

**The address of Mr Jerzy Pruski, Deputy President of the NBP, to the Sejm (Lower House of Parliament) during the debate about the draft law on the financial market on 23 June 2006.**

Mr Speaker, honourable Deputies!

The draft law on the Financial Market Supervision presented by the government assumes a complete departure from the existing supervision model, which has taken years to create. In the place of a tested, well-functioning, sectoral supervision of the financial market, a proposal is being put forward to adopt a radically different integrated approach, whose framework provides for a single institution encompassing the banking supervision, insurance supervision, supervision of the capital market, supervision of electronic money institutions and complementary supervision. Such a significant change in the organisation of supervision of the financial market requires an in-depth analysis of the matter, covering such areas as costs and benefits, stability and effectiveness of the financial sector in Poland and perspectives of its development, experiences of other countries and international comparisons. Finally the implementation of such fundamental changes requires that comprehensive consultations be conducted with institutions involved and with a broadly conceived financial circles.

Unfortunately, the justification of the draft law lacks material evidence confirming the need for the introduction of such radical changes into the system of supervision of the financial market, a point repeatedly raised in the past by the National Bank of Poland. Moreover, the proposed changes are implemented in spite of many critical observations brought up by other entities participating in this exceptionally short process of consultation.

In the case of the draft law on the supervision of the financial market, the need for convincing justification becomes one of extreme importance. This is due to the fact

that the law concerns a key area of our country's economic and social life. As long as the financial system remains stable and safe, Polish citizens willingly use its services and confer their savings to banks and other financial institutions. Millions of people already use banking services in Poland nowadays. Banks and other financial organisations fulfil the role of an intermediary between depositors and enterprises seeking financing for their economic projects. In this manner, banks bestowed with confidence gather people's savings in order to transform them in enterprises' investments. As a result, the possibilities of financing the development of the economy grow multifold and the effectiveness of capital improves, which leads to higher economic growth and higher standard of living.

Mr Speaker, honourable Deputies!

The banking sector remains the most important part of the financial system in Poland. At the end of 2005 banks' assets constituted 70 per cent of the financial system. The system is characterised by a high degree of stability, and therefore high level of safety of savings deposited in the banks. Between 2000 and 2005 the level of safety measured by the amount of capitals improved significantly.

The banking sector own funds grew in this period by ca. 48 per cent, reaching the value of PLN 45.7 bn. At the end of 2005 the solvency ratio reached the level of 14.6 per cent, considerably above the regulatory minimum of 8 per cent.

The high degree of stability of the banking sector goes hand in hand with high efficiency. In the recent years the relation of financial results to the amount of banks' assets and capitals improved greatly. The operating efficiency measured by the costs to profits ratio is also improving and steadily approaching the average value for EU countries.

It is also worth emphasizing that the sector of cooperative banks has recently displayed an even higher efficiency. This group of banks, after the restructuring

which it underwent in the nineties – due to the solvency ratio at the level of 14.7 per cent – is safe and runs a network of 3597 outlets, i.e. every third banking outlet in Poland.

A well functioning supervision enabled Poland to avoid the banking crisis, which affected many countries of our region and in the Czech Republic, for example, it ate up, according to World Bank estimates – 12 per cent of the GDP (according to data of the Czech Central Bank itself – 24 per cent of the GDP), and 10 per cent of the GDP in Hungary.

The domestic banking sector is characterised by a high degree of resilience against hypothetical disruptions caused by the worsening of the quality of credits, the price fall of financial assets or the weakening of the zloty. A positive assessment of the resilience of the Polish financial system to disturbances has been confirmed by experts of the International Monetary Fund and the World Bank during their mission which took place this year within the framework of the Financial Sector Assessment Programme.<sup>1</sup>

An efficient and stable financial sector increases the effectiveness of the monetary policy. Research carried out in the NBP indicates that the reaction time of banks to changes of interest rates and the scale of such adjustment in Poland is similar to that of the Euro zone. There is also positive interaction between the banking system stability and the effectiveness and safety of payment systems. The payment systems in Poland comply with the strictest international demands. It applies both to systems operated by the NBP, which comply with the requirements of the European Central Bank and systems operated by the National Clearing House, which are

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<sup>1</sup> The mission stayed in Poland from 20 April to 8 May 2006.

subject to the supervision by the NBP and comply with international requirements worked out by the Bank for International Settlements in Basel.<sup>2</sup>

Honourable Deputies!

Due to the time frame of the debate, the analysis I have presented here refers only to selected examples and most important indexes describing the banking sector from the point of view of its efficiency, stability and impact on the efficiency of the monetary policy and the safety of the payment system. The above suffices to formulate the conclusion that within little more than a dozen years a modern banking and financial system has been successfully built in Poland – a system, which in many aspects complies with high, if not the highest, international standards.

