

# **THE POLISH BANKING SYSTEM IN THE NINETIES**

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# **I. INTRODUCTION**

## **1. EXECUTIVE SUMMARY**

This publication is one of a number of papers prepared by the National Bank of Poland for the European Central Bank. 'The monetary policy in Poland in the nineties' and 'The NBP role in European integration' constitute the other papers.

This paper consists of three basic parts:

- the introduction, in which the effect of restructuring legislation on the development of the banking system and the organisation of banking supervision was discussed;
- the main body of the report, dealing with Polish banking law in the nineties; this discusses the main changes in Polish banking legislation in the nineties, including the most recent amendment to the Banking Act of 2001. Also covered are the significant role of banking supervision and the principles of licensing policy, together with the form of broadly understood prudential regulations as well as the principles of bank accounting;
- the third section reports on the situation of banking environment in Poland, discussing the processes occurring in the Polish banking sector within the last decade. The privatisation of Polish banks has been gone into in some detail, covering restructuring and consolidation, with reference to the cooperative banking sector. Finally, this last part of the paper contains information on the establishment of banking groups and financial conglomerates.

Lists of prudential regulations that are binding in Poland and recommendations decided in the GINB are annexed at the end of the paper.

This publication is planned as being a source of informative educating material, intending to aid the European Central Bank to become familiar with the changes in the Polish banking system which have taken place in the last twelve years following democratic change. The changes were so extensive that it could be accurately stated that the Polish banking system has altered drastically since 1989.

In this period the legislation on banking activities was completely altered, the banking supervision was established, capital requirements were set up and prudential regulations for banks were changed. In the banking sector these years were marked with restructuring, privatisation, and consolidation, as well as by an increasing competition in the banking sector. At the same time the banks have expanded their services, and new products and distribution channels have been introduced. The last few years have seen the rapid development of new banking services and distribution channels including electronic banking and Internet banking in particular.

The ending of the decade of the nineties is a provident time to present and summarise the key operational changes that have come about in the Polish banking system. This paper is intended to be a useful step in that direction.

## **2. THE DEVELOPMENT OF A MODERN BANKING SECTOR**

The reform of the banking sector was one of the crucial components of the reform of the Polish economy. In January 1989 the Sejm (The Polish Parliament) passed two Acts related to banking - the Banking Act and the Act on the National Bank of Poland. The basic importance of those Acts was to be seen in:

- the total reconstruction of the banking system (the Act allowed for the operation of state banks, joint-stock banks and cooperative banks),
- cancellation of governments' legislative powers
- setting up of ordering relationships between the banking system and the State Treasury, by an abolition of the mechanism of automatic lending for governmental purposes,
- the extension of the catalogue of banking activities and services.

In 1989 a two-tier structure of Polish banking was established, with 9 regional commercial banks, independent of the NBP, taking over about 400 hundred branches of the NBP. These banks took over lending and deposit taking obligations from the NBP. The established commercial banks provided the foundations for the development of universal banking. In the years following this new private banks were set up and state banks were privatised.

In this context it should be pointed out that the Polish banking system has been radically reconstructed since 1989. As of 2001 there were 75 commercial banks in Poland, with only one being state owned and 2 further banks having state majority capital. Five of the ten largest banks in Central and Eastern Europe are Polish entities, with two of them being the largest banks in the region.

Another step in the process of the construction of a new banking system, one that took into account the emergence of the market economy, was the passing of three Acts aimed at the rehabilitation of the banking sector and at increasing its stability:

- the Act on the Financial Restructuring of Enterprises and Banks of 1993
- the Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej of 1994,
- the Act on the Bank Guarantee Fund of 1994.

The development of the Polish banking system has forced commercial banks to seek strategic foreign partners, which would be in the position to support banking transformation by sharing their know-how. Initially such cooperation was only provided in the form of technical assistance; tasks accomplished within this framework contributed to the modernisation and reconstruction of the structure of individual commercial banks. However co-operation with foreign partners was gradually evolving - Polish banks were making twinning agreements with foreign banks, primarily from the European Union. The cooperation was invariably connected with the modernisation of banking operational principles and preparation for operation in a free market economy. The prospect of Polish membership to the EU and of free competition within this single market has prioritised the necessity of raising the capitalisation of Polish entities. As a consequence of this, Polish banks' strategic partners invested their capital into the sector. It may be stated that today Polish banks are modern concerns and their investors are some of the most important institutions in the international marketplace.

The financial cooperation with international financial institutions and European Community bodies played an important role in the modernisation of the Polish banking system and the putting into operation of the reforms necessary for future membership in the European Union and in the Economic and Monetary Union. The European Community was quick to play an important role in the support of financing economic transformation in Poland, starting in the early 1990s. The financial assistance of European Union countries has been being provided in two forms:

- non-repayable assistance within the PHARE programme, and
- loans from the European Investment Bank.

At present the use of assistance funds and the co-operation of the National Bank of Poland with European institutions take the form of twinning covenants, within which foreign expertise is participating in the process of NBP preparation to the EU membership.

#### **A. The revival of the Polish banking system – the banking law from 1989 to 2001**

The formation of a new legal framework, defining the principles of operation of the reformed Polish banking system, was started in 1989. Within 12 years a mono-bank system was transformed into a banking system developed on the principles of the free market. Operational regulations were changing with the progress in reforming the national economy and with the undertaking of Poland's international obligations to the OECD and the European Community. An equally significant component that was undergoing change during this period of systemic transformation was the banks' financial standing. The problems that affected the Polish banking system required specific legislation.

The Act on the NBP and the Banking Act of January 1989 created an overall framework for the revitalised banking system. The National Bank of Poland, as the central bank, was entrusted with the function of an issuing bank and with being the central credit and settlement institution as well as the central banking foreign exchange institution. At the same time the conditions to establish new banking organisations were put in place. Private joint stock banks were set up, side by side with state and cooperative banks, operating on the basis of the Banking Act and the Commercial Code.

The Banking Act of January 1989 specified the principles of banking activities, including establishment and organisation, as well as contingencies for liquidation and bankruptcy. The provisions of the act evolved with time. The first stage of amending the act was completed in December 1992 when the Act on Amendments to the Banking Act and Certain Other Legislation was passed. It introduced changes in regulations specifying the limit of credit exposure and the standard of capital holdings as well as the control of joint-stock bank shares transfers.

The Acts of 1989 were complex in the way they set out to regulate the operation of the banking system, which was until then rather straightforward. The following Acts, passed later on, turned the commercial part of the banking system into a very complex structure from the institutional and organisational point of view. These Acts were:

The Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej,

The Act on the Bank Guarantee Fund,

The Act on the Amalgamation and Consolidation of Certain Joint-Stock Banks,

The Act on the Building Societies and State Support to the Saving for Housing Purposes,

The Act on the Mortgage Bonds and Mortgage Banks.

Banking operation is significantly affected by The Act on Certain Forms of Support to Residential Construction and on Amendments to Certain Legislation, as well as by legislation of systemic nature, like the Commercial Code, the Civil Code, the Act on the Cooperative Law, the Economic Activity Act or the Law on Public Trading in Securities and Trust Funds. Banking legislation became a component of a larger whole – which forced the introduction of new acts, specifically the Act on the NBP and the Banking Act of 1997. These acts continue to include provisions that provide the source of principles of conducting banking business, of banks, branches and representative offices of foreign banks establishment and organisation as well as the principles of performing banking supervision, rehabilitation procedures and bank liquidation and bankruptcy.

## **B. The Act on the Financial Restructuring of Enterprises and Banks**

The Act on the Financial Restructuring of Enterprises and Banks created the legal framework to counteract the critical situation in the state banking sector and to solve the problem of bad debts, which was the main reason for the banking crisis at the beginning of the nineties.

This crisis was connected with the sudden deterioration of the financial position of companies, brought about by the transformation of the economic system. As the result of economic change the state stopped subsidising state enterprises, resulting in problems with loans repayments by these said enterprises. The amount of doubtful and bad debts in the banks' portfolios in 1993 reached the dangerous level of over 35% of the total amount of funds disbursed.

