsible for the supervision of the other financial services sectors, i.e. the insurance and re-insurance sector, the capital markets (investment services, collective investments, regulated markets, settlements, securities issuance and public offerings, takeovers and squeeze-outs, etc.), pension funds and pension companies, the payment services and e-money, FX services, consumer credits and consumer protection on financial markets. The CNB has its seat in Prague.

Legal framework

The regulatory framework of credit institutions is highly influenced by European law. European law applies in this area directly or indirectly, depending on the regulatory tool.

The key legislation applicable to Czech banks and credit cooperatives is represented by Directive (EU) 2013/36 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("**CRD IV**") and the CRR and the bulk of Commission-delegated directives and regulations, implementing and technical regulatory standards. Both instruments have been enacted in order to enhance the stability of the financial system, and stem from the requirements agreed by the G-20[6] in April 2009. The CRD IV package implements the Basel III capital accords and specifies the amount and form of capital that has to be maintained by credit institutions. CRD IV is implemented in the Czech Republic by the Banking Act and the CNB Decree No. 163/2014 Coll., on the performance of the activity of banks, credit cooperatives and investment firms, as amended ("**Decree 163/2014 Coll.**"). The CRR is, as opposed to CRD IV, directly applicable and sets forth detailed prudential rules in respect of credit institutions' capital requirements.

Other relevant European legislation includes:

- the MIFiD II/MiFIR regulatory regime of investment services, i.e. Markets in Financial Instruments Directive 2 (Directive 2014/65/EU, "**MiFID II**"), Markets in Financial Instruments Regulation (Regulation (EU) No. 600/2014, "**MiFIR**") Commission delegated regulation (EU) 2017/565 (the "**MiFID II regulation**") and respective delegated directives and regulations, implementing and technical regulatory standards;
- Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (the "**DGSD**");
- the Payment Services Directive 2 (Directive (EU) 2015/2366, "**PSD2**"), the E-Money Directive (Directive 2009/110/EC) as amended by PSD2 and respective delegated directives and regulations, implementing and technical regulatory standards;
- the AML regulatory regime, i.e. the Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the

prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (the 5th AML Directive and its implementing measures);

- the consumer lending regulator regime, i.e. Credit Agreements Relating to Residential Property Directive (Directive 2014/17/EU, the Mortgage Credit Directive, "**MCD**") and Consumer Credit Directive (Directive 2008/48/EC, "**CCD**");
- Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation, "**MAR**") and its implementing regulations; and
- the Directive on Undertakings for Collective Investment in Transferable Securities ("**UCITS V**") and the Alternative Investment Fund Managers Directive (2011/61/EU), as regards Czech banks acting as collective investment fund depositaries.

The key act governing the Czech banking sector at the national level is the Banking Act. Regulation of credit cooperatives is set out in the separate Act No. 87/1995 Coll., on Credit Cooperatives, as amended ("**Credit Cooperatives Act**").

There is a wide range of legislation implementing the Banking Act and Credit Cooperatives Act. Among the most important is Decree No. 163/2014 Coll., which implements CRD IV and includes detailed rules on management and control systems, risk management, qualifying holdings, informational requirements, remuneration, etc.

Periodical reporting *vis-à-vis* the CNB is governed by Decree No. 346/2013 Coll. on reporting of banks and foreign bank branches to the Czech National Bank, as amended. Rules on cooperation in tax administration and exchange of information implementing the Common Reporting Standards are provided for by Act No. 164/2013 Coll., on International Cooperation in Tax Administration, as amended ("**Act on International Tax Cooperation**").

The central register of accounts was established by Act No. 300/2016, on central evidence of accounts. The central register is maintained by the CNB and is accessible by a limited number of public authorities (including criminal law, tax and customs authorities, the Czech security service and the financial analytical office).

The regulation of payment service providers, e-money institutions and the provision of payment services and e-money issuance is set forth in a completely new Act No. 370/2017 Coll., on Payment Services, as amended ("**Payment Services Act**") and respective CNB Decrees.

The regulation of investment firms, capital markets and provision of financial (investment) services is included in Act No. 256/2004 Coll., on Business Activities on Capital Markets, as amended ("**Capital Markets Act**").

Resolution of financial institutions is governed by Act No. 374/2015 Coll., on Recovery and Resolution in the Financial Market, as amended ("**Recovery and Resolution Act**"), which implements the BRRD adopted by the European institutions in reaction to the global financial crisis.