Unquestionable and very important input in the creation of this modern branch of the economy was brought by institutions of supervision of the financial market, i.e. banking supervision, capital market supervision and insurance and pension funds supervision.

From the organisational side the financial supervision in Poland has been built on sectoral principles. Three separate institutions: The Committee for Banking Supervision, the Insurance and Pension Funds Supervisory Commission and the Polish Securities and Exchange Commission exercise supervision of individual sectors of the financial market. At the same time, which is important, they are guided by two principles:

Firstly, the principle of cross membership, according to which every commission includes representatives of the remaining supervisions, e.g. the Chairman of the Polish Securities and Exchange Commission (PSEC) is a member of the Commission for Banking Supervision (CBS), while the General Inspector of

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<sup>2</sup> Core Principles for Systemically Important Payment Systems

Banking Supervision (GIBS) is at the same time a member and participates with a consultative vote in the sittings of the Insurance and Pension Funds Supervisory Commission (IPFSC);

Secondly, the principle of information exchange and cooperation in exercising supervision of individual segments of the financial market; the basis for the implementation of this principles is provided by bilateral agreements between the CBS and the PSEC as well as between the CBS and IPFSC stipulated in sectoral regulations.

Furthermore, a Coordination Committee for Financial Conglomerates has been established, composed of all members of the three committees supervising individual segments of the financial market.

Poland has built its own, original supervisory model, which takes into consideration historic conditions and the level of economic development of our country as well as the size and structure of the financial market. The specific nature and at the same time the advantage of Polish solutions consists therefore in the establishment of such links among collegial bodies, which ensure close cooperation and broad exchange of information. The Polish supervisory model assumes a particular role of the NBP in exercising the supervision of the banking sector. Operational functions related to this supervision, i.e. analyses and inspections, are carried out by the General Inspectorate of Banking Supervision, which forms part of the NBP, and decisions are taken by an independent collegial organ – the Commission for Banking Supervision. Solutions in the area of banking supervision are similar to the French model.

The model of supervision of the financial market in Poland can be described as mixed.

Honourable Deputies!

This original model takes into account our local specific conditions and allows to combine the advantages of basic supervisory models: of sectoral supervision and integrated supervision, of supervision concentrated in the central bank and the model of supervision separated from the central bank. Advantages of such a mixed model mean, inter alia, that the central bank fulfilling determined supervisory functions can carry out in a better way its tasks related to the monetary policy and responsibility for the payment system and financial stability. It also has better conditions for the fulfilment of the function of the lender of the last resort and easy access to adequate and credible information in the case of an emergency situation.

At the same time, the mixed model functioning in Poland eliminates some of the faults of extreme solutions. Firstly, in this model there is no problem of excessive concentration of power in one institution. Owing to a clear division of tasks, the competences of the central bank and supervision are precisely delimited.

Secondly, the location of a part of the operational supervision at the NBP and the double subordination of the General Inspectorate of Banking Supervision allows to avoid unnecessary costs resulting from the repetition of the same tasks and activities by the central bank and the supervision. Thirdly, in an emergency situation the General Inspectorate of Banking Supervision may be quickly involved by the president of the NBP in the process of crisis management. The separation of the General Inspectorate of Banking Supervision within the structures of the NBP ensures both an adequate level of security and confidentiality of executed supervisory tasks.

Fourthly, the existence of several specialized supervisions eliminates the risk of a one-sided assessment of financial sector situation and is conducive to the exchange of opinions taking account of various points of view. In this manner the probability

rises of an adequately early detection of dangerous tendencies on the financial markets and of implementing early countermeasures against them.

Honourable Deputies!

I wish to strongly emphasize that the Polish banking supervision has gained enormous experience and reputation in the banking sector at home and internationally. Representatives of the central bank participate in the work of international organisations dealing with problems of banking supervision, such as the Basel Committee for Banking Supervision (BCBS), the Committee of European Banking Supervisors (CEBS) and the Banking Supervision Committee (BSC). The Polish banking supervision also enjoys a very good reputation in Central and Eastern Europe as well as in Central Asia.

It is confirmed by experience of TIBS – a training initiative for banking supervision comprising a series of seminars conducted in cooperation with the US supervision, organised for 21 countries of Central and Eastern Europe and Central Asia.

