OTC-MARKET IN THE CZECH REPUBLIC AND ITS COMPARISON WITH SOME OTHER CENTRAL EUROPEAN OTC-MARKET.

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Abstract

The article deals with OTC-Market in the Czech Republic. It describes a RM-system and principles on which is based, types of auction, direct trades, block trades, pre-trade validation, type of clients (ordinary and special), money account, Centre of Securities, the way how to become Special Client, shortly compare functioning of RM-S with OTC-Market in Slovakia.

1. Introduction

The voucher privatisation in the Czech Republic, which has taken place in two waves, resulted in about five million shareholders. The equities were issued by approximately 1 700 companies and in the second wave also by tens of mutual funds.

2. OTC-Market in the Czech Republic

In the Czech Republic, OTC-Market is represented by RM-System. RM-System (abbreviated as RM-S), joint stock company, was established in 1993 as a subsidiary of PVT, a. s. RM-S organizes securities trading but does not trade securities itself. RM-System is an electronic securities exchange which is tailor-made to take into account the conditions that exist in the Czech Republic. At the same time it is constructed on trends prevalent in the world today. It represents an ideal combination that makes it possible to satisfy the interests both of retail shareholders and large brokers. It has all the features of an extensive, modern and progressive securities market.

RM-system is not based on a membership principle, any physical or legal entity, domestic or foreign, can become a client and trade via the system. Within seven years of its existence, RM-S proved its ability to accommodate the requirements of the market. This system that originally served exclusively to trading by retail investors has developed a system
that fully supports middle-sized and big dealers. It offers a complete set of supporting services for the capital market participants, whilst continuously enhancing the levels of services for its ordinary and special clients.

3. Ordinary and special clients

Two basic groups of clients are recognised by the Trading Rules of RM-S – Ordinary and Special Clients. The Ordinary Clients submit their orders on order forms at trading places throughout the Czech Republic. At the trading places, clients also collect the results of their transactions. However, the most important category of clients comprises the professional brokers, investment companies, funds etc. Special Clients utilise various technical media for their transactions.

The group of Special Clients can be separate into several categories according to the technical media used for transactions. The clients who utilise computer diskettes are D-clients, clients who utilise modems are M-clients, clients who utilise on-line stations installed at some of the trading places are O-clients, and newly clients who utilize Internet. The modems or the on-line stations are particularly suitable for doing business from abroad.

The Special Client of the RM-S can become any legal or physical person who complies with certain basic technical requirements and who undergoes the compulsory training. If this person is a foreign client, it is necessary for him/her to have arranged in advance the setting up of a property account in The Centre of Securities (SCP) of the Czech Republic.

The M-client is provided with software that is rented him by the RM-System. The software enables the client to formulate and transmit orders via a modem to the RM-S specialized entry workplaces over fixed telephone lines. This connection is called “off-line” because an individual databank is created for the client at the specialized entry workplace of the RM-S, from which the orders are automatically collected in a batch regime at a moment the defined auction commences (the M-client does not have direct access). When the auction has ended, the databank is filled with information regarding the auction and the results of trading. That is the way, the client receives information that he can subsequently use in his future trading.

The O-clients utilise the most comfortable method of conducting business in the RM-S. This method utilises the so-called on-line stations. Such a station (actually modified PC) connects the client with the securities market in real time, so that the O-client is able to follow the bids and offers situations, submit orders and communicate with the other on-line station users. The O-client receives information about all the transactions concluded, including direct trades (see below). Because the O-client is continuously informed about all the changes occurring in the market, he is able to react immediately. Orders to trade are validated immediately upon their submission, and if this is positive, an auction follows immediately. The entire passage of orders, from the moment of their submission, through validation, matching and settlement in the Centre of Securities and on the crown account, lasts only a few seconds in the majority of cases, and a few minutes at the longest. This enables to sell the purchased shares immediately, and vice versa. Throughout the terminal, the O-client is informed about the results that relate to his orders. He also receives a complete summary of the trading results the following day. The on-line station further enables the connection, via a serial line, to the client’s own PC, and thus the transmission of externally formulated orders to the on-line station, and similarly the transmission of the results from the on-line station to the client’s own PC. That is why the O-client is not compelled to use only the on-line station, but can use his own software to process input and output information. At present, both Czech and English versions of this programme are available.
What is necessary to do to become a Special Client of the RM-S? Each interested party should apply, preferably in writing, to the Commercial Department of the RM-S headquarters. The letter of application must contain basic information about the applicant, his current activities in the securities markets, and information regarding his level of experience of the RM-S market. The RM-S will invite those interested for training and provide them with further detailed information.

Foreign clients access the RM-S market in the same way as domestic investors. The first step that they must take before they can start trading Czech securities is to visit the Central Counter of the Centre of Securities in Prague that will allocate them an identification number and open a securities account. Afterwards, they can register as a client of RM-System. To establish a property account in the SCP, a foreign physical person only needs to present his/her valid passport. Legal persons must submit an officially verified extract from the Register of Companies in the country of their origin, together with its officially verified translation into Czech, and the person performing such a registration on behalf of this subject must present his passport. If this person is neither a negotiator nor a representative mentioned in the submitted Register, he must also produce an officially verified Power of Attorney and its officially verified translation into Czech. Apart from passport, no documents submitted must be older than six months. After submitting the above mentioned documents, the client’s account is opened immediately.