Credit institutions are also obliged to comply with the anti-money laundering rules set forth by Act No. 253/2008 Coll. on Selected Measures against Legitimization of Proceeds of Crime and Financing of Terrorism, as amended ("**AML Act**").

Another important regulatory area, protection of personal data, is governed by the General Data Protection Regulation ("**GDPR**") (EU) 2016/679 and its implementing measures.

Lending to consumers is regulated in Act No. 257/2016 Coll. on Consumer Credits

("**Consumer Credit Act**"), which implements the MCD and CCD. The Consumer Credit Act also newly regulates non-banking providers of consumer credit and consumer credit intermediaries.

Restrictions applicable to credit cooperatives

Credit cooperatives are generally allowed to collect deposits or provide credit only to their members, who hold an equity share in the credit cooperative and have to pay the initial members' contribution (the initial member contribution may be further raised by an additional contribution).

Following certain problems in the credit cooperative sector in the past, an amendment to the Credit Cooperatives Act has been adopted, imposing substantial restrictions for credit cooperatives. One of the most controversial was the so-called 1:10 rule ("Rule 1:10"). This rule, applicable since July 2015, allows credit cooperatives to pay interest in respect of the deposit only up to the members' contribution multiplied by 10. The rule should strengthen the principles of the cooperatives and increase the involvement of the members in the cooperative's interest and eliminate the moral hazard of the members.[7] Further, from 1 January 2018, saving cooperatives are not allowed to provide to any member, or a group of entities/individuals linked to such member, credit facility funds exceeding 30 million Czech crowns (approx. €1.1 million) in total.

The provision of investment services by credit cooperatives is restricted. Credit cooperatives are limited to trade on their own account with limited scope of financial instruments (FX and interest hedging instruments, securities traded on a European regulated market, bond issued or guaranteed by an OECD state or issued by the EIB, EBRD and certain other financial institutions) for the sole purpose of hedging its business activities pursued under its licence.

On the other hand, banks are not limited in this way and may provide all types of investment services within the meaning of MiFID II.

## Recent regulatory themes and key regulatory developments

The recent regulatory themes and key regulatory developments are driven by the latest financial crisis and a need to react to new systemic risks.

Consumer credits, mortgage credits

One of the most notable changes in the retail financial sector is the enactment of a new Consumer Credit Act effective from December 1, 2016 implementing European regulation of the MCD and the CCD. The Consumer Credit Act covers consumer credits falling within the scope of the CCD, as well as mortgages falling within the scope of the MCD and other types of consumer credit.

It provides for, among others: (i) conduct-of-business rules for all consumer credit providers and intermediaries and their employees (including banking institutions); and (ii) institutional regulation providing the prudential rules for non-banking consumer credit lenders and intermediaries.

Under the Consumer Credit Act, all non-bank credit providers had to apply for a licence under the new regime and brought them under the supervision of the CNB. Approximately 88 non-banking consumer credit providers have been granted licences within the deadline set by the new law. The licensing requirement removed a large number of small-scale consumer credit providers from the market and aims to enhance the reputation of the consumer credit market.

New regulatory tools in mortgage credit supervision

Since 2015, the CNB has tried to cool down the dynamic growth of consumer credits (including, in particular, mortgages). According to data published by the CNB, the financing of residential property has seen a record boom in 2018; the interannual increase of real new mortgages amounted to CZK 15 billion. CNB pointed out the increasing risks connected with the ongoing boom of mortgage credits and potential underestimation of related risks by the banks as well as by clients. The growth has been led by low interest rates and may pose a risk of a new real estate bubble.

Consequently, in 2018 the CNB introduced new preventive macroprudential measures – an increase of the anticyclic reserve of banks (i.e. countercyclical capital buffer (CCyB) to 1.50% with effect from 1 July 2019 (for the fourth time since the end of 2015) and stricter rules for provision of mortgages. From 1 October 2018, the CNB has extended its existing recommendations for mortgage provision to also include income requirements. The debt of the applicant should not exceed 9x annual net income ("DTI" debt-to-income covenant) and at the same time the instalment of a debt should not exceed 45% of the net income of an applicant ("DSTI" debt service-to-income covenant). These limits should not be exceeded in more than 5% of all provided mortgages. The excessive cases shall be reasoned. These developments follow the CNB's previous recommendations focusing on LTV limitations, which remain in force.