The Act on the Financial Restructuring of Enterprises and Banks introduced such instruments as:

- bank arrangements,
- public sales of bank claims,
- swaps of equities of sole state shareholder companies to clear debt,
- the provision of funds to increase the banks' own funds.

Bank arrangements were the most important legal instrument introduced by the aforementioned act. This procedure enabled repayment of debts of state enterprises, of sole state shareholder companies, of companies in which shares owned by the state, state enterprises and sole state shareholder companies exceeded 50%, as well as of enterprises owned by the Agriculture Property Agency of the State Treasury – after restructuring of the claims of those entities.

The Act on the Financial Restructuring of Enterprises and Banks also introduced the procedure of a public sale of debts, containing certain exceptions from general regulations used in the public trading in securities and allowing the creditors to swap the claims for equities of debtor – enterprises.

Moreover, the Act has introduced the mechanism of providing funds and long-term Treasury bonds to supply with own funds the state banks and banks, in which the State Treasury owned more than 50% of shares. The Act specified a number of pre-conditions to obtain assistance:

- the analysis of the bank's credit portfolio quality,
- the separation of the classified assets,
- the organisation of special units handling the service of classified loans,
- the preparation of a restructuring plan for the classified loans portfolio.

The Act on the Financial Restructuring of Enterprises and Banks enabled the accomplishment of a number of assumed objectives: these were the financial strengthening of banks and restructuring of their credit portfolio, establishing a market for debts trading, reducing the payment bottlenecks, and introducing a regular monitoring of the banks' financial standing. Mention should also be made of the fact that the Act created a new path for privatisation of state enterprises and had a positive impact on the transformations of the ownership structure of this sector.

## **C. The Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej**

The cooperative banking sector, because of its fragmentation and its poor situation was the area that required the greatest restructuring.

Until The Act on Changes in the Organisation and Operation of the Cooperative Movement of 20 January 1990 came into effect the cooperative banks were obliged to conduct business as an affiliate of the Bank Gospodarki Żywnościowej (BGŻ), a state-

cooperative bank. The BGŻ was their central organisational and financial entity, and with regard to cooperative banks it carried out responsibilities vested to central cooperative unions, in accordance with the Act on the Cooperative Law - and at the same time held powers of banking supervision.

In September 1992 the President of the NBP decreed that all cooperative banks should be affiliated to one of the newly established regional banks or to the BGŻ. This operation was aimed primarily at improving the safety of the operation of the cooperative banks by including them in the common system of assistance mechanisms in regional associations.

From 1991 to 1993 co-operative banks established three affiliating banks: these were Gospodarczy Bank Wielkopolski SA in Poznań, Bank Unii Gospodarczej SA in Warsaw and Gospodarczy Bank Południowo-Zachodni SA in Wrocław. The Banks were also charged with the responsibilities connected with cash flow, settlements, IT systems, standardisation of internal procedures, training and legal assistance. Moreover, internal assistance funds were established as a type of mutual protection.

At the end of 1993 rehabilitation procedures were started in about 680 co-operative banks, including 250 where the banks were technically bankrupt. Further restructuring actions were initiated by the NBP. These efforts may be basically divided into two groups:

- financial or technical assistance,
- structural reconstruction of the sector, aimed at finding the appropriate legal grounds for cooperative banking operations.

Basic types of financial assistance included:

- low-interest loans from the NBP supporting the amalgamation of cooperative banks (the first loans was extended in 1994),
- discharging the necessity for co-operative banks undergoing the rehabilitation process from holding the required reserves,
- loans from the Bank Guarantee Fund (since 1995),
- tax exemption in 1995 and 1996,
- restructuring bonds to purchase bad loans and cooperative loans.

This assistance resulted in a permanent reduction in the number of failing cooperative banks. At the same time the number of bank amalgamations was gradually increasing.

The deepening crisis in the cooperative banks sector forced legislators to consider the restructuring of this sector by establishing a new legal framework for its secure operation in the future. The Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej of June 1994 enabled the establishment of the three-tier structure of the cooperative banking sector, consisting of cooperative banks, of regional banks and with the national bank at the top of this system. By the end of 1997 all (9) regional banks, provided for in the aforementioned Act, had been established. Moreover, two affiliating banks, i.e. BUG SA and GBPZ SA, were operating outside the three-tier structure, while GBW SA in 1995 adopted the status of a regional bank in accordance with the Act on the Restructuring of Cooperative Banks and of BGŻ. BGŻ was transformed on the grounds of the aforementioned act into a joint-stock company, to fulfill the functions of the national bank. Concurrently, cooperative banks were obliged to affiliate to one, geographically appropriate, regional bank.

The implementation of the Act improved the effectiveness of the cooperative banking sector. However, a few adverse changes also came about, negative aspects such as the creation of too many relatively weak regional banks, and the division of the sector. Because of those adverse factors the aforementioned Act had limited effect on the raising of sector operational efficiency.

The consolidation of regional affiliations of the cooperative banks through a system of mutual guarantees was one of the main assumptions of the Act - this assumption was not met. The main obstacle in accomplishing this intention was the reluctance of larger and stronger

cooperative banks to take over the responsibility for the liabilities of smaller and weaker banks.

Legislators were forced to seek another way to improve the operation of the cooperative banking sector. Bank amalgamations seemed to be the only method of accomplishing this objective in the short term. It must be emphasised that amalgamations in the cooperative banking sector shall be perceived as the reduction of the number of entities, but not of establishments (operating after the amalgamation as branches or sub-branches).

Amalgamations are indispensable because commercial banks were increasingly involved in retail banking in this segment of the market, which was traditionally dominated by cooperative banks. At the same time customers required a more professional service and better banking products.

In January 2001 a new act regulating cooperative banking – the Act on the Operations of Cooperative Banks, Their Affiliation, and Affiliating Banks – was implemented. It introduced a two-tier structure and charged the cooperative banks, which possessed own funds of less than euro 5 million, with affiliative obligations – the bank in question being required to select an affiliating bank and being free to change affiliation when and if it so desired. Moreover, affiliating banks may merge (in the previous Act those banks had to make an affiliation agreement with the national bank). Additionally BGŻ SA could affiliate cooperative banks.

This Act also introduced changes in the level of required capital for cooperative banks and specified the amount of own funds and the deadline to attain the levels of funds in the following way:

- euro 300,000 by 31 December 2001,
- euro 500,000 by 31 December 2005,
- euro 1 Million by 31 December 2010.

These challenges, resulting from intensified competition, may be met only by those cooperative banks which are strong and which have a high capital.

#### **D. The Act on the Bank Guarantee Fund (BGF)**

The reconstruction of the Polish banking system also required the establishment of an institution that would deal in a professional way with banking deposit guarantees. Until reform the State Treasury was the statutory guarantor, represented by the Ministry of Finance. The central bank, however, was forced – so as to protect the integrity of the banking system – to participate directly as the guarantor of deposits in banks undergoing restructuring.

The Act covers the following specifics: principles of establishment and operation of obligatory and contractual guarantees of bank account funds, types of action that may be taken to assist entities covered by the obligatory system of funds guarantees in cases of dangers of insolvency, as well as principles for collecting and using information regarding entities covered by the guarantee system.

The entities covered by the guarantee system contribute compulsory annual payments to the Fund and are obliged to establish a protection fund for guaranteed funds. Treasury securities and NBP money-market bills, deposited on a separate account, are assets that cover this fund. In addition, assets that cover the protection fund of guaranteed funds must not be pledged or be charged in any form and not be subject to a court or administrative enforcement.

Entities covered by the guarantee system may also undertake to expand the obligation of funds guarantee above the minimum specified in the obligatory system. The agreement on establishing a guarantee fund and principles of its operation shall be approved by the BGF Board.

