STANDARD SUMMARY PROJECT FICHE - TRANSITION FACILITY

1. Basic Information
   1.1 CRIS Number: CZ 2004/006-237/04.02
   1.2 Title: Financial Stability Issues in the Czech National Bank
   1.3 Sector: Internal Market and Economic Criteria
   1.4 Location: Czech Republic

2. Objectives
   2.1 Overall Objective(s):
   The existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union (2nd Copenhagen Criterion);
   The ability to take on obligations of membership including adherence to the aims of political, economic & monetary union (3rd Copenhagen Criterion);

   2.2 Project purpose:
   To enhance both the operational and the research-oriented know-how of the Czech National Bank (CNB) in the financial stability area and preparing the CNB’s Financial Stability Reports so that the Czech National Bank would be able to meet requirements of the ECB on contributing to the ECB Financial Stability Reports and to cope with the analytical challenges associated with the New Basel Capital Accord (“Basel II”) and the related EU Risk Based Capital Directive (RBCD);

   2.3 Justification
   Treaty Establishing the EC – Article 105, Paragraph 5 – “The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system”;
   Requirements of the European Central Bank – ECB Accession Master Plan of the Acceding Countries to the ESCB

3. Description
   3.1 Background and justification:
   Since 1989, the banking sector structure has undergone very dynamic development. A large number of the newly established banks were unable to cope with the strong competition and risky conditions associated with the economic transformation and were forced to terminate their operations. The tightening of the conditions for setting up new banks has restricted the entry of new entities into the sector, particularly since 1996. Recently, the structure of the banking sector has been affected by mergers of individual banks, leading to a concentration of the sector. Between 1989 and the end of 2003, a total of 63 banking licenses were granted and 28 revoked. Of these, 18 were revoked because of the relevant bank’s poor financial situation and failure to meet the prudential rules, 8 as a result of mergers, 1 because the bank failed to start its operations within the allotted legal period and 1 bank has been transformed by law into a specialized agency.

   As of 31 December 2003, there were 36 banks and foreign bank branches operating in the banking sector, a fall of one from the same time a year earlier.

   The structure of the Czech-banking sector appeared as follows:
   * 1 central bank
   * 2 banks controlled by the state (including municipalities)
   * 17 banks controlled by the foreign shareholders
   * 7 banks controlled by the Czech entities
   * 9 foreign bank branches.

   A competitive banking sector is one of the prerequisites for successful integration into European financial market structures with respect to stability, performance, profitability and legislative and regulatory harmonisation. A stable and competitive banking sector has a decisive effect on the quality of the entire financial sector. The domestic banking sector is developing in line with trends in European and international banking. It is being affected by economic developments both in the Czech Republic and in our trading partner countries.
Alongside improvements to the regulatory framework, the groundwork has been laid for the sound development of the banking sector, free of any major problems of a systemic nature. Now that the privatisation of the large Czech banks have been completed, the ownership structure of the sector has stabilised. The domestic banking sector is becoming integrated into European banking structures via supranational financial groups of large-bank owners. In the Czech Republic, foreign banks either directly or indirectly control almost 95% of the banking sector’s assets. The process of concentration through mergers and acquisitions is governed by the need to be competitive and to cut costs.

The concentration process in the Czech Republic is visible mainly in the growing significance of medium-sized banks, which are gradually expanding their activities. The results of the concentration process in the EU countries is also affecting the Czech banking sector, via mergers and acquisitions of banks that are now part of the domestic banking sector.

The decline in the number of banks and the ever-increasing level of total managed assets has brought about an increase in the average bank size. As of 31 December 1994, the average bank was managing total assets of CZK 27.7 billion, whereas by the end of 2002 the figure had more then doubled to CZK 74.0 billion.

The developments over the past three years demonstrate clearly that the near monopoly position (until recently) of the large banks as regards the two most interesting products from the point of view of clients - deposits and credits - is continuing to wane as the positions of the other bank groups strengthen.

Justification
Following the wave of emerging-market crises in 1997-98, an increasing emphasis has started to be put on analysing the links between macroeconomic and financial stability. Central banks have been discussing how to include asset prices and other financial indicators in their macroeconomic assessments. Banking supervisors and international financial institutions have listed macroeconomic instability among the potential shocks that may interact with financial vulnerabilities and cause systemic risk. The quantitative and qualitative techniques that are used for assessing financial system soundness include the macro-prudential analysis, stress testing, etc.

The work has been intensified on developing comprehensive international standards and best practices that would make the international financial architecture more resilient to shocks. The FSAP project was launched by the IMF and WB as a means of surveillance of the international standards being transposed into the national legal and regulatory systems. On the national level, many central banks have started to publish financial stability reports assessing the vulnerabilities in the domestic financial systems, or to prepare such reports internally.