Already in June 2017, the CNB issued an official communication recommending the Czech banks' means to manage risks connected with the provision of retail loans secured by residential property. These soft law rules recommended not to provide new mortgage credits with 90% LTV or higher, and to limit new mortgage credits with 80–90% LTV to a maximum of 15% of the total value of retail loans secured by residential property provided in the relevant quarter of the year. The dynamic increase of real estate prices (on average, 16% for 2017) and, according to the CNB's estimates, the overvalued prices of apartments, constitute the conditions for increasing divergence between real estate prices and mortgage loans, which has been designated as the highest risk for domestic financial stability since 2016.

The CNB announced that it is continuing its work on a draft bill, which would give it the power to set legally binding rules on selected credit indicators concerning mortgage credits including LTV, DTI and DSTI covenants, which would strengthen its powers in this area. The previous government's proposal of a new draft bill amending the Act on the Czech National Bank and the Act on the Circulation of Banknotes and Coins, aiming to broaden the range of instruments available to the CNB, was suspended at the end of the previous election term. In 2018, a new draft bill (including most of the content of the previous draft) was proposed by the Ministry of Finance and is at an early stage of legislative procedure.

Previously, the CNB informed credit institutions that it would intensify its supervision in the area of consumer credit due to the fast growth of indebtedness of households and increasing macroeconomic risk.

Credit cooperatives

Stricter regulation of credit cooperatives has become a continuous trend in the Czech Republic. Due to temporary provisions of the amendment to the Credit Cooperatives Act, credit cooperatives have faced new restrictions since 1 January 2018. A minimum amount of member's equity contribution is CZK 1,000; the balance sheet of a credit cooperative cannot exceed CZK 5,000,000,000; and loans provided to economically related persons cannot exceed CZK 30,000,000. Also, the Rule 1:10, which has been upheld by the Czech Constitutional Court, now applies also to deposits dating to before 1 July 2015, unless the

sum of member's equity contribution exceeds CZK 20,000. If such older deposits were increased or their maturity was prolonged, the Rule 1:10 applies regardless of the amount.

Capital requirements and internal management

As stated above, the Banking Act was amended in 2014 due to the implementation of CRD IV, which came into force as of 1 January 2014. The amendment introduced into Sec. 12m of the Banking Act new capital requirements in the form of capital buffers, as banks are, in addition to the capital requirements under the CRR, obliged to hold Tier 1 capital in the amount corresponding to the combined capital buffer (consisting of the capital conservation buffer, countercyclical capital buffer, systemic risk buffer, and, if the institution falls into the respective category, the capital buffer for global or other systemically important institutions). The same requirements apply to credit cooperatives pursuant to Sec. 8aj of the Credit Cooperatives Act.

CRD IV also introduced new requirements concerning management and internal control systems, i.e. management of the bank, remuneration, outsourcing and requirements concerning risk-management and internal control systems. The CRD also altered the system of remuneration of employees and members of the corporate bodies of credit institutions.

The CRR regulation, which has been applicable since 1 January 2014 (except for the limited scope of provisions which come into force later), meant the introduction of new rules in respect of the definition of asset categories – which are used to calculate the credit institution's capital (Common Tier 1, Tier 1 and Tier 2 capital).

BRRD

BRRD is a part of European legislation pursuing the protection of financial stability. It has been implemented in the Czech Republic by Act 374/2015 Coll., the Recovery and Resolution Act, which introduced measures used in case of failure of a credit institution or investment firm, and lays down obligatory contributions to national recovery funds, and imposes on credit institutions the obligation to create recovery plans.

The BRRD and the Recovery and Resolution Act enable the CNB to intervene not only when the credit institution is failing, but even in advance of this when it infringes applicable legislation or there is, due to, *inter alia*, a rapidly deteriorating financial condition, risk that the credit institution will fail in the future. In such situation, the CNB is entitled to apply, among others, the following early measures: (i) implement one or more of the arrangements or measures set out in the recovery plan of the credit institution; (ii) draw up an action programme to overcome the management problems; (iii) convene the general meeting of the credit institution; (iv) decide on the replacement of management; and (v) require changes to the institution's business strategy, etc.