The Act provides for penal sanctions. In the case of non-fulfillment of the obligations resulting from the Act penalties may take the form of fines, penalties of restricted freedom, or a term of imprisonment of up to 2 years.

The objective of the compulsory guarantee system of bank account deposits is to ensure that the depositors may be repaid funds collected on those accounts up to the amount specified by the Act. According to the provisions of the Act, deposits up to the zloty equivalent of euro 1,000 shall be entirely covered by a full guarantee. The upper limit of funds guaranteed at 90% rose in 2001 to euro 15,000 (in 2002 this will rise to euro 17,000 euro and in 2003 to euro 22,500).

The tasks of the fund in the field of providing assistance to entities covered by the system primarily involve providing repayable financial assistance in cases of danger of insolvency to purchase banks' equities or shares, and the strict control of the use of the aforementioned as well as controlling the conduct of proceedings aimed at rehabilitation of bank management.

The Bank Guarantee Fund was effortlessly incorporated into the Polish banking failsafe system. Herein it is stated that in the event of declaration of bankruptcy the payment of guaranteed bank deposits is secure and the operation itself will be carried out speedily and in accordance with professional guidelines.

### **3. THE ORGANISATION OF BANKING SUPERVISION**

During the period from 1989 to 1997 banking supervision was carried out by the NBP. However, the discussion on who was responsible for banking supervision, which has lasted since the mid-nineties, led to a compromise solution. The supervision of banking activities in Poland is performed by an independent Commission for Banking Supervision (CBS) and decisions and tasks specified by the CBS are carried out and coordinated by the General Inspectorate of Banking Supervision (GINB), which is a separate organisational unit within the structure of the National Bank of Poland. The most important tasks of the CBS include:

- specifying principles of banking activities, that ensure the safety of the funds held by customers at banks,
- supervising banks in the field of compliance with the law, their articles of associations and other regulations as well as with obligatory financial standards,
- performing periodic assessments of the banks' financial standing and presenting these to the Monetary Policy Council, as well as evaluating the impact of monetary, fiscal and supervisory policies on bank development,
- opinion making on organisational principles of banking supervision and establishing performance procedures.

The GINB tasks were specified as follows:

- granting authorisation for setting up of banking operations, monitoring the ownership structure and management qualifications,
- monitoring the financial stability of banks by a system of supervisory reporting,
- preparing prudential regulations, specifying permitted or recommended parameters of the specified banks' operations, the level of risk incurred and the adequacy of management,
- initiating and conducting, at the request of the CBS, supervisory action directed at banks in crisis situations, including monitoring the rehabilitation programmes and proceedings, and in situations of insufficient improvement of the financial position to apply to the CBS to take further steps resulting from the provisions of the Banking Act, i.e. liquidations, bankruptcies, amalgamations.

#### **4. RELATIONSHIPS WITH OTHER INSTITUTIONS**

The idea of strengthening the banking system has been fostered by cooperation with the Basle Committee for Banking Supervision (in particular in the field of implementing the Core Principles for Effective Banking Supervision – which provide the standard for prudential regulation and supervision – and the Methodology of Core Principles for Effective Supervision which contains requirements to assess the compliance with the Core Principles, as well as in active participation in forming the methodology of the new capital accord) and with other agencies and institutions of banking supervision worldwide together with international financial institutions, i.e. the World Bank or the International Monetary Fund. Cooperation and exchange of information with other domestic statutory bodies regulating the financial system are also of extreme value and importance- the aforementioned Polish bodies include: the Securities and Exchange Commission, the Bank Guarantee Fund, the Polish Banking Association, the National Chamber of Certified Auditors and the rating agencies.

The tasks that have been carried out have contributed to the construction of a modern and properly managed banking system in Poland. In this context, installing protection procedures for banking supervision against potential pressures from institutions and political influence, thus ensuring independence, was a significant factor to take into account while banking system reform and rehabilitation of the banking sector as a whole was taking place.

## **II. THE FORMATION OF BANKING LEGISLATION IN POLAND**

### **1. EVOLUTION OF BANKING LAW**

#### **A. Introduction**

Banks, like other entities (entrepreneurs, institutions that are not entrepreneurs, citizens), are obliged to comply with the existing regulations. Banking regulations and banking law hold a clear importance for bank operations, defined here as the regulations as a whole that regulate the structure of the banking system, the legal structure of banks, their operations and legal relationships originating in connection with this operation. Thus banking law is complex in its nature, herein are included standards of administrative-legal, financial and civil, and even criminal-law. These are linked by the object of regulations in the form of banking operations. That practically means that when defining legal grounds to perform banking operations it is necessary to take into account not only laws of particular character, but also normative acts that specify general conditions to perform business activities, i.e. the Constitution, the Civil Code, the Code of Commercial Companies or the Economic Activity Act.

In this part of the paper the changes in banking legislation in the nineties have been presented. The information presented below focuses on main legal acts that directly affected the shape of the banking system and that created conditions to perform banking operations in Poland in this period.

The reform of Polish banking law, when considered in the context as presented above, began before the political transformations that took place after the elections of 4 June 1989. As early as on 31 January 1989 the Sejm of the PRL passed two Acts: the Banking Act and the Act on the National Bank of Poland. These Acts – passed while Poland still had a socialist economy – following the political breakthrough (that occurred soon afterwards) and numerous subsequent amendments, became basic legal Acts regulating the operations of the banking system during the following period of systemic transformation. The Act on the National Bank of Poland, which expressed the principle of separate regulation of the NBP legal status and principles of operation observed in the post-war period, was related entirely to the central bank. The Banking Act specified principles of law connected with commercial banks' operation, establishment and organisation, as well as liquidation and bankruptcy.

The changing economic situation, the evolving market needs and the progressing internationalisation of the banking market were the main reasons for amendment to the Banking Act and to the Act on the NBP. However, because of dynamic transformations in the economy the changes were insufficient.

Therefore in June and August 1997 a package of banking acts was passed, which took effect on 1 January 1998. This package comprised new acts: the Banking Act and the Act on the National Bank of Poland, which replaced their predecessors from 1989. The aim of this legislation, with the passing and implementation of these Acts was to complete the period of Polish banking system transformation and to begin a new phase of operations. These acts were assessed – both by officials and in professional publications – as being compatible with European Union regulations.

The Banking Acts of 1989 and latterly of 1997 were seen to be of basic importance for banking operations in the 1990s. The special role of those two Acts was taken into account in the presentation of this part of the paper.

## **B. The period from 1989 to 1992**

In the Act of 31 January 1989 the NBP was defined as the state central bank, the central issuing bank and the central credit and settlement institution, as well as the central banking foreign exchange institution. Conditions to establish new banking institutions were created. Apart from state and cooperative banks, private banks were also set up, in the form of joint-stock companies, operating on the basis of provisions of the Banking Act and the Commercial Code. The Banking Act became the basic piece of legislation regulating the operation of this part of the banking system. The Act established principles of the banks operation as well as of their setting up, organisation, liquidation and bankruptcy. Relationships between commercial banks and the central bank were defined according to new principles. In the field of the monetary policy the administrative methods were replaced with economic tools (interest rates, exchange rates, required reserves, open market operations, bill of exchange discounts). Commercial banking supervision was also entrusted to the NBP. The amendment to the Act on the National Bank of Poland of 14 February 1992 (Dz.U. No 20, item 78) was an important stage in the process of strengthening the NBP independence. The amendment introduced the principle of the term of office and precisely defined situations, in which the President of the NBP may be recalled before the expiration of the term of office. The so-called Small Constitution, i.e. the Constitutional Act on Mutual Relationships between the Legislative and Executive Authorities of the Republic of Poland and on the Territorial Self-Government of 17 October 1992<sup>1</sup>, was a kind of normative summary of changes made in the political sphere at the turn of the 1980s and 90s. One of the provisions of this Act (Art. 40) referred to the banking system and stipulated that the President puts a request to parliament to appoint or recall the President of the National Bank of Poland. Therefore it can be seen that central bank regulations on the constitutional level were of residual character.

