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# Development of Banking sector and PSE

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# Banking sector

- One of the most tickler problem of whole economic transformation was development of the banking sector.



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# Banking sector before 1989

- Mono-structure banking system
  - In 1950 was established State Bank of Czechoslovakia (SBCS).
  - SBCS “hybrid” between state and private bank.
    - Central bank functions
      - Monetary police
        - Issue of paper money and
        - Foreign exchange rate policy
    - Government function
      - Tax collection
      - Control of wage development
    - Commercial bank functions
      - Collection of savings
      - Granting credits
      - Exchange of foreign currencies
      - Organization and running of payment mechanism
  - Clients of SBCS were only business companies not households.
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# Banking sector before 1989

- In Czechoslovak banking system existed banks with specific functions
    - Trading bank (Zivnostenska banka) the most important bank during interwar period that was confiscated in 1945.
      - In communism regime provided foreign exchange operations for private clients
      - It had business branch in London for
        - Arrangement relations with foreign banks
        - Foreign trade and other international transactions
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# Banking sector before 1989

- ❑ Czechoslovak business bank (CSOB) was established in the 1960's
    - Owned by SBCS and businesses of international trade (monopoly for trading with foreign countries)
    - Provided international payment with subjects in RVHP markets (social countries in Europe, Asia and Africa)
  - In banking sector existed two saving-banks
    - ❑ Czech state saving-bank
    - ❑ Slovak state saving-bank
      - Collected savings from households and granted credits for households.
      - Surplus of savings were transferred in SBCS and divided into state companies.
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# Banking sector before 1989

- Communism regime was aware of problems in banking system.
  - In 1989 was decided about transformation of mono-structure banking system in two tier banking system.
  - From SBCS were set off three state banks
    - Commercial bank (Komerčni banka)
    - General Credit bank (Vseobecna uverova banka)
    - Investment bank (Investicni banka)
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# Development of banking sector in the 1990's

- Development of banking sector in the 1990's can be divided in three phases
    - Establishing of new small banks
    - Privatization of large state banks
    - Banking crisis
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# New banks

- The number of new banks in Czech market was growing since the beginning of the transformation process.
  - At the beginning of transformation process conditions for establishing of new banks were weak.
    - Shareholder's capital 50 million CSK in 1990
    - But was accepted every tenth application for banking license
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- Government and State bank set these weak and liberal conditions to improve competition in banking sector.
    - This conditions were getting more restrictive in the process.
    - In April 1991 basic capital 300 millions of CSK and
    - from 1993 till nowadays 500 millions CZK
  - Despite of these liberal conditions banking sector in the Czech Republic was concentrated.
  - Small banks were weak and financial resources for their business activities were getting in the form of credits from large banks in interbank market.
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# New banks

Share of commercial banks in savings and credits in 1990		
Bank	% of credits	% of savings
Commercial bank	47,8	17,5
General Credit bank	20,1	7,9
Investment bank	14,6	8,3
State credit-houses	10,3	62,3
Others	7,2	4

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# New banks

- In 1991 were established first credit banks (kampelicky)
  - Simultaneously the number of small Czech bank was growing and also foreign banks opened their subsidiaries in the Czech republic.
    - Foreign bank focused only on the best clients -
      - Foreign companies that they were familiar with them from their domestic market.
    - According to government expectation:
      - Foreign banks should have promoted real competition in banking sector.
      - But these institutions were interested only in the most lucrative clients with the lowest rate of risk.
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# New banks

- In domestic market arose double pressure
    - Foreign banks overtook the most profitable clients and domestic banks cared only about subject with high level of risk or insolvent clients
    - Foreign bank pushed down banking fees for this profitable clients and thus limited possible fees of domestic banks
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# New financial institutions

- Specific group of institutions in banking sector were transformation institutions.
  - The best known is Consolidate bank
    - In consolidation bank were transferred
      - Bad liabilities of companies doing business in central planned economy
      - Bad loans in time of cleaning assets of banking sector
  - Other institution is Bohemia and Moravia Guarantee bank established in 1992 by government and large banks
    - Support of small and middle companies with credits and bank guarantees
  - Czech Export bank
    - Granting cheap credits for export companies.
    - Owned from 66,7% by state
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# Consolidation bank/agency