In case the credit institution is failing, the CNB is entitled to impose recovery measures which may include: (i) sale of the credit institution's undertaking; (ii) asset separation; (iii) transfer of the credit institution's undertaking to the bridge institution, a public institution created for those purposes; or (iv) use of the so-called bail-in tool, which enables the writing-off of the claims of the credit institution's shareholders and certain types of creditors as a part of recovery of the institution. Further forced administration may be also implemented.

Credit institutions are, under the Recovery and Resolution Act, required to create resolution plans for potential failure and submit them to the CNB and contribute to the Resolution Fund, which shall be used for recovery of losses caused by the failure of a credit institution.

The measures pursuant to the Recovery and Resolution Act have not been used by the CNB in practice yet, as it tends to impose traditional recovery measures in accordance with the Banking Act, such as the prohibition to provide further credit or collect deposits from clients,

and removal of the licence. This was the case for the last bank whose licence was removed, in October 2016.

The Recovery and Resolution Act has already been amended. The amendment completed and specified the existing transposition. It also extended the powers of the CNB to suspend the maturity of deductible capital tools or deductible liabilities of the obliged person. It also introduced changes in the competences and activities of the Guarantee System of Financial Market in order to unify the administration of funds entrusted to it.

Investment services

In the Czech Capital Market Act, the Directive and Regulation on Markets in Financial Instruments (MiFID II, MiFIR), the Market Abuse Regulation ("**MAR**") and the Directive on Criminal Sanctions for Market Abuse ("**CSMAD**") were transposed, aiming to provide greater effectiveness and transparency in the financial market. Implementation of the European rules, in particular, the MiFID II, brought substantial changes for market players, e.g.: strengthening of investor protection; new regulation of high-frequency and algorithmic trading; the introduction of a new trading platform-organised trading facility; and changes in reporting and information duties and conduct-of-business rules. Sanctions were further harmonised and toughened up. In connection with the MiFID II, a number of implementing bylaws have been adopted by the CNB (in particular, on detailed rules for provision of investment services, on reporting duties, on applications and notifications, on professional competences for distribution on capital market, etc.).

Bonds

In order to modernise and improve the existing regulation of bonds, the Bonds Act has recently been subject to extensive amendment. The amendment focused on the rules for mortgage bonds (in Czech, *hypoteční zástavní listy*) and extended the regulation to other types of covered bonds (in Czech, *kryté dluhopisy*). In particular, it provides rules for its administration should the bond issuer face insolvency. The amendment also dealt with certain deficiencies of the existing act; in particular, the absence of rules for security agents, which were in practice already commonly used, bonds with negative yield, or contingent convertibles.

Investment limits for qualified investors' funds

One of the most significant changes for investment funds in 2017 was the cancellation of investment limits for funds of qualified investors. Before, it was not possible to invest more than 35% of the fund capital in one type of asset. The Czech government, aiming to make the investment market more attractive, cancelled the statutory investment limits for diversification of assets in the qualified investors' funds. Deregulation allows more flexibility for setting the investment limits rules in the statutes of the qualified investors' funds themselves, and potentially also single-asset funds. The new regime also allows special funds (alternative non-UCITS investment funds) to invest 10% of the assets in qualified investors' funds.

However, favourable taxation of certain investment funds was limited in order to exclude from such treatment funds, shares of which are only formally listed on the regulated market and not actively traded (in particular, certain real estate developers). Following changes to the proposal in Parliament, the definition of the basic investment fund eligible for the reduced corporate income tax rate of 5% (contrary to standard 19%) shall, *inter alia*, include an investment fund listed for trading on EU regulated market, on which no corporate owns more than 10% and which does not pursue activities (trades) under the Trade Licensing Act.

Anti-money-laundering

The AML Act was amended in January 2017 to implement the 4th AML Directive.[8] The amendment also changed the definition of a "politically exposed person", which is now broader and includes persons in roles of only regional importance, as well as the definition of an "ultimate beneficial owner". There is also a new rule under which members of statutory bodies of legal entities are deemed to be ultimate beneficial owners if it is not possible to identify the "real" ultimate beneficial owner by other means. Pursuant to the amendment, the list of obliged persons was extended to investment intermediaries and providers of services related to virtual currencies. Further, client's due diligence shall be broader and newly include identification of the actual ownership structure of clients which are legal persons.

From 1 January 2017, the newly established Financial Analytical Office replaced and took over competences of the Financial Analytical Unit of the Ministry of Finance, the previous administrative body in the area of anti-money laundering.