The ongoing works on the New Basel Capital Accord (“Basel II”) and the related EU Risk Based Capital Directive (RBCD) will also put further demands financial regulators and supervisors to understand modern quantitative methods of risk assessment in the financial institutions, and in the financial system as a whole.

In line with these general trends, the Czech National Bank (CNB) has focused in the recent years on developing its financial stability analysis. This emphasis also reflects the difficulties experienced in the banking sector in the late-1990s, which were partly related to the currency turmoil in 1997 and the subsequent painful macroeconomic adjustment. The financial stability at the CNB, though, is still less advanced than the analysis of macroeconomic and monetary issues. As part of the research programme of the CNB for 2003-2004, the Bank Board has approved a project called “Financial Stability Issues: An Overview from the Central Banks’ Perspective”, stressing this area as one of the research priorities. The project has a learning dimension, aiming at creating the necessary analytical skills at the CNB, which could be subsequently applied in the operational work. At the same time, the bank regulatory department of the CNB has been working on developing a Czech financial stability report, the pilot version of which is going to be discussed by the CNB’s Bank Board in December 2003.

3.2 Linked activities:
There are no linked activities financed from Phare funds. This project shall be based on the above-mentioned CNB internal pilot project called “Financial Stability Issues: An Overview from the Central Banks’ Perspective” that will map and analyse the current state of development in Financial Stability area in the CNB. The project was launched in January 2003 and the completion of the project is expected in the 3rd Quarter2004.
3.3 Results:
- Further research priorities at the CNB in the financial stability field for the period after 2004 defined.
- Quantitative analytical techniques into the CNB’s Financial Stability Report and a set of background studies for this Report, including analyses of the credit and market risks, stress testing exercises, and so on, developed and introduced.
- The financial analyses beyond a sectoral segmentation, with the focus on the ability of the financial system as a whole to perform its core functions and on the interrelations between sectors extended.
- The CNB’s ability to cope with the increasing analytical and strategic requirements in the financial stability issues intensified by the process of the European economic integration and creation of the new international standards improved.

3.4 Activities:
The assistance will be provided via one twinning covenant providing:
- **One Pre-Accession Advisor** experienced in financial stability analyses, staying at the CNB for 18 man-months and approx. 2-3 short—term experts (approx. 90 man-days).
  - The PAA and short-term experts shall:
    - assist in **defining the financial stability analyses framework**, and **designing the reporting system** in the financial stability area. This would include defining the priorities, developing of statistical and mathematical methods for the assessment of financial stability,
    - **advice** the CNB staff in **drafting the Financial Stability Reports**, and **co-ordinating** the researchers when working on the ECB Financial Stability Reports. A personal engagement in some of the research projects should be a part of the expert’s tasks. An emphasis would be put on facilitating the learning process of the CNB’s staff.
    - be involved in **research and training seminars held at the CNB** related to financial stability issues. Lectures shall be given by the PAA, and potentially by other short-term experts from the partner institution. Potential participants from the CNB shall include the bank regulation and supervision staff, research department, advisers to the bank board and interested staff from the monetary department (number of participants in seminars: approximately 20 - 30 persons – approx. two rounds of approx. 4 seminars (approx. 5 days each – Total man-days = 40 man-days).
    - organize **short-term internships** (max. one week each) for the CNB’s staff in the partner institution, including consultation with the experts responsible for the financial stability research, preparations of the financial stability reports and reporting to the EU institutions. The Czech National Bank shall cover air-tickets of the CNB participants in short-term internships programme (number of participants in training: approx. 20 persons).- Total man-days = 100 man-days.

Purpose of this training shall be a familiarisation of CNB specialists with the know-how to be applied by them on the spot in the EU-member Central Bank in the form of learning by doing.
This irreplaceable training shall create the needful practical experience of the CNB specialists to be used in the preparation of CNB Financial Stability Reports and CNB contribution to the ECB Financial Stability Reports undertaken in the Czech Republic.

The PAA and short-term experts shall closely work with experts from the bank regulation department and research department and advisers to the bank board and the CNB cross-sectional Working Group on Financial Stability Issues.

3.5 Lessons learned:
All relevant recommendations regarding previous Phare projects in the field were taken into account when designing this project.
4. **Institutional Framework**

The Beneficiary of this project shall be the Czech National Bank – namely the Banking Regulation Department and the Research Department.

The project shall be implemented under the authority of the Czech National Bank and will be managed by the Steering Committee consisting of representatives of the CNB, PAA and representatives of the EU-member Administration delivering the assistance, representatives of the Centre for Foreign Assistance of Ministry of Finance of the Czech Republic and CNB Phare Unit.