- Established in February 1991 originally only for 126 days but in fact existed till 2007.
  - In this bank were transferred
    - bad debts from state companies in the value of 80 billion CSK and
    - bad assets from large state banks.
  - Primary aim of Consolidation bank was
    - restructure or decay of companies that transferred assets in Consolidation bank.
    - This aim was not never fulfilled.
  - Consolidation bank became a store for bad loans and played important role in cleaning of Czech bank before their sale to foreign investors.
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- In Consolidation bank was during 1999 – 2000 five institutions
    - Revitalization Agency – cleaning financial accounts of specific companies like Aliachem, CKD Praha, Skoda Plzen
    - Czech Financial – buyout of classified credits in small banks
    - Konpo – control and debt recovery of Commercial Bank
    - Prisko – transferred all liabilities from former state company Skoda – Car
    - Sanakom – transferred bad credits of bank Investment bank
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- Because Consolidation bank was established as a bank it had to fulfill all conditions suitable for commercial bank although its purpose was different
    - E.g. According to Banking Act
      - Consolidation bank had not acquired a majority share in non-banking subjects and it limited its restructured aims in controlled companies.
  - In 2001 Consolidation bank was transferred in Consolidation agency and became its continuator without limitation related with its former bank statue.
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# Bank privatization

- At the beginning of the 1990's existed 4 large fully state banks
    - Czech state saving-bank
    - Trading bank
    - Commercial bank
    - Investment bank
      - And Czechoslovak business bank with significant state share.
  - According to current opinion the highest revenue from bank privatization could be obtained in 1991-1995 because of weak position of foreign bank in Czech market and Czech banks were not suffered by classified credits from transformation process.
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- In 1992 were 4 fully state banks transferred in joint stock companies and part of their stocks designed for privatization process.
  - After privatization process state became minority shareholder in these banks with share from 48-49 %.
  - In next years privatization process left off
    - Because of lack of rules for sale of banks to foreign investors.
    - Whole process was slowed down by several minority shareholders actions against important bank decisions.
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- Dispute point of whole transformation process is slow privatization of banking sector.
  - The main problem was existing credit channels between banks and state companies established in central planned economy
  - This credits became uncollectible and in final phase they were paid off by tax payers.
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- Privatization process of banks was postponed because of privatization process as a whole.
  - The main fear was related with turn off the financial resources for domestic companies that did not fulfill strong international criteria.
  - If privatized bank stopped credit granting to state companies these companies would get in troubles.
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- On the other hand postpone of bank privatization arose opportunity for political pressure in banks to grant credit to companies that did not satisfy bank conditions.
  - Banks nourished companies that should have bankrupted and granted credits for losing projects.
  - It is reason why important part of credits became classified.
  - State proprietorship encourage morale hazard
    - Bank expected that in case of financial problems will get financial support by government that also happened for several times.
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# What does term-classified credits mean

- All bank's credits are classified according to Czech National Bank criteria
- Five main groups:
  - Standard credits
  - Watch credits
  - Substandard credits
  - Doubtful credits
  - Loss credits

# What does term-classified credits mean

- Standard credits - no doubts about future pay-off of the credits. Instalments and securities are settled regularly.
- Watch credits - high probability about future pay-off. Instalments and securities are settled with some troubles, but there are not longer than 90 days after settlement.
- Substandard credits- higher improbability of total settlement, but partly settlement high probable. Instalments and securities are settled with troubles, but there are not longer than 180 days after settlement.

# What does term-classified credits mean

- Doubtful credits - total settlement high improbable. Instalments and securities are settled with troubles, but there are not longer than 360 days after settlement.
- Loss credits total settlement impossible, will not payoff or payoff in small rate. Instalments and securities are longer than 360 days after settlement.
- Classified credits are the last three groups of credits.
- In the Czech Republic in the 1990's high share of these classified credits, mainly loss credits.
- For example: in 1995 21.3% of credits were loss credits.