As a part of implementation of the 4th AML Directive, an electronic register of ultimate beneficiary owners ("**UBO**") was launched. The register is maintained by register courts. Corporates and other legal entities registered in the commercial register are obliged to register their UBO from 1 January 2018. The register is not public; access can generally be granted only to competent authorities (such as courts, criminal authorities, tax administrators, and public prosecution offices, tax or other fees administration offices), to persons conducting identification and customer due diligence under the AML Act, and other persons having a legitimate interest relating to the prevention of certain crimes. Failure to register UBO is not sanctioned; therefore a number of companies do not pursue registration as an administrative burden. However, registration plays an important role for public procurements or public subsidies in evidencing of the UBO for a participant.

Payment services

The PSD2 was implemented in Czech law by a new Payment Services Act replacing the previous law from 2009. The Act together with its implementing legislation governs the area of payment services, and rights and duties of the payment services providers and their clients, with some complexity. New rules include, among others: strong customer authentication for payment transitions initiated through the internet or other electronic means; decrease of the fee to be paid in the case of an unauthorised payment transaction from €150 to €50; and the regulation of new types of payment services, such as payment initiation and account information services. Consequently, companies providing payment initiation services and account information services now need to apply for a CNB licence. In comparison to the previous PSD implementation, the new Payment Services Act no longer provides special treatment for microenterprises, which were previously treated under the same regime as consumers.

The new Payment Services Act also includes implementation of new European payment services legislation focused on further enhancement of consumer rights (comparability of fees related to payment accounts, payment account-switching and access to payment accounts, and interchange fees for card-based payment transactions).[9]

Central register of bank accounts

The central register of accounts has been established and is operated by the CNB. The main purpose of the register is to support the public authorities in criminal investigation and prosecution. The central register provides from 1 January 2018, to selected authorities upon their request, a list of account of certain persons kept by the credit institutions in the Czech

Republic. The relevant data are reported by credit institutions (including branches of foreign credit institutions operating in the Czech Republic) on a daily basis.

The central register of accounts aims to enable certain authorities (authorities involved in criminal proceedings, anti-money laundering, financial or customs administration or the State intelligence agency), to make a quick inquiry to find out which credit institution manages (or managed) an account of an entity they are interested in.

Personal data protection and cyber-security

It is worth noting that the GDPR became effective and replaced Directive 95/46/EC.[10] The GDPR introduced stricter rules on data protection and higher penalties for infringement thereof. The new Czech Personal Data Protection Act adapted to GDPR and partially implementing also Directive (EU) 2016/680 on the protection of natural persons with regard to the processing of personal data by competent authorities, is currently being heard by the Parliament.

In July 2017 an amendment to the Cyber Security Act was adopted. It implements Directive (EU) 2016/1148 concerning measures for a high common level of security of network and information systems across the Union, and aims to enhance cyber-security. The Act applies also to operators of essential services in sectors of banking and financial market infrastructures.

International tax cooperation

Financial institutions are, according to amended wording of the Act on International Tax Cooperation, which has also been amended due to the DAC II[11] and DAC III, subject to automatic exchange of information, and obliged to report to the tax institutions regarding reported accounts maintained by it.

## Bank governance and internal controls

Regulation of bank governance and internal control is included mainly in the Banking Act and Decree No. 163/2014 Coll., both reflecting the requirements of CRD IV.

Management and risk control system

Pursuant to Sec. 8b of the Banking Act, banks must maintain a management and internal control system, which shall in particular deal with: (i) prerequisites of due administration and management of the bank (including management principles and processes, an organisational structure determining powers and responsibilities and the processes of management as well as conflict-of-interest rules, administration and accounting procedures, a system of remuneration of persons with significant influence on the bank's risks, etc.); (ii) a risk management system; (iii) a system of internal control including internal audit and compliance; (iv) rules to ensure trustworthiness, expertise and experience of the board members; and (v) rules to ensure the expertise and experience of the board of directors and the supervisory board as a whole.

The management and risk control system should be effective, coherent and appropriate with regard to the characteristics, extent and complexity of the risks attached to the business model of the bank.

The system of management and internal control shall, pursuant to Sec. 10 of Decree 163/2014 Coll., implement the general guidelines of EBA, ESMA and other specified European institutions, unless the implementation of such guidelines is in breach of applicable laws. The CNB usually publishes the guidelines on its website.