The Polish banking supervision has been submitted to the assessment of international institutions: the International Monetary Fund and the World Bank as well as the European Commission. The assessment by the mission from the European Commission, which included supervisors from Germany and Finland, was of particular importance. Their objective was to establish if the Polish banking supervision complied with EU standards and if it is able to supervise branches of Polish banks in other member states, once they start their operation in the European Union. The mission also strived to establish whether we will be able to guarantee an adequate level of supervision of Polish banks which are branches of other member states' banks.

The European Commission and the International Monetary Fund as well as the World Bank gave a very good opinion on the Polish banking supervision.

Mr Speaker, honourable Deputies!

I would like to refer to some of the premises presented by the Finance Minister as arguments in favour of abandoning the existing mixed model and replacing it with an integrated model.

The most important argument given in the justification of the draft law is the emergence of financial conglomerates and the lack of an institution capable of making a comprehensive assessment of those.

Yet, the Coordinating Committee for Financial Conglomerates is exactly such an organ. According to its assessment, there are no groups in Poland now which could be considered to form such conglomerates.

Also the IMF draws attention to the lack of premises for the introduction of an integrated supervision. The final statement of the Consultative Mission of the IMF of May 2006 formulates the following opinion: “(...) In this connection, we have concerns about the authorities’ recently-aired proposals for establishing an integrated supervisory agency. Currently, financial conglomeration – the standard reason for introducing an integrated financial supervisor – is minimal, and the present arrangements for managing cross-sectoral linkages meet Poland’s needs.”<sup>3</sup> - end quote. A similar position with respect to the draft law was adopted by the European Central Bank.

Honourable Deputies!

In the justification of the draft law the Minister of Finance states also that: “In recent years there has been a distinct tendency to move from decentralised

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<sup>3</sup> The final statement of the IMF mission of 22.05.2006.



supervision to integrated supervision. It should be noted that this trend has been happening worldwide and does not concern only European countries.” It is difficult to agree with this opinion. In the European Union there is no single model of supervision of the financial market. The official position of the ECB indicates that within the European System of Central Banks no particular model is preferred, but there is visible support for the participation of the central bank in banking supervision.<sup>4</sup>

In spite of the tendency observed in the nineties to create one supervisory institution outside the central bank, in 13 out of 25 member states the banking supervision still remains part of the central bank, and in two (in Austria and Germany) the central banks still performs many of the supervisory activities, even though in 2002 external bodies supervising the financial market were created. Apart from Malta and Luxembourg, in all EU countries central banks retained a significant role in the exercise of supervision of the banking sector. Taking into consideration the position of the European Parliament, as well as the role of the European Central Bank and its role in the creation of monetary policy and ensuring financial stability, member states started to locate prudential supervision of the whole financial market in the central bank. Such a solution has already been implemented in four out of the thirteen member states (chronologically: in Ireland, the Netherlands, Slovakia and the Czech Republic). A similar solution has been adopted by Estonia. The example of Slovakia merits particular attention, as in this country a decision was taken to move a newly created institution supervising the financial market to the central bank. In this manner, since 1 January 2006, the National Bank of Slovakia has been exercising the supervision of the whole financial market. It is clear that European solutions envisaging an important role of the central bank are very different from the solutions designed by the government

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<sup>4</sup> The role of Central Banks in Prudential Supervision. ECB, 21.03.2001, [www.ecb.int](http://www.ecb.int)

in which the influence of the NBP on banking supervision is to be de facto eliminated.

The integration of supervisions takes place within the central bank, not outside it, on account of clear benefits and mutual interaction between the monetary policy, the financial stability and the safety and stability of payment systems. The suggested integration of the financial supervision coupled with a marginal role of the central bank is therefore incompatible with the direction of transformation of the supervisory bodies in the EU countries. In this sense the prepared changes are also incompatible with the ECB opinion.

Honourable Deputies!

No evidence has been presented whatsoever to corroborate the next thesis, namely that the introduction of the integrated model will result in savings and will optimize human resources. The process of supervision integration is usually very costly, particularly in its initial stages. Carrying out real integration will imply significant expenses on the new seat, new computer hardware and new unified software. The lack of cost and benefit analysis does not allow to determine in any way possible savings resulting from the reorganisation of the supervision. Also international experiences do not provide evidence supporting the claim of such savings taking place. What is more, some studies indicate that the costs of supervision functioning after the implementation of changes actually increased. For instance, the estimated costs of the functioning of the financial supervision after the creation of the Financial Services Authority in Great Britain are higher than before the change. At the same time the proposal for the supervision costs to be covered by supervised institutions, not the budget, does not mean that those costs will be lower. They will most certainly be transferred onto the customers of the financial institutions.

Mr Speaker, honourable Deputies!

