CZECH REPUBLIC

BANKING

SUMMARY

As of September 30, 1998, 47 banks operated in the Czech Republic, including 14 foreign banks and nine branches of foreign banks. The largest five locally incorporated banks dominate the market, with 66 percent of the banking sector's overall assets. Foreign banks and their branches accounted for 22 percent of banking sector assets as of year-end 1997, a substantial increase from only 6 percent as of year-end 1993.

The Czech government continues to hold near majority stakes in three large banks. The privatization process only recently evidenced any notable progress, beginning with the sale of the government's stake in the Investment and Postal Bank to Nomura in 1998. The banking sector remains weak, with domestic banks burdened by large volumes of delinquent loans. The Czech government is looking to improve the sector's performance through further bank privatization, stricter bank oversight and simplified bankruptcy laws.

The Czech National Bank (CNB) regulates banking operations. In response to the weakness of the sector and the financial irregularities which characterized the banking sector in the early 1990s, the CNB, in coordination with the government, has tightened prudential requirements, introduced legislation to separate banks' investment and banking operations, and increased bank supervisory staff. Further regulatory changes are expected in the runup toward EU accession.

There are 14 foreign banks and nine branches of foreign banks. Currently two U.S. banks conduct commercial banking operations (other than representative offices) in the Czech Republic. Citibank is one of the most prominent foreign banks in the Czech Republic, and operates through a wholly-owned bank subsidiary. GE Capital recently purchased Agrobanka, a medium-sized Czech bank forced into receivership. To date, U.S. banks have not entered the retail banking sector, though the recent purchase of Agrobanka by GE Capital is expected to bring a U.S. presence to the retail banking sector. As of July 31, 1998, U.S. banks controlled less than 5 percent of total banking sector assets.

The CNB issued no new bank licenses in 1997, and only two banks received licenses in 1996, following an informal moratorium on new bank licenses from 1994-1995, as the central bank attempted to clean up the troubled sector. The central bank has stated that it will grant new licenses to those banks, foreign or domestic, which will improve the overall quality and competitiveness of the banking sector. Foreign banks are generally permitted to engage in the same range of financial activities as domestic banks. The one exception is a restriction on the issuance of mortgage-backed debt securities by branches of foreign banks. U.S. banks have not reported any instances of discriminatory treatment.

DESCRIPTION OF THE MARKET

Structure of the Market

As of December 31, 1997, 50 banks were operating in the Czech Republic, including 14 foreign banks and nine branches of foreign banks. Total banking sector assets equaled US$67.4 billion in 1997, with the lion's share of recent increases attributable to foreign banks and foreign bank branches. The banking sector is dominated by the five largest locally-incorporated banks, consisting of Komercni Banka (Commercial Bank), Ceska Sporitelna (The Czech Savings Bank, which dominates the household sector), Konsolidacni Banka (The Consolidation Bank), Investicni-Postovni Banka (IPB, or The Investment and Postal Bank), and Cesko-Slovenska Obchodni Banka (CSOB, or The Czechoslovak Trade Bank). All five banks have universal banking licenses. They accounted for a combined 66 percent share of banking sector assets as of year-end 1997, compared with 84 percent at the beginning of 1994. The decline in their market share is, in large part, attributed to the entry of foreign banks into the system. Foreign banks and their branches accounted for 22 percent of banking sector assets as of year-end 1997, a substantial increase from only 6 percent as of year-end 1993.

As of year-end 1997, the government held major stakes in four large locally incorporated banks: Komercni Banka (49 percent), Ceska Sporitelna (45 percent, but with 53 percent of the voting rights), Konsolidacni Banka (100 percent), and CSOB (40 percent by the Czech government, 27 percent by the Czech central bank, and 25 percent by the Slovak central bank). The government also retains a 49 percent stake in the Czechmoravian Development Bank, with additional shares held by the Ceska Sporitelna (13 percent), Komercni Banka (13 percent), Investicni-Postovni Banka (13 percent), CSOB (2 percent) and Agrobanka (11 percent).