Corporate bodies and committees

The corporate bodies of a bank differ for monistic and dualistic systems. In the more common dualistic system of corporate governance, the elected corporate bodies consist of: (i) a board of directors (in Czech, *představenstvo*) having at least three members; and (ii) a supervisory board responsible for control of the bank. If the bank applies the monistic system, the corporate bodies must be the following: (i) a management board (in Czech, *správní rada*) having at least five members; and (ii) a statutory director. The statutory director cannot be simultaneously the chairman of the management board, unless expressly permitted by the CNB. In both cases, the supreme body of the company is the general meeting of shareholders.

Members of the above-described elected corporate bodies of the bank must meet the requirements of trustworthiness, professional expertise and experience.

Definitions of trustworthiness, sufficient professional experience and expertise, and the list of documents required by the CNB to assess the fulfilment of the mentioned requirements, are provided by the CNB Decree No. 233/2009 Coll., as amended. Some details have been further elaborated in the Official Communication of the CNB of 3 December 2013 regarding the interpretation of the terms *trustworthiness* and *competence*.

In general, trustworthiness is assessed with particular respect to: criminal records of office-holders; insolvency history including any companies in which such persons have held executive or control positions or were under its control; previous administrative delicts; civil proceedings relating to activities of such persons on the financial market; and withdrawal of any trade licence or disqualification from professional bodies.

In accordance with Sec. 8c of the Banking Act, banks which are considered important with regard to their size, internal organisation, character, extent and complexity of their activities (generally if their balance sheet is in the amount of 5% of the total balance of all entities in the relevant sector), shall also establish the following committees: (i) a risk committee; (ii) an appointment committee; and (iii) a remuneration committee composed of non-executive members of the corporate bodies of the bank. Banks which are not considered important can also create a joint risk committee and audit committee. Similar rules apply for credit cooperatives (Sec. 7ab of the Credit Cooperatives Act).

The corporate bodies of a credit cooperative consist of: (i) a general meeting of members (in Czech, *členská schůze*); (ii) a board of directors (in Czech, *představenstvo*); (iii) a control committee (in Czech, *kontrolní komise*); and (iv) a credit committee (in Czech, *úvěrová komise*). The trustworthiness, professional expertise and experience requirements also apply to the elected bodies of a credit cooperative (under points (ii) to (iv) above) as well as conflict-of-interest rules and certain restrictions on holding executive positions in other entities.

In addition, pursuant to Sec. 44 of Act No. 93/2009 Coll. on Auditors, as amended, banks and credit cooperatives which are considered public interest entities shall also establish an audit committee with at least three members, composed of non-executive members of the corporate bodies or independent individuals.

Remuneration

Remuneration of banks and credit cooperatives is regulated in detail by Decree No. 163/2014 Coll. (implementing the requirements under CRD IV), in particular by its Annex 1, and operates on the following principles:

(a) general principles of remuneration of all its staff members; and

(b) special principles for remuneration of staff members (staff members whose activities

may have significant influence on the risk profile of the bank, including as defined by Commission Delegated Regulation (EU) No 604/2014).

The special principles also govern the form and structure of the remuneration, stipulating that the remuneration consists of both fixed and flexible aspects. The fixed amount shall be a sufficiently large proportion of the total remuneration, so that a flexible approach to the aspect of the remuneration can be applied. The ratio between the fixed and flexible aspects is subject to some restrictions.

Further, remuneration of employees responsible for internal control activities cannot be dependent on the performance of the controlled organisational unit.

Banks are also obliged to submit to the CNB information about their remuneration system and the number of persons whose remuneration has exceeded the amount of €1 million (or its equivalent) in an accounting period.

Further regulation of remuneration and inducements is provided for: (i) by the Consumer Credit Act as regards certain staff members in consumer lending; and (ii) by the MiFID II regulation as regards inducements and remuneration in investment business.

Outsourcing

Outsourcing of activities is allowed under the conditions set by Decree No. 163/2014 Coll. (mainly Sec. 12 and Annex 7 of this Decree). Outsourcing of activities which are important for the credit institution must be further notified to the CNB.

## Bank capital requirements

Requirements for capital and liquidity, as well as the obligation of credit institutions to create capital buffers, are primarily governed by CRD IV, CRR and also by the Banking Act and Decree No. 163/2014 Coll.