The Banking Act of 31 January 1989, which took effect on 10 February 1989, combined elements characteristic for the planned economy with regulations based on Western European models. The provisions of the Act had to facilitate the accomplishment of the independence and self-financing principle of banks operating at reasonably equal conditions for all market players providing commercial services.

The foundations of banking financial management regulated in the Act provided statutory guarantees of independence and self-financing (which became a component of the statutory definition of a bank). According to those provisions banks shall cover operational costs as well as the liabilities to the State Budget and contractual liabilities, and also expenditures for development and other needs from the income obtained. According to the Act banking operations comprised also of the carrying out of banking activities and other forms of economic activity. Banking operations were defined by listing them in an open catalogue<sup>2</sup>, i.e. other activities than those listed in the Act could be considered as banking

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<sup>1</sup> Dz.U. No 84, item 426; of 1995: No 38, item 184, No 150, item 729 and of 1996: No 106, item 488.

<sup>2</sup> Such operations comprised, in particular:

- 1) operating bank accounts,
- 2) taking saving deposits and time deposits,
- 3) performing bank settlements,
- 4) extending and taking loans and cash advances,
- 5) performing operations involving cheques and bills of exchange,
- 6) taking from and placing deposits at domestic and foreign banks,
- 7) extending and taking bank endorsements and guarantees,
- 8) trading in foreign exchange valuables and providing financial services for the foreign trade,
- 9) servicing government borrowings,
- 10) issuing securities and trading in securities,
- 11) performing operations ordered in relation to the issue of securities,
- 12) safekeeping valuables and securities and providing safe deposit facilities.

activities. The banking operations specified by the Act were entailed by the banks' monopoly of their performance – banks could perform them according to the scope defined in their articles of association. Some of those operations were regulated in the Act in a broader way. These included: bank accounts and monetary settlements, loans and cash advances, the issue of bank securities, and bank guarantees. Other activities of banks, specified by the Act, consisting in investment activity and participation in business undertakings of financial character<sup>3</sup> were not considered as banking operations. The matter of the right to hold foreign exchange valuables and for banks to trade in the same was to be regulated in the banks' articles of association. With regard to the operations performed, banks were obliged to maintain liquidity, this consisting in conducting operations in such a way so as to ensure the meeting of liabilities when they became due. In its original wording the Act charged banks with the duty of being guided in relation to their operations with monetary-credit policy guidelines passed by the Sejm.

Specific obligations and powers were connected with the conduct of banking operations, these taking the form of: the right to issue contractual standards (regulations)<sup>4</sup>, banking secrecy<sup>5</sup>, State Treasury guarantees<sup>6</sup> and the right to issue documents with the status of official documents as well as to issue enforced collection orders<sup>7</sup>.

Banks could operate as state banks, cooperative banks, joint-stock banks and state-cooperative banks. The Act also permitted the operation of foreign banks' branches and representative offices in the Polish market.

The principles and the approach to establishing banks, as well as the basic elements of their internal organisation and the organisational structure of the supra-banking character were of course regulated. The above took into account the specifics resulting from the distinction of legal forms of individual banks.

The establishment of a bank was made dependent on: ensuring that the bank would be furnished with enough own capital adequate to the size of the intended operations, together with other resources necessary to conduct those operations, as well as with premises adapted to due safekeeping of the valuables held in the bank, and also due provision made for appropriate training and consideration made to the professional experience of persons designated to fill managerial positions.

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<sup>3</sup> Apart from performing banking operations banks could: establish commercial or civil companies and cooperatives, perform business activities jointly with other entities or provide financial consulting-advisory services, undertake according to the scope defined in their articles of association other business activities not stipulated in the Banking Act as well as establish and liquidate branches and other establishments abroad and also could be shareholders of foreign banks and enterprises operating in Poland.

<sup>4</sup> The role of regulations, as contractual standards, consisted of supplementing provisions of agreements made by banks within the conduct of services – regulations defined rights and duties of the parties in the field not covered by the agreement.

<sup>5</sup> The banking secrecy referred to the information on movements and balances on bank accounts. However, such information could be provided by banks only to entities specified in the Act.

<sup>6</sup> So-called guarantee of the State Treasury was designed as the exception from the principle that the State Treasury shall not be liable for obligations of banks. The liability resulting from this guarantee covered obligations on: saving deposits held in state banks and also in other banks that enjoyed this right prior to taking effect by the Act (i.e. operated under provisions of previously binding act and that under the previous act were also covered by the State Treasury guarantee). Moreover, apart from so-called guarantee the State Treasury was liable for those obligations of banks, where liability was assumed under guarantees and endorsements.

<sup>7</sup> Privileges in the form of the right to issue documents with the force of official documents as well as to issue enforced collection orders were enjoyed by banks covered with the State Treasury guarantee. An enforced collection order is a document providing the basis for the enforcement. In a normal mode the enforced collection order is issued after the completion of juridical or administrative proceedings – so banks enjoying this privilege obtained a possibility to bypass the administrative or juridical proceedings what made their vindication of financial claims substantially easier.

State banks could be established and liquidated by ordinance of the Council of Ministers, having obtained the opinion of the President of the National Bank of Poland. A state-cooperative bank was to be established by ordinance of the Council of Ministers, in agreement with the Supreme Cooperative Council, having obtained the opinion of the President of the National Bank of Poland. Cooperative banks and joint-stock banks could be established after obtaining the consent of the President of the National Bank of Poland to establish the bank. Establishing a branch or a representative office of a foreign bank in Poland occurred pursuant to the permit issued by the Minister of Finance, in agreement with the President of the National Bank of Poland.

The Act set up the Banks Council, as a coordinative, advisory and consultative body of banks. The council was comprised of the President of the National Bank of Poland and his/her First Deputy, presidents and representatives of banks specified in the Act (14 persons) and one representative of the Minister of Finance and one representative from the Central Planning Office. Among various issues considered by the Council the following shall be mentioned:

- 1) draft credit plans and assumptions of the monetary–credit policy of the state, a draft balance of payments and a draft aggregate financial plan of banks,
- 2) draft reports of the National Bank of Poland on the accomplishment of plans and assumptions, referred to in point 1,
- 3) draft assessments of the monetary situation of the state by the National Bank of Poland.

The regulations on establishing affiliations by banks, the operation of which resulted in a permanent, common operation of interested banks creating such a structure on the basis of statutory principles, played a significant role in the formation of the organizational structure of the Polish banking system.

The Act entrusted the supervision over banking operations as well as branches and representative offices of foreign banks to the National Bank of Poland. To perform tasks connected with the conduct of supervision over banks operations in May 1989 the Department of Banking Supervision was set up within the NBP structure, which in 1990 was renamed the General Inspectorate of Banking Supervision.

The regulations on the supervision entailed by the Banking Act were supplemented by the provisions of the Act on the National Bank of Poland. The banking supervision performed by the NBP was to ensure:

- 1) the security of savings and deposits held on bank accounts,
- 2) the compliance of banks operations with the provisions of the Banking Act, in particular in the field of the relationship with legal and natural persons.

The competence vested to the NBP, obliging it to accomplish the aforementioned objectives, may be divided into specific groups, assuming the basic functions it had to perform as the criteria. These include: licensing functions, regulatory function and a control-administrative function. Another separate area of responsibility and banking supervision authority is connected with the use of rehabilitation-liquidation procedures against banks.

The competence grouped in the licensing function included NBP powers at the stage of bank establishment – issuing authorisations to establish a cooperative bank or a joint-stock bank and opinions on establishment of a state bank and a state-cooperative bank.