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- In 1998 was privatized Investment bank to Japan investment company Nomura
  - Price of this bank was low only 6 billion CZK
  - Bank was weak with classified credits about 20%
  - Nomura was not a strategy partner and their main purpose for this business was getting the portfolio of companies owned by this bank
    - Especially brewery and glass companies
  - In recession this bank got in serious trouble with high flow off of savings (34 billion CZK) and became insolvent.
  - In 2000 bank was move on Czechoslovak Business bank.
    - Sometime is this process labeling as a state confiscation
    - Czechoslovak Business bank overtook this bank with government guarantee (it is expected that this guarantee are in value of 160 billion CZK)
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- In 1998 was elected left oriented party Social Democracy that promised no other state aids in banking sector.
  - In reality new government started looking for foreign owners for state banks and offered state guarantees.
  - Government promised sell all state banks till 2000.
  - In spring 1999 Czechoslovak business bank was sold KBC
    - 40 billion CZK
    - The higher revenue from bank sale in transformation period
    - This bank was the most healthy bank in Czech banking system
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- In 2000 was sold Czech state saving-bank to Austria Erste Bank
    - Erste Bank paid for 52 % shares 19,3 billion CZK
    - Government must invest in his bank 46 billion CZK before sale to recover bank balance sheet.
    - Classified credits were transferred in Consolidation bank.
    - The main loses of this bank were from
      - Bad loans from the beginning of the 1990's
      - Poor quality guarantees
      - Losses form collapse of Russian market after 1998
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- Privatization of Commercial bank was stopped by company B.C.L. Trading when bank lost 8 billion CZK in single trade
    - Between 1998 and 1999 Commercial bank lent 100, 150 and 200 millions dollars.
    - Documentary credits were bound by delivery of agricultural products from Ukraine and Russia.
    - Investigation found out that this supplies never happened.
  - Commercial bank was privatizes as a last large bank in 2001 when was bought by Societe Gererala in 40 billion CZK.
  - Total cost for recovery of this bank are estimated in value of 75 billion CZK.
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# Crisis in banking sector

- During the 1990's banking sector in the Czech Republic passes several crisis
  - At the beginning of transformation process there was a need of credit and fears from oligopoly structure of banking sector.
  - Bank licensing was benevolent till the first banking crisis in 1993.
  - In first transformation phases only small banks were suffered by crisis.
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- First small bank in troubles was
    - Credit and Industry bank
    - Classified loans in this bank got 90 % and in bank lost 450 millions dollars.
    - The reason was over limit granting of credits in general manager that was also owner of the bank.
    - CNB withdrew license this bank.
  - In the same year other banks got in financial troubles
    - AB bank
    - Credit bank
    - Czech bank
      - In largest debtors of these bank were their shareholders.
  - Other bank that went bankruptcy was Bank Bohemia
    - Managers of this bank signed guarantee in value 30 times higher that was basic capital of this bank.
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- As a reaction to problems in small bank sector there was announced program for consolidation of banking sector.
    - Consolidation program II
    - Central bank stopped licensing for new banks
    - Banking supervision became more restrictive
  - But other small banks got in troubles.
  - In 1996 the largest private Czech bank Agrobanka got in troubles with total lost 35 billion CZK.
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- Total costs for recovery small banking sector were insignificant in compare with recovery of large bank sector.
  - Large bank with some level of state proprietorship were consider to be too large for fail.
  - Large banks were supported during pre-privatization period.
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- Sector of credit banks get in trouble at the end of the 1990's.
    - Since 1996 they became more popular and had approximately 110.000 members with savings 10,3 billion CZK
    - They were attracted because of higher interest rate in compare with commercial banks
    - In 1999 problems in three largest credit banks
      - In these three credit banks was concentrated 60% of all deposits
  - In next year in the troubles get next 12 credit houses.
  - As a reaction in 2000 was adopted of Credit houses act that
    - forbidden transfer of credit house savings in subsidiary companies
    - Limited licensing
    - Restricted supervision
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# Reasons of banking crisis

- I. Debts of companies and problems with debt redemption
    - In banking sector existed 1900 billion CZK bad debts from central planned economy.
    - Banks were vulnerable in face of failure of large debtors.
    - In the lack of capital companies oriented only in credits because capital markets did not work.
  - II. There was a lack of experiences with market oriented economy at the beginning of the 1990's.
    - Subjects in the market existed without any business history
    - No market skills of bank employees
    - Information asymmetry in banks
      - Most active credit applicants were applicants with the most risk projects
      - Problem with bank supervisory
        - In small banks lots of cheap credits granted to shareholders
        - In large state bank no control of bank activities by government.
          - Political pressure for credit granting to support privatization and whole transformation
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- III. Worst situation in small bank in compare with large banks.
    - In these small banks were lack of basic capital thus carried out operation with higher risk
    - Lack of capital influenced the confidence of savers and limited possibilities for gaining cheap financial resources.
    - In this sector was also significant level of criminal acts
  - In whole sector was combination of lack educated management, disproportionately high interest rates and criminal acts
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# Recovery of banking sector

