

## **DECREE**

No. 123/2007 Coll.,

### **stipulating the prudential rules for banks, credit unions and investment firms**

as amended by Decree No. 282/2008 Coll., Decree No. 380/2010 Coll. and Decree No. 89/2011 Coll.

Pursuant to Article 8b, 5, Article 11a, 9, Article 12a, 8, Article 12b, 8, Article 15, Article 22, 2, Article 24, 1 and Article 26d, 3 of Act No. 21/1992 Coll., on Banks, as amended by Act No. 120/2007 (hereinafter the “Act on Banks”), and pursuant to Article 1a, 3, Article 7a, 5, Article 7b, 9, Article 8, 9, Article 8b, 1, Article 11, 3 and Article 27, 1 of Act No. 87/1995 Coll., on credit unions and certain other related measures and on the amendment of Czech National Council Act No. 586/1992 Coll., on Income Taxes, as amended by Act No. 120/2007 Coll., (hereinafter the “Act on Credit Unions”) and pursuant to Article 199, 2, s a) and b) and g) and t) of Act No. 256/2004 Coll., on conducting business in the capital market, as amended by Act No. 120/2007 (hereinafter the “Act on Business Activities on the Capital Market”), the Czech National Bank stipulates:

## **PART ONE**

### **INTRODUCTORY PROVISIONS**

#### **Article 1**

#### **Subject of the Decree**

The Decree incorporates the relevant regulations of the European Union<sup>1</sup> and governs

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<sup>1</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)

Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast)

Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

Commission Directive 2007/18/EC of 27 March 2007 amending Directive 2006/48/EC of the European Parliament and of the Council as regards the exclusion or inclusion of certain institutions from its scope of application and the treatment of exposures to multilateral development banks

Commission Directive 2009/27/EC of 7 April 2009 amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provisions concerning risk management

Commission Directive 2009/83/EC of 27 July 2009 amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management

Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC

- a) the requirements for the governance and the contents of the governance audit report, the manner, structure and periodicity of its preparation and the time of its submission,
- b) capital adequacy, i.e.
  - 1. the rules for calculating capital adequacy including procedures implemented in the calculation, the rules for specifying capital, the definition of individual capital requirements, and the specification of procedures for their calculation, the stipulation of conditions for the use of basic and special approaches in calculating capital requirements and the definition of special approaches that require the competent authority's approval,
  - 2. the due particulars of the application for prior approval for the use of a special approach and for a change in the use of a special approach submitted to the Czech National Bank,
  - 3. the form and content of an application for registration on the list of credit assessment agencies and the requirements for the methods of assessment, the credibility and transparency of a credit assessment of the person who is to be registered on the list of credit assessment agencies,
- c) the rules of the exposure and the rules for the transfer of risk,
- d) the rules for the acquisition, financing and evaluation of assets,
- e) the content of data to be published on an individual and consolidated basis, including an abbreviated scope of the data on the observance of prudential rules, as well as the form, manner, structure, periodicity and time-limits for the disclosure of data and the content of the data verified by the auditor<sup>2)</sup>,
- f) the content, form, time-limits and manner of submitting certain information and documents to the Czech National Bank, and
- g) the criteria for the exclusion of persons from the consolidated group for the purpose of the observance of prudential rules on a consolidated basis.

## Article 2

### Definition of terms

(1) For the purposes of the Decree the following definitions shall apply:

- a) 'Member State' shall mean a Member State of the European Union or other state comprising the European Economic Area,
- b) 'delta equivalent of an option' means the fair value of the underlying instrument multiplied by the value of the option's delta,
- c) 'delta of an option' means the ratio of the change in the fair value of an option to the change in the fair value of the underlying instrument, i.e. the first derivative of the fair value of an option with respect to the fair value of its underlying instrument,
- d) '[group of connected persons](#)' means two or more natural or legal persons which, unless proven otherwise, constitute a single risk because

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Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management

Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies

<sup>2)</sup> Act No. 93/2009 Coll., on auditors, and amending certain other legislation (the Auditors' Act).

1. they are mutually connected in the relationship of a controlling and a controlled person, or
  2. their mutual relations are such that the financial difficulties of one of the persons may cause repayment problems for at least one of the other persons,
- e) 'exposure' means an asset or off-balance sheet item,
- f) 'financial institution' means a person that is not an institution and which, as its decisive or fundamental activity, acquires or holds participations in legal persons or performs an activity that may be performed by a bank, and also an investment company, investment fund, pension fund, insurance undertaking and reinsurance undertaking which performs activities according to special legislation; all the aforementioned also relates to foreign persons with a similar scope of activity,
- g) 'gamma' means the ratio of the change in an option's delta to the change in the fair value of the underlying instrument, i.e. the second derivative of the fair value of an option with respect to the fair value of its underlying instrument,
- h) 'LGD value' means loss given default, which refers to the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default,
- i) 'PD value' means the probability of default of a counterparty over a one year period,
- j) 'information system' means a functional unit ensuring the obtaining, processing, transmission, dissemination and storing of information in any form.