The regulatory function is connected with the application of the term known as supervisory prudential standards. In the original wording of the Act the provisions comprised by the Act set up two such standards: the credit exposures standard and the standard of capital holdings of the bank. The first was determined as the total amount of loans extended by a bank to one borrower or to a group of financially related borrowers; this amount shall not exceed 15% of the sum of non-distributable own funds and bank deposits. In addition, the amount of credit extended on the basis of one credit agreement shall not exceed 10% of those

funds. The standard of capital holdings is the maximum amount of shares and equities contributed to one legal person and the value of purchased equities and bonds, set at the level of 25% of the total of those funds. The Act provided the possibility to exceed the aforementioned limits subject to the consent of the President of the National Bank of Poland.

The competence within the control-administrative function allowed the NBP on the one hand to collect the information and analyse the situation in individual banks and within the banking system as a whole, and on the other hand to apply supervisory measures to prevent undesirable consequences or to counteract them. Information on the banking situation was collected by reports submitted to the central bank by commercial banks and by the conduct of supervisory activities in those banks. These activities were performed by authorised employees of the NBP, which for this purpose were vested the right to enter the premises of a bank and of its establishments<sup>8</sup>.

Within the supervisory measures the President of the NBP was vested the right:

- to oblige the bank to take measures necessary to restore liquidity, to increase reserve funds, to increase numbers of shares issued, to perform a specific restructuring of assets, and to make claims more realistic, to desist from particular forms of advertising, and
- apply for recall of or suspension from office, until consideration of the application, of the president, vice president, or any other member of the management board, whose activities flagrantly infringe the law or bank's articles of association or threaten it with a substantial loss, and to appoint a temporary bank manager or a temporary member of its management board.

The aforementioned measures taken within the supervision must not infringe in any way the contractual obligations that the bank has entered into.

The rehabilitation-liquidation procedures that applied to banks finding themselves in financial difficulties came under the jurisdiction of the NBP within the conduct of banking supervision. Those procedures, according to the criterion of the effects of their application, may be broken down into two categories:

- those used within the rehabilitation proceedings – aimed at maintaining the bank's legal existence by rehabilitating its management,
- liquidation-bankruptcy – aimed at ending the bank's legal existence, guaranteeing the maximum possible protection of customers interests; these procedures regulated the taking the bank over by other banks or a bank or a temporary taking the bank over by the National Bank of Poland, the bank's liquidation and the bank's bankruptcy.

The result of elections on 4 June 1989 determined the direction of the development of the political and economic sphere. The desire for the reorientation of the economy to that of a market economy required changes in legislation. The first amendments to the Banking Act, made in September and October 1989, aimed at introducing temporary regulations connected with the performance of the budget and with other issues connected with the state finance.

The first broader amendment was made with the Act of 28 December 1989 (Dz.U. of 1989 No 74, item 439).

This amendment introduced the banks' right to the exclusive use of the terms "bank" and "kasa" in the name, to define the activity, or in advertising. The principle assigning to banks the monopoly of performing banking operations as specified by the Act was also

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<sup>8</sup> Activities performed within the supervision of banks operations involved, in particular:

- reviewing bank's balance sheet,
- reviewing the performance of the duty to maintain liquidity by a bank,
- reviewing the compliance of extended loans and advances with regulations on the credit exposure limit,
- reviewing the security taken against loans and advances as well as timeliness of repayment,
- reviewing the interest rate applied on the loans and advances as well as on savings and deposits,
- reviewing bank's financial standing.

corrected – after the amendment these operations could also be performed by financial organisations other than banks, if authorised to do so on the basis of the Act. Regulations on deadlines to perform payment orders and on commission on banking operations and fees for other banking services, charged by banks, were made more precise. New regulations enabling the transformation of state and state-cooperative banks into joint-stock companies were of crucial importance for the organisational structure of the banking system.

Elements of the decision of the President of the NBP on issuing consent to establish a bank (*inter alia*, by foreign persons or by means of employing foreign capital) were made more precise. NBP instruments – supervisory measures falling within the control-administrative function – were expanded and made more exact. Recommendations on restoring liquidity, increasing reserve funds, increasing the amount of shares issued, performing the specific restructuring of assets and making claims more realistic, as well as an avoidance of particular forms of advertising, were separated from among those measures. The amended regulations allowed the President of the NBP to impose the obligation to fulfill the recommendations by means of decisions, which were, however, subject to the control of a commercial court. Decisions regarding the placing of banks into administration, bank liquidation and take over procedures were also deemed to be subject to court decisions.

The amendment to the Banking Act of 14 January 1992 continued the changes described above (Dz. U. of 1992 No 20, item 78).

The scope of changes introduced by this amendment was also extensive. The banks' monopoly for performing banking operations and for the use of the terms "bank" and "kasa" was strengthened with regulations introducing a criminal liability for the infringement of this policy. The practice of banking operations being guided in relation to monetary policy guidelines passed by the Sejm was abolished (at the same time in the Act on the NBP the monetary-credit policy guidelines were replaced with monetary policy guidelines). Definitions of terms "domestic bank" and "foreign bank" were introduced. Banks that were authorised to trade in foreign exchange valuables received the right to purchase securities issued abroad, the determination of which was vested to the President of the NBP acting in agreement with the Minister of Finance. A controversial provision was also introduced, which allowed the President of the NBP, acting in agreement with the Minister of Finance, to authorise a commercial company to perform some specific banking operations. This opportunity was not used by the President of the NBP until the end of the binding force of the Banking Act of 1989. Regulations on banking operations – this time on bank accounts, monetary settlements by banks and bank guarantees – were broadened again. Access to the banking secrecy by the NBP, courts and public prosecutors was made more precise. Banks were also made responsible for publishing audited financial statements, specifically company balance sheets and profit and loss accounts, according to principles defined by the President of the National Bank of Poland. In addition, banks were obliged to make available on the premises, in full view, and fully accessible to the public, the applicable interest rates regarding bank account deposits and funds, on loans and advances, as well as commission payable for banking operations and services. The provision of privileges to employees, shareholders and members of bank bodies by offering preferential interest rates on savings, deposits and funds on time accounts as well as on loans, that were strikingly more favourable than those generally available, was prohibited. The privilege of issuing documents that have the status of legal documents was extended throughout the banking sector.

Provisions on state-cooperative banks and on the Banks Council were abolished. Regulations on the schedule and the path of transformation of the only state-cooperative bank, i.e. Bank Gospodarki Żywnościowej, into a joint-stock bank (initially the transformation was to occur on 30 June 1992) were introduced within transitory provisions. These provisions

anticipated the possibility of the establishment of regional banks and joint-stock companies by cooperative banks, using a part of the assets of Bank Gospodarki Żywnościowej.

Also regulations regarding the organisation of state banks were changed and regulations on privatisation of banks restructured into joint-stock banks were introduced.

Significant changes were again introduced in the provisions specifying the supervisory competence of the NBP. The requirements, which were specified to be the pre-condition for establishing banks, were expanded and made more precise<sup>9</sup>. A principle was introduced that stated that a bank could begin operations only after the ascertainment by the National Bank of Poland that the bank possessed the premises that were adapted to the proper safekeeping of valuables held in the bank. Along with this regulations on the issuing of authorisation by the President of the National Bank of Poland to establish a bank were expanded and regulations changed in this respect specified: the scope of information contained in the application for authorisation, required annexes to the application, the schedule of proceeding on issuing authorisation, the design and the scope of the authorising decision, including the authorisation to establish a bank by foreign persons or with participation of foreign capital, and the rights of bank employees – expatriates – in the area of purchasing foreign currency and transferring it abroad. The authority to authorise the establishment of a branch or representative office of a foreign bank was transferred to the President of the National Bank of Poland, acting in agreement with the Minister of Finance. The Act specified that such a decision might determine how much of that bank's foreign capital must be made available for financial operations within Poland. The broadening of powers vested to the NBP within the licensing function by the regulation of the control of joint-stock banks' shares transfer was a significantly new phenomenon introduced by the discussed amendment to the Banking Act. According to this new regulation, the acquisition by a single shareholder of the holding of shares in a banking organisation giving the right to more than 10% of votes in a general meeting of shareholders required notification of the NBP. Had a bank shareholder, as a result of the transfer of bank's shares, held a portfolio of shares giving the right to more than 20%, 33%, 50%, 66% or 75% of the total voting rights during a general meeting of shareholders, it would have been necessary to obtain NBP approval for the acquisition of the said shares. The Act considered the acquiring or holding of shares by a subsidiary as the acquiring or holding of shares by the parent organisation. The limit of credit exposure was changed within the provisions falling to the regulatory function, which after the change became standard practice, restricting the bank's exposure on loans and cash advances as well as claims on bank guarantees, endorsements and letters of credit, and also on other bank's liabilities incurred due to the customer's instruction within dealings with one company or group of companies related by capital or management. Own funds of a bank, the design of which was determined by the changed provisions of the amended Banking Act, became the basis for the credit exposure limit and for the standard of capital holdings changed in this way. On the basis of these