The basic parameters of connections and data networks are defined by the international CCITT recommendations that ensures mutual compatibility to an international standard. Such connections are provided, for example, by the following data networks: USA – DATA NETWORK, AT&T WORLDNET, SPRINTNET, GLOBENET, Germany – DATEX-P, France – TRANSPAC, NTI, Great Britain – BTI IPSS, BT TYMNET, Canada – DATAPAC, GLOBEDAT, FASPAC.

Client’s data and information is protected by the following way: terminal only contains the installed application that enables the client to trade. All other client data relating to their orders are kept by RM-System and transferred to the terminal only during periods of connection. Therefore a terminal that is switched-off contains no information that relates to trading. In order to prevent unauthorized personnel from using the terminal, the use of active smart cards were created.

4. Trading

As was already mentioned above, RM-S is not based on a membership principle, any physical or legal entity, domestic or foreign, can become a client and trade via the RM-S. This particular aspect forms the base for one of the main principles applicable to processing of all the orders – pre-trade validation. This means that in case of sell orders, controls are performed in Centre of Securities as to whether the seller actually owns the securities that are being offered for sale. On the other side, RM-S checks whether the buyer has deposited a sufficient amount of cash for the proposed trade.

The result of the pre-trade validation process is the confidence it provides for all the clients in the knowledge that a counterparty really owns, at a moment the trade is being matched, what is being offered. Just as the anonymity of trading guarantees confidentiality of data and protection against its misuse, the pre-trade validation rule protects the clients against irresponsible behaviour of a counterparty and provides the client with maximum security of trading.
5. The Centre of Securities (SCP)

The majority of securities in the Czech Republic are issued in book-entered form. All the accounts of the owners of dematerialised securities and registers of issuers are held, in an electronic form, by an organisation set up by the Ministry of Finance – the Centre of Securities. In its operations RM-S uses the modern DEC computer technology, both for the processing of trades and for direct contact with SCP and the bank. The market organized by the RM-S trades exclusively with book-entered securities registered in the SCP.

All financial movements relating to trading with securities on the RM-System are implemented through the Investiční a poštovní Bank. All clients may use either the special “jumbo” account, in which the RM-S automatically opens a sub-account upon their registration, or their own individual account with this bank. The individual account necessitates negotiating a three-way contract between the Investiční a poštovní Bank, the RM-S and the client in question, with view to the setting up and the management of this account and its utilization for trading in the RM-S, and for settlement purposes. The purchased securities are recorded on the owner’s property account in SCP. Money for securities sold is added to the seller’s cash balance on the account at the Investiční a poštovní Bank used by the clients for trading through RM-S.

6. Type of trades

RM-S organizes the so called continuous auction every working day. This is a continuous trading method whereby the auction prices change during the day in accordance with the actual demand and supply. This fast method of trading, when it is possible to buy or sell the same security several times during a single day, provides clients with room to exercise their business acumen. Into the auction, both the orders from ordinary clients submitted at the trading places, and orders submitted by “special clients” via on-line stations, off-line stations and on computer diskettes are included. RM-S publishes every day feasible price ranges for each title, thus defining the upper and lower limit of prices within which it is possible to trade with a given security during that specific day. These prices ranges are defined on the basis of the trading results of the previous day’s trading. Only orders that are in the central database at the moment the auction round takes place and that have successfully gone through pre-trade validation, are included in the matching. Then, financial and property settlement follows.

RM-S also offers its clients another option, the so called direct trades. These are non-anonymous trades between two partners, usually based on previously concluded contracts.

Another option represents so called block trades whereby RM-S performs anonymous matching of big blocks of shares. Clients are notified of the existence of such blocks in advance. These blocks represent primarily the shares of companies that are held, and gradually offered for sale, by the Fund of National Property as part of the privatisation process.

RM-S also makes it possible that all its clients can use selected services of the SCP, for example transfers of securities given as gifts, transfer between owners, but also services for professional brokers acting on behalf of their clients. On the primary securities market, RM-S offers the issuers and issue intermediaries the provision of technical and administrative support during a new security issue, and that for shares, mutual trusts both of open-ended and close-ended mutual funds, and for bonds.
RM-S also organizes training for each method of order submission. During this training the participants or their authorised representatives acquaint themselves in detail with the functions and scope of the RM-S software. All the applicants that have provided the RM-S headquarters with a written request to become Special Clients are invited to attend the appropriate training.

7. OTC-Market in Slovakia

OTC-Market in Slovakia is represented by RM-System Slovakia which was established, after splitting the former Czechoslovakia, in 1993. This system is therefore very similar to Czech system of trading on OTC-Market. At present, this system ensures the highest liquidity in the Slovak capital market.

Although the Slovak capital market is smaller than Czech capital market, a new securities market operator licence for trading derivatives was granted in December 1998. The trading and clearing system for derivative market is fully electronic integrated. A mutual agreement between RM-System Slovakia and the Austrian Futures and Option Exchange (OTOB) was signed. The objective of this agreement is to establish, within a project of the Central European Clearing House & Exchanges (CECE), a cooperation regarding the product distribution, networking and listing of derivatives products. Final idea of the project is to create common Central-European transparent area for securities trading.

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