Komercni Banka and Investicni Banka were established in 1990, when the commercial banking functions of the Czechoslovak National Bank were separated from central banking functions. Long-term investment assets were transferred to Investicni Banka, and the assets of the remaining commercial activities were transferred to Komercni Banka. The liability side of both banks consisted primarily of short- to medium-term funds from Ceska Sporitelna. Komercni Banka is the largest commercial bank in the Czech Republic. In 1993, Investicni Banka merged with Postovni Banka (a bank specializing in bill payment and funds transfers through Czech post offices) to build up its retail business. The merged entity, now known as Investicni-Postovni Banka, is the fourth largest bank. Ceska Sporitelna, also established in 1990 and presently the second largest bank, is the successor organization of the Czechoslovak State Savings Bank, the country's only savings bank in the Communist era. Ceska Sporitelna recently expanded its activities to include lending to small- and medium-sized companies, and investment banking and treasury activities. Prior to 1989, virtually all Czechoslovak foreign trade and major projects were financed by CSOB, which still holds an estimated 70 percent share of the foreign financing market.

Konsolidacni Banka, the third largest and only majority government owned bank, was established by the Czechoslovak government in 1991 to administer US$3.7 billion of non-performing loans of the major banks. Konsolidacni Banka also evolved to serve as a government development bank, and has even provided credits to ailing firms in a few cases. The remaining smaller, locally incorporated banks have varied ownership structures. Shares of three of the larger banks – Komercni Banka, Ceska Sporitelna, and IPB – are traded on the Czech Stock Exchange.

The Tosovsky government, which concluded its term in June 1998, began implementation of long-promised privatization of the banks, with the sale of the government's minority stake in IPB to longtime suitor Nomura in March 1998. It also set in motion the process to privatize Komercni, the Czech Savings Bank and the CSOB by the year 2000. At this time it is unclear whether the new Social Democratic government, while generally supportive of continued bank privatization, will adhere to its predecessor's timetable or proceed at a slower pace. The IFC approved in July a ceiling of US$75 million to purchase a stake of between 10 percent and 15 percent in CSOB. In addition, the European Bank for Reconstruction and Development gained a 10 percent stake in Ceska Sporitelna in 1998.

The weakness of the financial sector, including the banks, is one of the most serious problems afflicting the Czech economy. During the early 1990s, privatization of companies through the issuance of "voucher" shares to citizens rapidly created a voluminous and largely unregulated equity market. Investment funds promising to deliver high returns for management of individual vouchers quickly formed. Banks owned many of the funds which bought up these voucher certificates issued during the privatization process. As the remaining shares in these industrial concerns were held by individuals, the banks ended up owning the largest blocks of shares in many nonfinancial companies. The banks and firms exploited this relationship: Firms sought loans instead of raising capital by other means, and banks forced these firms to take on noncompetitive loans. The linkages between the banks, the funds and corporations, combined with weak regulation of capital markets and poor oversight of the banks, led to the issuance of questionable loans to many corporations, and a subsequent rise in the banks' classified loans. This situation was further complicated by the banks' inability to foreclose on collateral due to outdated and inadequate bankruptcy and commercial codes.

Burdened by bad debt, total banking sector losses began to mount. As of June 30, 1998, 28.9 percent of bank credits were classified as non-performing (more than 30 days past due), not including loans held by the Konsolidacni Banka and Ceska Financni programs. This share is expected to rise due to stricter provisioning requirements and oversight by the central bank, and the recent sluggishness of the economy. The weakness of the banks has limited the extension of new credits, acting as a further drag on economic growth.