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<sup>9</sup> A bank could be established, if:

- 1) it was ensured that the bank would be provided with:
  - a) capital, the amount of which would match anticipated banking operations and to the scale of operations intended, subject to the condition that one founder could own no more than a half of the capital, subject to provisions of Art. 57 para 2,
  - b) premises adapted to the proper safekeeping of valuables held in the bank or fit for such adaptation,
- 2) the founders and persons anticipated for managerial positions in the bank gave a guarantee of performing the business in a way that would properly protect the interests of bank's customers,
- 3) at least two persons proposed for managerial positions in the bank possess the education and professional experience necessary to manage a bank,
- 4) the plan of bank's operation for at least three years presented by the founders indicated that this operation would be safe for the funds collected in the bank.

Bank's capital could not originate from a loan or advance and could not be charged in any way.

provisions the President of the NBP obtained an influence on the amount of funds by the powers to issue permissions to take into account in the calculation of own funds the funds collected on bank accounts, on long-term deposit accounts, as well as the total sum of own funds of banks related together by capital and organisation. A possibility to expense against income the provisions to a general risk fund, intended to cover losses on extended loans and advances, resulting from the discussed amendments shall be considered as an element connected with the regulatory function. The authorisation of the President of the NBP to determine binding liquidity standards for banks, the regulations for the covering of the bank's assets by own funds, and standards of permissible risk in banks operation became the basis for supplementing the supervisory prudential standards regulated in the Act.

The provisions specifying NBP competence determining the control-administrative function have also been changed significantly. The principle of gradually raising the supervisory measures was introduced. In the situation where it is found that a bank has been persistently not fulfilling the recommendations of the President of the NBP, or the bank operation is carried out with flagrant infringement of the law, or of the articles of association, or creates a significant threat to the interests of holders of savings and deposit accounts, the President of the National Bank of Poland, having not met with a positive outcome even after cautioning the aforementioned banking entity in writing, was authorised to apply broadened supervisory measures, which took the form of sanctions against the bank's management and the bank itself<sup>10</sup>. The President of the NBP obtained a possibility to establish administrators (for a period not longer than 3 months), which would be authorised to make decisions of the bank in respect of its financial rights and obligations, what became a specific supervisory measure, utilised irrespective of the aforementioned sanctions. Decisions made within the supervisory measures could be appealed to a competent commercial court.

The first stage of the Banking Act reform ended with the Act on Amendment to the Banking Act and to Certain Other Legislation of 19 December 1992 (Dz.U. of 1993 no 6, item 29). It introduced changes in the design of regulations on the credit exposure limit and on the capital holdings standard as well as the control of joint-stock banks' share transfers.

Within those changes the loans endorsed by (or guaranteed by) the government or international financial institutions specified by the President of the National Bank of Poland were excluded from the credit exposure limit and the bonds issued by the State Treasury and the National Bank of Poland were deleted from the standard of capital holdings. The President of the National Bank of Poland was authorised to determine a separate limit for the purchasing of those bonds by banks.

An additional clause regarding the issue of a decision on whether to authorise the purchase of shares or rights conferred by shares was introduced in the form of a requirement whereby a bank's shareholder undertakes to agree to a warranty to operate the bank in such a way that the interests of its customers are properly protected. Additionally, funds allocated for purchasing shares must not have originated from a loan, from credit or be liable to any

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<sup>10</sup> Within those sanctions the President of the NBP could:

- 1) apply to a competent body of the bank to recall the president, vice president or another member of bank's management board directly responsible for the irregularities found;
- 2) suspend from office members of the management board, referred to in point 1, until the consideration of the application for their recalling; suspension from office shall involve the exclusion from making decisions of the bank in respect of its financial rights and obligations;
- 3) restrict the scope of bank's operations; this restriction consisting in the prohibition of making new contracts;
- 4) revoke the authorisation to establish the bank and order the bank's liquidation.

The restriction or the revocation of the authorisation to establish the bank could also occur in the case of finding that the bank was not meeting the conditions specified in the authorisation to establish the bank.

charges. The amendment introduced also the right to appeal against this decision to the Supreme Administrative Court. As a result of not obtaining an authorisation to purchase bank's shares by a shareholder, the voting rights of the said shareholder in a general meeting of shareholders of the bank were reduced to 5% or to the number of voting rights resulting from the previous authorisation.

### **C. The period 1993 - 1997**

Changes introduced in the Banking Act were determined both by external conditions and by the situation (primarily economic) in the country.

External conditions resulted from Poland's aspirations for membership of the European Union (formerly the European Community). In the Europe Agreement establishing an association between the Republic of Poland and the European Communities and their Member States of December 1991, which took effect on 1 February 1994, the approximation of the existing and future laws, in particular in the field of the banking law, company law, accountancy, financial services, principles of competition and consumer protection, supervision and regulatory systems as well as the counteracting of money laundering, was considered to be a precondition for economic integration. The aforementioned issues were taken into account during the 10-year transition period. The amendments introduced to the Banking Act aimed at gradual adjustment of conditions for performing banking business to the standards set by EU regulators.

The financial standing of banks was the other element that was continuously directly affecting the shape of changes introduced in regulations on the operations of the banking system in the initial stage of the systemic transformation. It became clear relatively quickly that the problems of the Polish banking system required new legislation going beyond the framework determined in the Banking Act and the Act on the NBP. Therefore, irrespective of consecutive amendments to these two acts, the legislator's activity in the area of banking law was also expressed in passing Acts of specific character, supplementing the regulations of the two above Acts.

The first stage witnessed legislation focusing on creating the legal framework for actions aimed at overcoming the crisis which occurred in the Polish banking system in the first half of the 1990s, because the reform of the banking system was introduced during extremely unfavourable external conditions for Polish banks. Both private and cooperative banks experienced this problem which was brought about by various factors. State banks and banks – sole shareholder companies of the State Treasury – also underwent the same problems. Taking the above into consideration, during 1993 and 1994 a decision was made to include ten of the state owned banks in a capital restructuring programme on the basis of the Budgeted funds. Formal-legal grounds to counteract the crisis situation in the state banking sector – by transferring funds to increase own funds in both the state banks and the banks in which the State Treasury had a controlling interest, and also to solve the problem of bad debts (mainly those of state run companies) – were provided by the Act on the Financial Restructuring of Enterprises and Banks and on Amendments to Certain Legislation of 3 February 1993 (Dz.U. No 18, item 82).

The cooperative banking sector exemplified the symptoms of the banking crisis. The situation of the above sector, in 1992, featured a primarily too low capital as compared to bad assets and the level of off-balance-sheet commitments, meaning that the entire sector faced two alternatives: the provision of rapid additional capital hence meeting the capital requirements and other parameters specified by the Act and by the NBP supervisory regulations, which would allow further independent operation to continue, or to join an affiliating structure, capable of operating in the conditions of a market economy. Cooperative

banks that were not suited to independent operation, affiliated in the affiliating banks<sup>11</sup> under NBP pressure. However, the restructuring process based on the programme of establishing the affiliating structures required support – both financial and legislative. On 24 June 1994 the Sejm passed the Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej and on the Amendment to Certain Legislation (Dz.U. No 80, item 368). It created the legal framework for the operation of a three-tier structure in the form of a national group of cooperative banks, comprising: cooperative banks – regional banks affiliating cooperative banks – the national bank affiliating regional banks. The Act included also regulations aimed at creating relationships between individual components of this organisation, ensuring their stability, as well as restructuring cooperative banks using public funds (namely restructuring bonds of the State Treasury and funds allocated by the NBP). The Act was not applicable to cooperative banks that met capital requirements necessary to perform independent banking operations. Thus was made possible the maintenance of these banks' operations according to general principles entailed by the Banking Act.