Capital requirements for credit institutions are determined as a certain percentage ratio of the total risk exposure amount, calculated in accordance with the detailed rules provided for by the CRR. Pursuant to Art. 92 of the CRR, credit institutions are obliged to hold: (i) a Common Equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6%; and (iii) a total capital ratio (the sum of Common Equity Tier 1 and Tier 1 capital) of 8%. Which assets are included in each category of capital is specified in detail by the CRR.

The Banking Act also includes rules on the creation of different types of capital buffers, protecting the bank against specific risks. These rules may be stricter in the case of institutions identified as systemically important. Those rules are further elaborated in a wide range of the Commission's implementing regulations and consequent technical standards adopted by EBA.

The aforementioned European legislation on capital and liquidity standards was enacted by the European Union in order to enhance the stability of credit institutions operating within its territory and reflects the Basel III requirements agreed by the G-20 after the 2008 financial crisis.

In June 2017, the CNB announced an increase of the countercyclical capital buffer (CCyB) with respect to domestic expositions, from 0.5% to 1% with effect from 1 July 2018. In December, the CNB increased the CCyB further to 1.25% with effect from 1 January 2019. The reason was, in particular, continuing fast increase of credits, in particular for residential property as well as consumer credits. According to the CNB Financial Stability Report 2016/2017, the domestic financial sector remains stable and preserves its high resilience against potential adverse financial shocks, which was confirmed in the CNB's macro-stress

tests using data available as of the end of September 2017. However, systemic risk in the area of real estate financing is not purely hypothetical, according to the central bank. The increase of the countercyclical capital buffer (CCyB) continued further: 1.5% from 1 July 2019; and 1.75% from 1 January 2020. The reasoning for the last increase was that it was due to analysis on the CNB Czech economy continuing during an expansion period of the financial cycle, and vulnerability towards potential worsening of the economic situation thus increased.

According to the CNB Financial Stability Report 2016/2017, the CNB has actively participated in discussions on minimum requirements for own funds and eligible liabilities ("**MREL**"). The CNB stressed that the framework should in future allow a sufficient amount of MREL to be set for absorbing losses and potential recapitalisation, in particular with respect to systemically important institutions. Nevertheless, according to the CNB, such framework should respect conditions in the Czech banking sector and the individual characteristics of the Czech banks.

Later in 2018, the CNB published its general approach to setting minimum requirements for MREL to provide a transparent outlook to its approach in the future years.[12] From 2019, MREL should be set for each bank individually by the CNB. The MREL requirement will be filled continuously during a sufficiently long transition period by increase of capital, issuance of bonds or other tools. The CNB anticipates the fulfilment of this requirement: the banks should, in the next four years, provide capital or eligible liabilities in the amount of approx. CZK 120 to 140 billion.

### Rules governing banks' relationships with their customers and other third parties

Conduct of business rules in general

Czech civil law (in particular) provides only a limited amount of defined types of banking contracts (account agreement, deposit, letter of credit, direct debit, bank guarantee, etc.). These types of contract are specified in Act No. 89/2012 Coll., the Civil Code, as amended (the "**Civil Code**"); but as the law deals with only the general features of each agreement, the rights and obligations of the parties are stipulated in detail in the contract with the bank, supplemented by the general term and conditions. In the case of retail customers (consumers), freedom of contract is substantially limited by general consumer protection law,[13] which also grants consumers special rights. The Civil Code also protects the consumers in respect of distance contracts and contracts negotiated away from business premises, as well as in respect of certain other aspects of consumer contracts.

Special conduct-of-business rules are provided for by the Consumer Credit Act, Payment Services Act, Capital Markets Act and the Foreign Exchange Act. For example, pursuant to the Consumer Credit Act, banks and other lenders shall act towards the clients with professional care, provide them with pre-contractual information, assess the creditworthiness of a client, and fulfil numerous information duties. Further, the Consumer Credit Act limits the amount of potential sanctions in case of default, prepayment fees, regulates the calculation of annual percentage rate of charge, and grants consumers the right to withdraw from the agreement in a 14-day period, excepting mortgage credit agreements.

Complaints

Banks and credit cooperatives are obliged to implement internal mechanisms for dealing with clients' complaints and make them accessible in their business premises. The Consumer Credit Act also expressly requires publication on the bank or credit cooperative's website.