The Programme Officer at the CNB shall be responsible for the preparation, technical control and implementation of the project.

5. **Detailed Budget (M€)**

<table>
<thead>
<tr>
<th>Project Component</th>
<th>Transition Facility Support</th>
<th>National Cofinancing*</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Investment Support</td>
<td>Institution Building</td>
<td>TF(=I+IB)</td>
</tr>
<tr>
<td>Twinning covenant</td>
<td>0,500</td>
<td>0,500</td>
<td>0,500</td>
</tr>
<tr>
<td>Total</td>
<td>0,500</td>
<td>0,500</td>
<td>0,500</td>
</tr>
</tbody>
</table>

*In cases of co-financing only

6. **Implementation Arrangements**

6.1 **Implementing Agency**

Responsibility for the administration related to the procedural aspects of procurement, contracting and accountancy will rest upon the CFCU, Ministry of Finance of the Czech Republic, Letenská 15, 118 10 Prague 1, Czech Republic. The PAO is Mr. Jan Slavíček, Head of CFCU, jan.slavicek@mfcr.cz, phone: +420 2 5704 4551, Fax: +420 2 5704 4550.

6.2 **Twinning**

Beneficiary institution will be the Czech National Bank, Banking Regulation Department. The project leader is Mrs. Věra Mašindová, Executive Director of Banking Regulation Department, Czech National Bank, Na Prikope 28, 115 03 Prague 1, phone: +420 22441 4417, fax: +420 22441 2686, E-mail: vera.masindova@cnb.cz.

Responsibility for the technical aspects related to preparation, implementation and technical control will rest with the Project Implementation Unit at the Czech National Bank. The Contact Person is Mr. Jan Málek, Phare Senior Programme Officer, Czech National Bank, Na Prikope 28, 115 03 Prague 1, phone: +420 22441 4459, fax: +420 22441 3448, E-mail: jan.malek@cnb.cz.

6.3 **Non-standard aspects**

N/A

6.4 **Contracts**

(1) Twinning covenant – 0,500 M€

7. **Implementation Schedule**

7.1 Start of tendering/call for proposals: 3Q / 2004

7.2 Start of project activity 1Q / 2005

7.3 Project Completion 3Q / 2006

8. **Sustainability**

As part of the research programme of the CNB for 2003-2004, the Bank Board has approved a project called “Financial Stability Issues: An Overview from the Central Banks’ Perspective”, stressing this area as one of the research priorities. The Bank Board approved the creation of cross-sectional Working group “Financial Stability Issues” within the CNB with participation of advisers to the bank board and experts from the bank regulation and supervision department, research department, and monetary department.

9. **Conditionality and sequencing**

N/A
ANNEXES TO PROJECT FICHE

1. Logframe planning matrix
2. Detailed implementation chart
3. Contracting and disbursement schedule
## LOGFRAMME PLANNING MATRIX

### Project title: Financial Stability Issues in the Czech National Bank

<table>
<thead>
<tr>
<th>Overall Objective</th>
<th>Objectively verifiable indicators</th>
<th>Sources of Verification</th>
<th>Assumptions</th>
</tr>
</thead>
</table>
| - the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union (2nd Copenhagen Criterion); | - Acknowledgement by the European Commission and the ECB | - EC Report  
- National & CNB statistics  
- International reports/publications  
- Reports from commercial banks | |

### Project purpose

- To enhance both the operational and the research-oriented know-how of the Czech National Bank (CNB) in the financial stability area and preparing the CNB’s Financial Stability Reports so that the Czech National Bank would be able to meet requirements of the ECB on contributing to the ECB Financial Stability Reports and to cope with the analytical challenges associated with the New Basel Capital Accord (“Basel II”) and the related EU Risk Based Capital Directive (RBCD); The ability to take on obligations of membership including adherence to the aims of political, economic & monetary union (3rd Copenhagen Criterion);

<table>
<thead>
<tr>
<th>Objectively verifiable indicators</th>
<th>Sources of Verification</th>
<th>Assumptions</th>
</tr>
</thead>
</table>
| - Acknowledgement of Financial Stability Reports issued by the CNB by the ECB. | - Financial Stability Reports issued by the CNB;  
- Financial Stability Reports issued by the ECB;  
- A&E reports from implementing unit | - World / EU economic growth remains positive for each of the five years following the completion of the project; |