The draft law lacks material justification of the need for the implementation of such radical changes. Also the financial impact of this introduction remains unclear. Finally, the proposed changes are incompatible with the direction of transformation of supervisory bodies in the European Union. While benefits remain undocumented, the proposed changes are accompanied by **very serious threats**.

The time chosen for carrying out the changes is **the worst possible**. The government intends to reorganise the system of supervision of banks in the period of intense technical and legislative work on the introduction of the New Capital Agreement. The New Capital Accord (Basel II) will enter into force on the 1 January 2007 and will be the biggest organisational challenge that banking supervisions<sup>5</sup> and banks in Europe have faced so far. Basel II addresses totally new problems and introduces new regulations, including i.a. credit risk models used by banks and new principles of assessing capital adequacy. On account of the scale of the undertaking, the European Commission anticipates that the process of introducing new supervisory solutions will end as late as 2011.

The near date of Basel II entering into force has also determined the direction of changes in supervisory regulations in EU countries. Organisational changes were conducted in such a way as not to disturb the activities of banking supervision. Changes introduced recently in the Czech Republic and Slovakia consisted in adding other supervisory institutions to the banking supervision. Poland is the only country in which opposite solutions are under consideration, aiming to take the banking supervision out of the central bank. In the face of the imminent implementation of Basel II, these changes pose the threat of disturbances in the

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<sup>5</sup> Norton (2004): The Single Regulator Model and the United Kingdom – Pros, Cons and Issues With Deposit Insurance.

work of banking supervision and of lowering its efficiency. A similar problem concerns the Polish Securities and Exchange Commission with respect to investment firms and the Insurance and Pension Funds Supervisory Commission in view of the impending introduction of the resolutions of the Solvency II directive, which is the equivalent of Basel II in the insurance sector.

Honourable Deputies!

The process of introducing Basel II will begin in six months' time. According to the draft law, in six months' time the GIBS and the CBS would also be dissolved. Prior to that, the Commission for Financial Supervision would take over the competences of the IPFSC and the PSEC. In other European countries the process of such thorough supervisory transformations lasted from two to six years. A question arises: how the drafter intends to reduce the risk of disorganisation of the supervision of the financial market in the period so critically important for its efficient functioning, while carrying out the integration at such a precipitated pace? The IMF in the already quoted statement concerning Poland, remarks: "The financial system is about to undergo several changes with the introduction of Basel II and Solvency II standards. And rapidly changing patterns of credit growth allow for no slippages in supervisory attention or expertise. Thus, while an integrated supervisor may be a good idea at a later stage of financial development, there are no compelling arguments to do it now, and several for not doing it now. Should the authorities advance the idea, it would need meticulous preparation to ensure the new institution has a governance structure independent from political influence and sufficient power and expertise to use best international practices. " - end of quote. In the light of the above, apart from the occurrence of typical operational risks (e.g. human resources, technological, management and legal risks) I would like to point

to additional risks related to the government plans of reorganising Polish banking supervision during the introduction of Basel II.

Firstly, there is a risk of legislative delay. The reorganisation of banking supervision at a time when it should concentrate on the preparation of draft laws introducing Basel II may hamper the timely implementation of these regulations in Poland.

Secondly, there is a risk of disturbances in the work of Polish supervision. The reality of such possibility is illustrated by the example of the British supervisory body (the Financial Service Authority), which needed years in order to regain the operational efficiency of supervision.

High quality and efficiency of banking supervision is the effect of work of many people. It should always be remembered that the biggest value of the Polish banking supervision and – I believe – other supervisory institutions is its human capital. Without a clear and well-documented need we should not adopt solutions exposing this value to unnecessary risk. In this context I would also like to draw your attention, honourable Deputies, to the fact that banking supervision will be additionally diverted from its normal tasks due to the work of the investigating committee for the examination of capital and ownership transformation in the banking sector and the activities of the banking supervision from 1989 to 2006.

Mr Speaker, honourable Deputies!

The circumstances related to the planned changes, the extraordinarily short time for their implementation and the very essence of the suggested solutions may lead to the conviction that these changes are dictated by current political needs. I would like to point out that such a danger or even the very perception of its existence would have serious negative effects for the future of both the financial sector and the supervisory bodies.

To conclude my speech, I would like to underline once more that the implementation of the project submitted to the Sejm creates serious threats in a key area, in which Poland has managed to work out good solutions. At the same time there is no evidence showing that taking such risk may give our country any significant gains. One should not abandon rashly the workable solutions, **therefore on behalf of the National Bank of Poland I appeal to you, honourable Deputies, to retain those well-tried frameworks, which are the result of many-year work and which have given Poland numerous benefits.**

Thank you for your attention.