Dispute resolution

Notwithstanding the right to raise legal action before the competent court, retail clients are further entitled to initiate proceedings before the special resolution body – the Financial Arbiter dealing with financial services within its competence. Commencement of proceedings is free of charge. The decision of the Office of the Financial Arbiter can be appealed by so-called objections, which are decided on by the Financial Arbiter itself. The final decision of the Financial Arbiter is binding and enforceable but may be contested before a court of law.

Restrictions on inbound cross-border activities

Czech regulation generally governs the provision of financial services within the territory of the Czech Republic. If a foreign credit institution intends to carry out its activities within the territory of the Czech Republic, different regimes apply to EU and non-EU entities. Non-EU banks are required to obtain a licence from the CNB for their branch. For EU banks, the European passport applies. The CNB has published its criteria for determination of the place where financial services are provided in a statement dated 25 November 2011.

Deposit guarantee schemes

Deposits of all private clients of credit institutions are insured by the Financial Market Guarantee System under Sec. 41a *et seq*. of the Banking Act and Sec. 14 of the Credit Cooperatives Act, implementing the relevant European legislation – the DGSD. The guarantee scheme is based on obligatory contributions of credit institutions into the deposit guarantee fund. The deposits are guaranteed up to a limit of €100,000 per client and bank. In a limited scope of cases, when the client is a natural person and the deposit serves a specifically defined purpose, the limit may be raised up to €200,000.

Investor Compensation Schemes

Banks providing investment services obligatorily participate in the Czech investor compensation scheme fund (in Czech, *Garanční fond obchodníků s cennými papíry*). This scheme provides for compensation of 90% of all assets (money or investment instruments) belonging to the clients and held on their behalf in connection with investment business, up to a limit of €20,000 per client and bank providing investment services.

The further conditions are provided by the Capital Markets Act implementing EU Directive 97/9/EC on investor-compensation schemes.

Anti-money laundering regulation

Credit institutions are obliged to carry out KYC and due diligence procedures pursuant to the conditions laid down by the AML Act, and Decree No. 67/2018 Coll. on certain requirements for the system of internal principles, procedures and control measures against money laundering and terrorist financing. During identification of customers, banks and credit cooperatives shall identify politically exposed persons and persons against whom international sanctions have been imposed. Banks and credit cooperatives must have internal AML rules and update them regularly. Training of employees must also be ensured.

Suspicious transactions must be reported to the Financial Analytical Office, which is an independent office from the Ministry of Finance. The Financial Analytical Office also published the model AML rules.

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## Endnotes

1. At the end of January 2019, the group of four Czech largest banks consisted of Česká spořitelna (Erste group), ČSOB (KBC group), Komerční banka (Société Générale group) and UniCredit Bank.
2. I.e. Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No. 648/2012.
3. The draft bill amending the Czech Credit Cooperative Act (in Czech, *zákon o družstevních záložnách*) was adopted by the Czech Parliament in December 2014. Most of its provisions took effect on 1 May 2015. This new piece of regulation provides for, e.g., a limit for deposit interests which shall be linked to the shareholding of the client (who is also a member of the credit cooperative) in the credit cooperative.
4. European Economic Area, i.e. Member States of the European Union, Iceland, Liechtenstein and Norway.
5. EBA's main objective is to promote the harmonisation and correct application of the European legislation regulating prudential requirements and supervision of credit institutions in the European Union. For this purpose, the EBA issues technical standards or guidelines in various areas. Technical norms are issued upon the mandate given by the (EU) Commission and include more detailed norms in respect of prudential requirements for credit institutions. Guidelines are not legally binding, but according to the Regulation (EU) No. 1093/2010, the competent authorities and financial institutions shall make every effort to comply with those guidelines and recommendations; therefore, those documents practically have a regulatory impact as well. The CNB very often refers to such guidelines and works to ensure that the supervision of the financial market participants is compliant with such guidelines.
6. The group of 20 states, the European Union being a member thereof, having the strongest economies in the world, represented by the heads of governments or ministers of finance.
7. Deposits in credit unions are often connected with high interest and at the same time they have the same protection of deposits in the deposit guarantee scheme as the banks.
8. Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds.
9. Regulation (EU) 2015/847 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions and Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features.
10. Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.
11. Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.
12. Consumer protection is, among other laws and regulations, governed by Act No. 634/1992 Coll., on Consumer Protection, as amended.
13. Available at CNB's website: https://www.cnb.cz/cs/verejnost/pro_media/tiskove_zpravy_cnb/2018/20181031_mrel.html.

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