- In 1991 number of classified credits between 15-20 %
  - Consolidation program I for large state banks
    - Cleaning of banking sector from bad debts
    - This bad debts were taken over Consolidation bank
    - Total costs of this program 100 billion CZK
- Problems in sector small banks solved by
  - Consolidation program II
    - Designed for banks that did not pass capital adequacy (8 %)
    - Total costs of this program 33 billion CZK and bank in this program finished by withdrawing of license
- Rescue of credit houses sector was related with withdrawing of licenses
  - Total loss from this sector 90 billion CZK.
- Total cost for recovery of banking sector are differentiate
  - Recovery of 4 largest bank costs – 216 billion CZK
  - Revenue from sale of this banks – 112 billion CZK

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# Stock Exchange

- Beside banks other important institution is capital market.
  - Important event for establishing Prague Stock Exchange (PSE) was voucher privatization.
  - Until establishing of PSE all trades were realized in temporary market.
  - First issue outside of PSE was Commercial bank stocks traded since 1990.
    - Total volume was 1 billion CZK and was traded in primary market
  - In 1990 Ministry of Finance issued first Government securities for financing property restitutions.
  - At the end of 1992 all activities of temporary market were overtaken by PSE.
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- In 1993 was in PSE placed 622 issuances from voucher privatization and till the end of the year next 333 issuances were added.
  - 8,5 million Czechoslovak citizens became shareholders.
  - In 1993 first official Government bond was placed
  - 1994 was started day-to-day trading
  - In the half of the 1990's was traded with more than 100 issuances in PSE.
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- The interest about securities in PSE was low.
  - The main volume of trade was with bonds.
  - The character of trade was “direct trade”
    - Bilateral trade with subjects out of PSE
      - Only with registration in PSE
    - Direct trades had no influence in prices of securities
      - 90 % of trading with stocks
      - 100 % trading with bonds
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- In 1996 a lot of foreign investors left PSE
    - Weak regulation
    - Fraud conductions
    - Lack of interesting investment possibilities
  - In the process the rules and trading conditions were improved.
    - Market was spitted in
      - main with the most quality stocks – blue chips (13 blue chips in 2009)
      - Mid market and free market
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## SPAD On-line

20.10.2009 | 10:19

Název	Akt. kurz [Kč]	Změna [%]	Objem [tis. Kč]
<a href="#">AAA</a>	14,08	0,50	0,00
<a href="#">CETV</a>	481,10	1,28	5 159,51
<a href="#">ČEZ</a>	869,10	1,13	196 497,97
<a href="#">ECM</a>	352,60	-0,82	0,00
<a href="#">ERSTE GROUP BANK</a>	775,50	-1,27	9 359,00
<a href="#">KOMERČNÍ BANKA</a>	3 715,00	0,43	43 619,83
<a href="#">NWR</a>	172,05	0,03	5 496,26
<a href="#">ORCO</a>	196,51	1,56	2 265,20
<a href="#">PEGAS NONWOVENS</a>	433,50	-1,03	1 890,60
<a href="#">PHILIP MORRIS ČR</a>	8 926,00	0,28	4 010,35
<a href="#">TELEFÓNICA O2 C.R.</a>	422,10	-1,15	17 754,29
<a href="#">UNIPETROL</a>	137,17	0,12	0,00
<a href="#">VIG</a>	1 093,00	-0,73	0,00
<b>Celkem</b>			<b>286 053,01</b>

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# Sum up

- Whole transformation process was closely connected with banking sector.
  - Banks play key role in process of transformation money in investments and if this relation is harmed it will influence whole economy.
  - Czech banking sector cumulated troubles during transformation
    - Faults in management
    - Lack of banking skill
    - Fraud conduction
  - It led to crisis of banking sector as a whole.
  - Suffered were small banks as well as large.
  - Small banks left banking sector
  - Large banks were rescued by tax payer's money
  - Development of PSE was questionable
    - PSE did not become alternative resource of financing and in transformation process helped in concentration of proprietorship.
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