The Accounting Act was passed on 24 September 1994 (Dz.U. No 121, item 591). Its importance goes beyond the operation of the banking sector because it introduced principles of bookkeeping as well as of preparing and publishing financial statements, applicable virtually to all economic operators, consistent with European Union standards. However, the Act, together with related executive provisions, were of particular importance for banks. The executive provisions to the Act defined a model chart of accounts for banks, particular accounting principles for banks, principles of drawing up banks' consolidated financial statements, principles for provisioning against the risk of banking activity. On the basis of solutions included in those acts a new reporting package for banks was introduced at the beginning of 1997. Solutions included in those acts, supplemented with regulations defining prudential standards for banks, make up the whole, enabling a detailed analysis of the situation of individual banks and of the entire banking system.

The Act on Certified Auditors and Their Self-Regulatory Body was passed on 13 October 1994 (Dz.U. No 121, item 592). It determined the principles of certified auditor working practice and the organisation of professional self-government. Like in the case of the Accounting Act, its importance goes beyond the operation of the banking sector. Nevertheless, the statutory regulations for the profession of certified auditors are especially important for banks. This is a safety condition for economic relations – the professional opinion of and certified auditors' report shall provide the source of reliable, independent and professional information on businesses audited by them, as on banks and their counterparties.

The Act on the Bank Guarantee Fund (BGF) of 14 December 1994 (Dz.U. of 1995, No 4, item 18) became a very important law for the stabilisation of the Polish banking system. The BGF fulfils functions of two types: the first is connected with the implementation of the deposit guarantee system, the second consists of providing assistance to banks in situations of threats to their solvency. The Act introduced the principle of guaranteeing funds held at all banks operating in Poland. The guarantee applies both to natural and to legal persons. The introduction of a general system of deposit guarantees resulted in reducing the responsibility of the State Treasury liability for saving deposits, i.e. the State Treasury guarantee. The State Treasury guarantee regulated in the Banking Act was maintained in a residual form – the responsibility of the State Treasury was reduced to liabilities on saving deposits collected by three banks: Powszechna Kasa Oszczędności Bank Państwowy, Polska Kasa Opieki SA and Bank Gospodarki Żywnościowej SA (by 31 December 1999) and deposits held in housing passbooks issued by 23 October 1990.

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<sup>11</sup> These included: Bank Gospodarki Żywnościowej, Gospodarczy Bank Wielkopolski SA, Bank Unii Gospodarczej SA, Gospodarczy Bank Południowo-Zachodni SA.

The passage of the Act on the BGF closed the 'crisis' stage of the reform of Polish banking law. The next stage was the period in which new laws were passed or earlier laws were amended – responding to the requirements of the national economy and the approaching date of the wider opening of the Polish market of bank services. As the crisis was being resolved and the situation in the banking system stabilised, the requirements of the national economy passing the crisis and the strengthening of integration with European and global structures, including the approaching date of opening Polish financial market to foreign competition, came to the fore among reasons of changes introduced in the legal regulations for commercial banks operations. It soon became clear once more that the problems occurring in the legislative sphere could not be solved only by amendments to the Banking Act. Therefore the next specific Acts were enacted.

The poorly developed system of finance in housing industry was one of this industry problems. This problem was to be solved (at least partly) by the Act on Certain Forms of Support to Residential Construction and on Amendments to Certain Legislation of 26 October 1996 (Dz.U. No 133, item 654). The Act assigned an important role to banks, specifying the form of saving and lending for housing purposes within a financially separated, particular form of activity, in the form of housing credit unions. The act did not introduce changes in the organisational structure of the banking system – in fact, housing credit unions became a specific form of banking operation.

The capital strength of Polish banks was assessed as relatively low. The entering into force of provisions of the Act on the Amalgamation and Consolidation of Certain Joint-Stock Banks of 14 June 1996 (Dz.U. No 90, item, 406) was to be one of the methods to solve the problem. The Act set up foundations for banking consolidation by regulations on banking groups and by a particular method of bank amalgamation. A banking group regulated in the act is a two-tier organisational structure consisting of the parent bank and a subsidiary bank or banks. It exists as an entity between formally separate (as subjects of rights) joint-stock banks, related in terms of capital and organisational nature, which means that the group is to a certain degree, in some circumstances regarded as though it were a uniform bank. The particular method of bank amalgamation resulted from the introduction of a simplified – as compared with that regulated in the Commercial Code – generally binding procedure of joint-stock bank amalgamation. This simplification was justified with the subjective scope of binding regulations specified in the Act – it applied only to joint-stock banks, whose shareholders included only state legal persons.

The model of the banking system established by the Banking Act of 1989 was based on the principle of universal banking, i.e. on the assumption that all banks, provided that they comply with requirements set by the law (mainly requirements on the providing with adequate capital), may perform all banking operations. This principle was also not infringed by the Act on Certain Forms of Support to Residential Construction by the State introducing housing credit unions as a particular type of banking operation. The Act did not impose subjective limitations on the possibility to operate housing credit unions only by a specified group of banks. The Act on Building Societies and on the Support by the State to Saving for Housing Purposes passed by the Sejm on 5 June 1997 (Dz.U. No 85, item 538) introduced the element of specialised banking (understood as performing a specific banking activity according to special principles, different from those binding generally). This act contains solutions – alternative to those in previously passed Act on Certain Forms of Support to Residential Construction and on Amendments to Certain Legislation – on saving for housing purposes. The basic difference consists in the fact that the Act of 1997 entrusted collecting funds for housing purposes to the building societies, which were to operate as independent joint-stock banks. Savings operations in building societies would be run on the basis of agreements on targeted saving for housing purposes, with a design related to saving-credit accounts operated

by housing credit unions. So this Act introduced a separate category of banks in the form of building societies, for which separate types of banking operations have been defined.

Changes in banking legislation made during the period from 1992 to 1997 resulted primarily from the enlargement of a package of regulations entailed by the provisions of the aforementioned specific Acts, and which were elemental for the operation of the banking system and for performing banking activities. In addition, the Banking Act was also amended. From the quantitative point of view amendments to this act resulted primarily from provisions of the said specific Acts, and – to be more precise – from the necessity for the mutual adjustment of provisions of all those acts. Certain solutions were introduced to the Banking Act regardless of specific acts. For example the Act on Amendments to Some Acts Regulating the Principles of Taxation and to Certain Other Legislation of 6 March 1993 normalised the rights of all banks in the field of using the enforced collection orders, while the Act on the Amendment to the Tax Duty Act and on Amendments to Certain Legislation of 31 May 1996 (Dz.U. No 75, item 357) excluded the providing by banks the information to tax authorities and to fiscal inspection agencies from the regulations on banking secrecy.

