Evolution of the Supervisory Function within the CNB

Seminar marking the 20th anniversary of the Czech and Slovak Central Banks

October 2nd, 2013
I.
The Czech Financial Sector
• The Czech financial sector is dominated by banks
As of July 2013, capital adequacy was 17.6% (Tier 1 ratio 17.3%)
The Czech banking sector remains profitable during crisis despite the adverse economic conditions which feeds into capitalization.
Profitability of the Banking Sector

- Return on Equity (RoE) and Return on Assets (RoA) still rather high in international comparison

![Graphs showing RoE and RoA](source: IMF FSI)

Source: IMF FSI
Czech Banks‘ Funding

- Funding structure is sound
- Key ratios have not changed much over years ...

Liquidity ratios in the banking sector

Deposit-to-loan ratio in selected economies (in %)

Source: CNB

Source: ECB
• Non-performing loans (NPL) going up in the corporate segment while stable in the housing sector ...

Credit Risk Indicators

- Non-performing loans
- Non-financial corporations
- Households

- Total loans
- Non-financial corporations
- Households

- Housing loans
- Consumer loans

Graphs showing the percentage of non-performing loans over time for different sectors.
**NPL coverage has stabilized, but structure of NPL got worse ...**

**Provisions and coverage of NPLs by provisions**

<table>
<thead>
<tr>
<th>Year</th>
<th>Substandard (%)</th>
<th>Doubtful (%)</th>
<th>Loss (%)</th>
<th>NPLs, total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>37.4</td>
<td>21.1</td>
<td>41.4</td>
<td>100.0</td>
</tr>
<tr>
<td>2010</td>
<td>39.2</td>
<td>13.4</td>
<td>47.4</td>
<td>100.0</td>
</tr>
<tr>
<td>2011</td>
<td>32.6</td>
<td>14.0</td>
<td>53.5</td>
<td>100.0</td>
</tr>
<tr>
<td>2012</td>
<td>27.1</td>
<td>14.3</td>
<td>58.6</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Not past due**

<table>
<thead>
<tr>
<th>Year</th>
<th>Not past due (%)</th>
<th>Up to 3M past due (%)</th>
<th>More than 3M past due (%)</th>
<th>NPLs, total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>52.4</td>
<td>9.2</td>
<td>38.4</td>
<td>100.0</td>
</tr>
<tr>
<td>2010</td>
<td>51.6</td>
<td>9.9</td>
<td>38.5</td>
<td>100.0</td>
</tr>
<tr>
<td>2011</td>
<td>46.1</td>
<td>9.4</td>
<td>44.5</td>
<td>100.0</td>
</tr>
<tr>
<td>2012</td>
<td>43.7</td>
<td>9.5</td>
<td>46.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CNB, CNB calculation
Recent data confirm just a slow loan growth

Year-on-year growth rates of a bank loans in the Czech Republic
(in %)
Source: CNB

Year-on-year credit growth to households
(in %)
Source: CNB
The stress tests and other analyses demonstrate that the Czech financial sector is well prepared for potential stresses. Banks have a large capital buffer which enables them to absorb adverse shocks and maintain the sector’s overall capital adequacy sufficiently above the regulatory threshold of 8% even in a very unfavorable scenario. To maintain high public and investor confidence in the stability of the Czech banking sector in the current adverse economic environment, banks must maintain a high capacity to absorb potential credit and market losses. No acute risks to financial stability requiring immediate action are identified.
II.
Supervision of
the Czech Financial Sector
Integration of Supervision

- **Supervisory institutions – till 1.4.2006**
  - CNB – banks
  - Office of State Inspection in the Insurance and Pension (Ministry of Finance) – Insurance companies and Pension funds
  - Office for Supervision of Credit Unions – credit unions
  - Czech Securities Commission – investment funds, mutual funds, stock exchange, brokers and intermediaries, etc.

- **Supervisory institution – integrated supervisor – since April 2006 till now**
  - CNB is the only one supervisor
    - banks, foreign bank branches, credit unions
    - insurance companies, foreign insurance company branches, reinsurance company, pension funds depositories
    - securities companies, investment funds, investment companies, mutual funds, brokers and intermediaries
    - payment institutions
Functional Model of Supervision

• Functional model – since January 2008
  • Financial Market Regulation and Analyses Department
  • Licensing and Enforcement Department
  • Financial Market Supervision Department

Financial Market Supervision Department

- Credit Institutions Supervision Division
- Insurance Sector Supervision Division
- Capital Market Supervision Division
- Risk Management Control Division
- Proceedings Rules and Professional Care Control Division
Since March 2011
• Financial Market Supervision Dpt.

<table>
<thead>
<tr>
<th>Prudential supervision</th>
<th>Off-site</th>
<th>On-site</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prudential Supervision Division</td>
<td>Conduct of Business Supervision Division</td>
<td></td>
</tr>
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<td>Prudential Inspection Division</td>
<td>Conduct of Business Inspection Division</td>
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</tbody>
</table>
CNB – Integrated Supervisor

- Easy day-to-day communication + information-sharing synergies
- Easier communication with supervised entities, foreign supervisors
- Stronger position in the crisis situation
- Enables to monitor the whole financial market (financial stability perspective)
- Ability to analyze the impact of development in one sector to other sectors or the whole economy
- Strong technical and professional support
- Unification of reporting formats for different sectors where suitable
- Unification of supervisory techniques for different sectors where suitable
- Faster development of supervisory methods, internal procedures etc.
Integrated Supervisor in Independent Central Bank

- Easy sharing information from money market, payment system (existence of Chinese walls) – crucial for banking supervision
- Combination of financial stability and supervisory point of views – common working groups (stress testing exercises for banks and insurance companies)
- Independent and apolitical decision-making process
- Allows to focus on systemic risk
- Adequate financial sources enable hiring experienced staff and using necessary technical support
Cooperation

- Colleges
- Technical assistance to third countries (Egypt, etc.)
- Active participation in EBA
  - Board of Supervisors
  - Management Board
    - CNB representative member of the first EBA mediation panel
  - SCRePol
    - Standing Committee on Regulation and Policy
- Mediation Panel
  - CNB representative member of the first EBA mediation panel
Challenges posed by Banking Union

- **Regulatory area**
  - EBA regulatory role even more important (draft BTS)
    - No major challenge (formal double simple majority voting in EBA, but established practice of reaching decisions on consensual basis and level of harmonization reached so far makes decision-making easier)

- **Supervisory area**
  - Might face some challenges concerning Q&A and SSH (Single Supervisory Handbook) in relation to individual supervisors and SSM
  - Concerns implementation practice and colleges
    - Up to now weights of individual authorities were balanced
    - Newly one supervisor (ECB) will be much stronger and bigger than any other

- **Risk of a wrong set-up with regard to the SSM**
  - Two-speed Europe
  - Tensions between two blocks (participating and non-participating MSs)
  - For one block it will be easier to over-rule the other block
  - Instead of single market we will end up with more fragmented markets within the EU
Lessons To Be Learned

• Importance of having
  • Conservative financial sector
    • Dominated by banks which are
      • well capitalized and
      • have sound funding structure
  • Integrated supervision
    • Alignment of supervisory techniques, methods and procedures across sectors
    • Information sharing, communication and reporting advantages
    • Supervisory and financial stability synergies
Thank you for your attention

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