(2) For the purposes of the Decree the following definitions shall also apply

- a) 'institution' shall mean
1. a credit institution,
  2. an investment firm or foreign investment firm,
- b) 'special purpose entity' means a person
1. that is not an institution,
  2. that is established in order to provide securitisation or securitisations,
  3. whose activity is limited to acts that are essential to achieve the stated goal, and
  4. whose legal form and organisational arrangement ensure an absolute isolation of the unit from the credit risk of the originator,
- c) 'capital investment' means a participating security, ownership interest, a membership participation or similar asset or a subordinated loan,
- d) 'capital requirement' means the required capital coverage of the risk undertaken,
- e) 'collateral' means a thing, right or other property value used to protect a receivable,
- f) 'commodity' means a physical product traded on the market,
- g) 'Macaulay duration' means the weighted average of the periods between the present time and the maturity dates of individual cash flows, where the weights represent the fair values of the corresponding cash flows,
- h) 'small and medium-size entrepreneur' means an entrepreneur whose annual aggregate net turnover is less than an amount equivalent to EUR 50 000 000,

(3) For the purposes of the Decree the following definitions shall also apply

- a) 'margin' means the value of financial instruments specified by a clearing house that must be transferred by the person to a clearing house account as a collateral for the duration period of stock market derivative contracts,

- b) 'margin lending transaction' means a transaction by which an institution provides credit in connection with the transfer of securities or their trading, the credit being secured by securities,
- c) 'monetary gold' means gold in the form of tradable ingots in accordance with the LBMA standard (London Bullion Market Association),
- d) 'modified duration' means a quotient whose numerator is the Macaulay duration and whose denominator is the sum of one and the yield to maturity,
- e) 'clean-up call option' means an option that gives the originator the right to repurchase or extinguish the securitised exposures before all the underlying exposures are extinguished, if the balance of unpaid exposures has fallen below the specified value,
- f) '[operational risk](#)' means the risk of loss due to deficiencies or failings in internal procedures, the human factor or systems, or the risk of loss due to external factors, including legal risk,
- g) 'authority to act' means a bank licence, licence to act as a credit union or licence to act as an investment firm,
- h) 'relevant competent authority' means the Czech National Bank or other competent authority of a Member State which decides on applications to use a special approach to calculate a capital requirement<sup>3)</sup>.

(4) For the purposes of the Decree the following definitions shall also apply

- a) 'subordinated loan' means a receivable from a granted deposit, credit, loan or another receivable whose repayment is bound by the condition of subordination<sup>4)</sup>,
- b) 'liable entity' means
  1. a bank,
  2. a credit union,
  3. an investment firm, and
  4. an investment broker
- c) 'AMA Approach' means an advanced approach for calculating the capital requirement for operational risk,
- d) 'ASA Approach' means the Alternative Standardised Approach for calculating the capital requirement for operational risk,
- e) 'BIA Approach' means the Basic Indicator Approach for calculating the capital requirement for operational risk,
- f) 'IRB Approach' means an approach for calculating the capital requirement for the investment portfolio's credit risk and the risk of the investment portfolio's dilution based on an internal rating,
- g) 'originator' means the person that
  1. participated, on its own or in concerted conduct, directly or indirectly, in creating the contractual obligation or future obligation of another person relating to securitised exposures, or
  2. acquired credit risk exposure from another person with the aim of its securitisation,

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<sup>3)</sup> Article 12a of Act No. 21/1992 Coll., on Banks, as amended.

Article 8 of Act No. 87/1995 Coll., on credit unions and certain other related measures and on the amendment of Czech National Council Act No. 586/1992 Coll., on Income Taxes, as amended,  
Article 9 of Act No. 256/2004 Coll., on Business Activities on the Capital Market, as amended.

<sup>4)</sup> For example, Article 34 of Act No. 190/2004 Coll., on Bonds, as amended.

- h) 'dilution risk' means the risk that the size of the receivable will decrease due to the provision of monetary or non-monetary payment to the obligor,
- i) 'securitisation' means a transaction or a system of transactions by which the credit risk connected with one or more exposures is distributed over individual tranches, where
  1. the financial flows from this transaction or system of transactions depend on the quality of the underlying exposures, and
  2. the subordination of tranches defines the distribution of losses over the period for which the transaction or system of transactions are valid,
- j) 'securitised exposure' means any exposure in securitisation,
- k) 'jointly managed venture' means a person that is
  1. an institution,
  2. a financial institution other than an insurance undertaking, reinsurance undertaking, insurance holding entity or a mixed-activity insurance holding entity<sup>5)</sup>, or
  3. an ancillary services undertaking,if a person included in the regulated consolidated group (Article 5) participates in the management of the relevant person, together with at least one person not included in the regulated consolidated group, whose liability or guarantee for the obligations of the relevant person are limited by the size of the participation in the capital stock of the relevant person.