Due to budgetary pressures, commitment to continued economic reform, and unsuccessful past attempts with government intervention, the Czech government continues to reject a broad bailout plan for the troubled banking sector, looking to bank privatization, stricter oversight, tightened provisioning requirements and simplified bankruptcy laws to improve the sector's performance. In 1996, as part of an overall "small bank" stabilization plan following the failure of two small banks and the forced administration of a third, the CNB established Ceska Financni to shore up the smaller domestic banks. Under this program, small banks transferred US$405 million in bad loans to Ceska Financni with the understanding the loans would be repurchased in seven years. As of June 30, 1998, only one of the original seven banks in this program remained in receivership. The Tosovsky government announced its intentions to spend as much as US$330 million to cover losses stemming from the transfer of nonperforming loans from locally-incorporated banks to Konsolidacni Banka. It is unclear whether the new government will follow up on this.

Electronic banking has started to penetrate the Czech market. The level of services offered by Czech banks varies widely. Presently, electronic banking is oriented exclusively toward current account transactions, including payments abroad. There are two ATM networks operating in the Czech Republic: one operated by Ceska Sporitelna and the second by a group of 18 banks sharing a common network. Ceska Sporitelna has issued almost 1.2 million ATM cards and has 825 ATM machines. The other network has issued 600,000 cards and operates 532 ATMs.

Regulatory Structure

The CNB is an independent monetary and regulatory authority that has responsibility for licensing and regulating banking activity. The CNB has come under fire in recent years for inadequate bank supervision, that in turn has been attributed to the current weak state of the banking sector and high level of non-performing loans.

In response, the central bank more than doubled the number of bank supervisory staff and tightened provisions and reserves for non-performing loans, and prudential requirements in general. Mandatory deposit insurance now covers 90 percent of deposits valued at approximately US$12,000 in a single bank, except for foreign currency deposits. Banks are restricted in lending of no more than 25 percent of regular capital to a single client. New amendments to the banking act implemented in February 1998 prohibit banks from holding controlling stakes in companies other than banks, financial institutions, and companies providing banking support services. The total amount of banks' stakes in all non-financial companies will be limited to a maximum of 60 percent of a bank's equity, with a single investment totaling no more than 15 percent. The amendment also requires banks to separate commercial and investment banking divisions.

Other recent amendments boost the central bank's supervisory powers by enhancing its capability to enforce stricter reporting requirements. Additionally, the CNB issued new regulations in 1998 requiring the creation of provisions to cover the spread between the purchase and market price of securities in banks' portfolios. With a view toward accession to the European Union, the central bank plans to revise further regulations governing the sector in order to harmonize with EU norms.

U.S. PRESENCE IN THE MARKET

There are currently 14 foreign banks and 9 branches of foreign banks. Foreign banks can establish bank subsidiaries, direct branches, joint ventures, offshore branches, and representative offices. Foreign banks can also acquire locally incorporated banks. However, the CNB issued no new bank licenses in 1997, and only two banks received licenses in 1996, following an informal moratorium on new bank licenses from 1994-1995, as the central bank attempted to clean up the troubled sector. European banks dominate the foreign banking sector.

There are two U.S. banks with banking operations other than representative offices in the Czech Republic, which controlled less than 5 percent of total banking sector assets as of July 31, 1998. Citibank is one of the most prominent foreign banks in the Czech Republic, and operates through a wholly-owned bank subsidiary. GE Capital recently purchased Agrobanka, a small Czech bank forced into receivership. Chase Manhattan, Bankers Trust and J.P. Morgan also have representative offices, operating in the investment banking sphere. To date, U.S. banks have not entered the retail banking sector, though the recent purchase of Agrobanka by GE Capital is expected to bring a U.S. presence to the retail banking sector.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Foreign bank participation in the Czech banking sector remains an important element in the successful transition of the Czech economy and efforts to enhance the competitiveness and stability of the banking sector. The central bank has stated that it will grant new licenses to those banks, foreign or domestic, which will improve the overall quality and competitiveness of the banking sector. Foreign banks are generally permitted to engage in the same range of financial activities as domestic banks. The one exception is a restriction on the issuance of mortgage-backed debt securities by branches of foreign banks. U.S. banks have not reported any instances of discriminatory treatment.

The Czech Republic's GATS commitments of December 1997 accurately reflects current practice.