### Results

<table>
<thead>
<tr>
<th>Twinning</th>
<th>Objectively verifiable indicators</th>
<th>Sources of Verification</th>
<th>Assumptions</th>
</tr>
</thead>
</table>
| - Further research priorities at the CNB in the financial stability field for the period after 2004 defined.  
- Quantitative analytical techniques into the CNB’s Financial Stability Report and a set of background studies for this Report, including analyses of the credit and market risks, stress testing exercises developed, and so on developed and introduced. | - Acknowledgement of Financial Stability Reports issued by the CNB by the ECB using quantitative analytical techniques incl. analyses of the credit and market risks, stress testing exercises developed.  
- trained personnel, | - Research papers covering the financial stability area in the CNB Working Paper Series and the CNB Internal Research and Policy Notes;  
- the CNB’s Financial Stability Report;  
- Monthly progress reports from the Czech National Bank Senior Programme Officer; | - Measure of the objectivity of the reports produced by those involved in the implementation of the project |
- The financial analyses beyond a sectoral segmentation, with the focus on the ability of the financial system as a whole to perform its core functions and on the interrelations between sectors extended.
- The CNB’s ability to cope with the increasing analytical and strategic requirements in the financial stability issues intensified by the process of the European economic integration and creation of the new international standards improved.

<table>
<thead>
<tr>
<th>Activities</th>
<th>Means</th>
<th>Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Twinning activities:</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| • Assistance in defining the financial stability analyses framework, and designing the reporting system in the financial stability area. This would include defining the priorities, developing of statistical and mathematical methods for the assessment of financial stability,  
  Advice to the CNB staff in drafting the Financial Stability Reports, and co-ordinating the researchers when working on the ECB Financial Stability Reports. A personal engagement in some of the research projects should be a part of the expert’s tasks. An emphasis would be put on facilitating the learning process of the CNB’s staff.  
  Research and training seminars held at the CNB related to financial stability issues. Lectures given by the PAA, and potentially other short-term experts from the partner institution. Potential participants from the CNB include the bank regulation and supervision staff, research department, advisers to the bank board and interested staff from the monetary department (number of participants in seminars: approximately 20 - 30 persons – approx. two rounds of approx. 4 seminars (approx. 5 days each) – Total man-days = 40 man-days.  
  Short-term internships (max. two weeks each) of the CNB’s staff in the partner institution, including consultation with the experts responsible for the financial stability research, preparations of the financial stability reports and reporting to the EU institutions. (number of participants in internships: approx. 10 persons).- Total man-days = 100 man-days. |
| Twinning covenant: 0.5 MEUR      |                               |             |
| Assistance to be provided by one PAA and 2 – 3 STEs from EU-Member State administrations:  
  - PAA - 18 man-months;  
  - Short-term Experts - approx. 90 man-days;  
  - Training seminars - approx. 20-30 persons – 40 man-days;  
  - Short-term internships – approx. 20 persons from the CNB, in the partner institution – 100 man-days |
| In total: 29 man-months         |                               |             |
Preconditions:
### Detailed Implementation Chart

**Project**: Financial Stability Issues in the Czech National Bank

<table>
<thead>
<tr>
<th>Action</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004</td>
</tr>
<tr>
<td>- Selection of a Member State</td>
<td></td>
</tr>
<tr>
<td>- Preparation and Signature of T.C.</td>
<td></td>
</tr>
<tr>
<td>- Project activities commence</td>
<td></td>
</tr>
<tr>
<td>• Implementation of activities</td>
<td></td>
</tr>
<tr>
<td>• Delivery of training seminars held in the CNB</td>
<td></td>
</tr>
<tr>
<td>• Staff internships</td>
<td></td>
</tr>
<tr>
<td>- Completion of the project</td>
<td></td>
</tr>
</tbody>
</table>
### CONTRACTING AND DISBURSEMENT SCHEDULE

**Cumulative Quarterly Contracting Schedule (mil.€)**

<table>
<thead>
<tr>
<th>Project</th>
<th>3Q/04</th>
<th>4Q/04</th>
<th>1Q/05</th>
<th>2Q/05</th>
<th>3Q/05</th>
<th>4Q/05</th>
<th>1Q/06</th>
<th>2Q/06</th>
<th>3Q/06</th>
<th>4Q/06</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Stability Issues in the Czech National Bank</td>
<td>0,500</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0,500</td>
</tr>
</tbody>
</table>

**Cumulative Quarterly Disbursement Schedule (mil.€)**

<table>
<thead>
<tr>
<th>Project</th>
<th>3Q/04</th>
<th>4Q/04</th>
<th>1Q/05</th>
<th>2Q/05</th>
<th>3Q/05</th>
<th>4Q/05</th>
<th>1Q/06</th>
<th>2Q/06</th>
<th>3Q/06</th>
<th>4Q/06</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Stability Issues in the Czech National Bank</td>
<td>0,050</td>
<td>0,100</td>
<td>0,150</td>
<td>0,200</td>
<td>0,300</td>
<td>0,400</td>
<td>0,500</td>
<td></td>
<td></td>
<td></td>
<td>0,500</td>
</tr>
</tbody>
</table>