(5) For the purposes of the Decree the following definitions shall also apply:

- a) 'sponsor' means a person that is not the originator and which creates and administers a securitisation system such as an asset-backed commercial paper programme or another securitisation system, as part of which it purchases exposures from third persons,
- b) 'spot transaction' means the purchase or sale of financial instruments or commodities with such a delivery date that the period from the conclusion of the transaction to its settlement is not longer than two days, or longer than another period according to the respective market conventions,
- c) 'synthetic securitisation' means securitisation in which the credit risk is spread over individual tranches by means of credit derivatives or guarantees, while the exposure remains the asset of the originator,
- d) 'traditional securitisation' means securitisation by which exposures are economically and legally transferred to a special purpose entity which issues securities in such a manner that the transfer is accompanied by the legal separation of the exposures from the originator and payments to investors are not a liability of the originator,
- e) '[long settlement transaction](#)' means a transaction in which a counterparty undertakes to deliver a security, a commodity or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a settlement or delivery date that is contractually specified as a date later than the market standard for this particular transaction, or a date later than five business days after the date on which the counterparty enters into the transaction, if this time-limit is shorter,
- f) 'tranche' means a contractually created segment of credit risk connected with exposures, where the position in this segment represents higher or lower credit risk than a position of the same size in any other segment, without taking into account credit protection

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<sup>5)</sup> Article 38 of Act No. 363/1999 Coll., on insurance undertaking and a change to certain related acts (Act on Insurance Companies), as amended.

provided by third parties to the holders of the position in the relevant segment or in other segments,

- g) 'book value' means the amount in which an asset, liability or equity is stated in the balance sheet, or the amount in which the item is stated in the off-balance sheet, where in the case of an asset this refers to an amount reduced by accumulated depreciation and allowances,
- h) 'value adjustment' means an allowance established for an asset, an accumulated write-off or an accumulated loss resulting from the valuation of an asset at fair value on the basis of credit risk,
- i) 'central counterparty' means the person that receives settlement instructions issued by the participants of the payment or settlement system and is their exclusive intermediary in settling instructions or transactions,
- j) 'credit instruction' means a bank, foreign bank or a credit union.

(6) For the purposes of the Decree the following definitions shall also apply

- a) 'nth-to-default credit derivative' means a credit derivative which relates to an exposure basket, on the condition that the nth default of any exposure is the reason for payment under the protection by this derivative,
- b) 'first-to-default credit derivative' means a credit derivative that relates to an exposure basket, on the condition that the first default of any exposure is the reason for payment under the protection by this derivative, and this credit event terminates the contract,
- c) 'credit enhancement' means a contractual arrangement under which the credit quality of a securitised exposure is increased; credit enhancement may be performed by assigning several subordinated tranches or by another type of protection,
- d) 'recognised stock exchange' means an entity organising a market that is recognised by the relevant organs and which functions regularly and has rules issued or approved by the relevant organs of the country in which the entity has its registered office which define the conditions under which the stock market operates, the conditions of access to the stock market and the conditions which must be met by an instrument in order that such instrument can be traded in the stock market. In the case of a derivatives stock market the clearing mechanism shall stipulate that derivatives are subject to daily updates of margins which, in the view of the relevant organs, provide suitable protection for market participants;
- e) 'recognised investment firm from a third country' means a person that fulfils the definition of an investment firm if it was established on the territory of a Member States, was authorised to conduct business in a third country and is subject to and satisfies prudential rules, which the competent authorities consider to be no less strict than the rules stipulated for investment firms,
- f) 'weighted modified duration' means the total modified duration of individual instruments weighted by the fair values of these instruments,
- g) 'vega' means the change in the fair value of an option per unit change in the volatility of the underlying instrument; i.e. the first derivative of an option's fair value with respect to the volatility of the underlying instrument,
- h) 'warrant' means a security which gives the holder the right to purchase an instrument at a stipulated price before or at the expiry date of the warrant. It may be settled by the delivery of the instrument itself or by cash settlement,

- i) 'employee' means a person who is in a labour-law relationship or other similar relationship with the liable entity, or another person that is a member of the liable entity's statutory or other body,
- j) 'eligible rating agency' means a person that provides credit assessments and which is registered on a list of credit assessment agencies maintained by the Czech National Bank according to the Act on Banks.

(7) For the purposes of the Decree the following definitions shall also apply

- a) 'organisational section' means a person or specific group of persons charged with the performance of a specific activity of the liable entity,
- b) 'resecuritisation' means securitisation, when the credit risk connected with one or more underlying exposures is split into tranches and at least one underlying exposure is a securitised exposure,
- c) 'recognised clearing house' is an entity providing the settlement of transactions recognised by the relevant authorities, while the settlement of transactions is carried out regularly, has rules issued or approved by the relevant authorities of the state where this organisation has its registered offices, which define the conditions under which settlement takes place and the conditions for access to settlement.