#### **D. The 1997 reform of the banking law**

The work on the parliamentary bills of the Act on the National Bank of Poland (as early as in 1995 two bills for this Act were submitted) and the government bill of a new Banking Act gathered pace in late spring and summer of 1997. In the work of the relevant subcommittee, and later of combined parliamentary committees, the government bill replaced a parliamentary bill of the Act on State Banking Supervision. The Sejm was working parallel on the President's bill on mortgage bonds and mortgage banks. It appears that the acceleration of work on "banking" laws in the parliament resulted, *inter alia*, from the passage and adoption of the new Constitution of the Republic of Poland, in which one of articles (Art. 227) was devoted to the position of the National Bank of Poland. That provision defined the NBP as the central bank of the state vested with the exclusive right to issue the currency and to determine and implement the monetary policy. It specified also the directory bodies of the NBP (consisting of the President, the Monetary Policy Council and the Management Board), and the method of their appointments and main tasks. The Parliament was at the same time considering the President's bill on mortgage bonds and mortgage banks. As the result of an unprecedented acceleration in legislation on 1st August 1997 the Sejm passed the Act on the National Bank of Poland, the Banking Act and the Act on Mortgage Bonds and Mortgage Banks. Having considered the amendments proposed by the Senate, the Sejm passed the amendments on 29th August 1997 and they were implemented on 1st January 1998.

The Act on Mortgage Bonds and Mortgage Banks (Dz.U. of 1997 No 140, item 940) determined the principles of issue of, purchase, and redemption of mortgage bonds as well as principles of establishment, organisation, operation and supervision over mortgage banks. Mortgage banks could be established as joint-stock banks only. Provisions of the Banking Act and provisions of the Act on the National Bank of Poland shall be used, as appropriate, as principles of establishment, organisation and operation of mortgage banks not stipulated in the Act.

The Act on the National Bank of Poland (Dz.U. of 1997 No 140, item 938) and the Banking Act (Dz.U. of 1997 No 140, item 939) passed in 1997, when implemented on 1st January 1998, replaced the legislation passed in 1989. At this point attention should be drawn to the changes in the conditions of their operation. When the acts of 1989 took effect these took the form of complex regulations of banking system operations. However the banking system was in itself a relatively non-complicated structure. The Acts – on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej, on the Bank Guarantee Fund, on the Amalgamation and Consolidation of Certain Joint-Stock Banks, on Building Societies and

on the Support by the State to Saving for Housing Purposes as well as on the Mortgage Bonds and Mortgage Banks – turned the commercial part of the banking system into a highly complex structure, both from the institutional and organisational point of view. The Act on Certain Forms of Support to Residential Construction and on Amendments to Certain Legislation as well as acts of systemic character like the Commercial Code, the Civil Code, the Act on Cooperative Law, the Economic Activity Act or the Law on Public Trading in Securities and Trust Funds were very important for the determination of principles of banks operations. So the Banking Act is a component of a larger whole – the legislator had to take into account conditions resulting from the existing legal status. For commercial banks the Banking Act continues to be the most frequently implemented law, so in a way the most important one. Like its predecessor, the Act of 1989, it provides regulations for principles of: carrying out banking business, the establishment and organisation of banks, branches and representative offices of foreign banks, as well as performing banking supervision, rehabilitation proceedings, bank liquidation and bankruptcy. With reference to its regulations the provisions of other banking laws are of a specific regulatory nature – the specialised business and organisation of banks performing such business are subject to provisions of the Banking Act in the area that was not regulated in those acts.

The position of the NBP is determined by the Constitution and the new Act on the NBP. They define the NBP as the central bank of the Republic of Poland. According to the Constitution it is vested the exclusive right of issuing currency, as well as determining and implementing the monetary policy. The Constitution stipulates that the NBP is responsible for the value of the zloty. The Act on the NBP specifies that the basic objective of the central bank shall consist in maintaining price stability, supporting at the same time the economic policy of the Government, insofar as this does not constrain the basic objective of the NBP. Acts and resolutions of the Sejm were omitted as the criteria providing the guidance for the NBP in this cooperation. The scope of NBP activity was defined via tasks imposed on the central bank. Apart from the basic objective the NBP tasks include (according to the Act):

- 1) organising monetary settlements,
- 2) managing official foreign exchange reserves,
- 3) conducting foreign exchange operations within the limits specified by the law,
- 4) providing banking services to central government,
- 5) regulating banks' liquidity and providing them with refinancing facilities,
- 6) establishing the conditions necessary for the development of the banking system,
- 7) drawing up an account of the national balance of payments for reporting purposes, together with balance of foreign assets and liabilities of the central government,
- 8) performing other tasks specified by the law.

The Act separately mentions the specific task of the exclusive right to issue the currency of the Republic of Poland.

While performing its tasks the NBP shall cooperate with appropriate bodies of the state in establishing and implementing the economic policy, and at the same time pursuing the assurance of the due implementation of the monetary policy, in particular:

- to provide the state authorities with the monetary policy guidelines and with the information on the implementation of the monetary policy and on the situation in the banking system,
- to cooperate with the Minister of Finance in working out central government financial plans, presenting its opinion on draft regulations in the field of economic policy,
- to present its opinion on draft regulations concerning the banks' operations and significant for the banking system.

The NBP, as the central bank, performs the functions of the issuer, the monetary policy creator and performer, the National Bank (for government requirements) and the

Central Bank for the banking sector as well as fulfilling the role of a central foreign exchange institution. Its structure includes also that of a separate organisational unit – the General Inspectorate of Banking Supervision, which is the executive body of the Commission for Banking Supervision.

Specifying the legal system of the NBP, the Act stipulates that the NBP shall possess legal status and form and shall have the sole right to employ the seal with the national emblem; its operations shall be conducted countrywide, while its registered office shall be in Warsaw. The NBP shall not be subject to the requirement of entry in the register of state enterprises. The NBP may be a member of international financial and banking institutions. However, it cannot be a shareholder of other legal persons, except for those providing services to financial institutions and the State Treasury.

The Act, developing provisions of the Constitution, specified the method of the appointing of individual directing bodies of the NBP and their responsibilities. These bodies include: the President of the NBP, the Monetary Policy Council (MPC) and the NBP Management Board. It might be argued that the new Act created an actual triple division of powers within the NBP.

The President of the NBP is appointed by the Sejm, at the request of the President of the Republic of Poland, for a term of six years. The same person is prohibited from serving as the President of the NBP for more than two consecutive terms of office. The President of the NBP is the superior to all NBP staff, and their right and duties shall be as specified by the Labour Code and in the work regulations determined by a separate law (hence such legislation shall be put before the Parliament in the nearest future). Formerly the employment regulations for the NBP staff were determined by an ordinance of the Council of Ministers.

The President of the NBP chairs the Monetary Policy Council, the NBP Management Board, the Commission for Banking Supervision and represents the NBP in its external relationships. The President of the NBP may attend meetings of the Sejm and of the Council of Ministers.

The Monetary Policy Council is composed of: the Chairperson, who is the President of the NBP, and nine members appointed in equal numbers by the President of the Republic of Poland, the Sejm and the Senate from among experts in the field of finance. Members of the Monetary Policy Council are appointed for a term of six years. Meetings of the Monetary Policy Council may be attended by a representative of the Council of Ministers without voting rights, who may submit motions to be considered by the MPC. Every year the Monetary Policy Council determines the monetary policy guidelines and notifies the Sejm of them together with the submission of the draft Budget by the Council of Ministers. The MPC submits to the Sejm a report on the performance of the monetary policy guidelines within five months of the end of the fiscal year.

The MPC, specifically, in guidance with the monetary policy guidelines:

- 1) sets the NBP interest rates,
- 2) determines the principles and the ratio of the required reserve,
- 3) sets upper limits of liabilities resulting from loans and advances taken by the NBP from foreign banking and financial institutions,
- 4) approves the NBP budget and the report on the NBP activity,
- 5) accepts the annual statements of the NBP,
- 6) determines the principles applicable to open market operations.

The MPC performs the assessment of the NBP Management Board activity in the field of the performance of monetary policy guidelines and adopts accounting principles for the NBP, submitted by the President of the NBP.

The Management Board directs the activity of the NBP. The Management Board is composed of: the President of the NBP, in the capacity of the Chairperson, and 6 - 8

members, including two Vice Presidents. Vice Presidents of the NBP and members of the NBP Management Board are appointed and recalled by the President of the Republic of Poland at the request of the President of the NBP. The NBP Management Board implements resolutions of the Monetary Policy Council and adopts resolutions on matters not reserved by the Act for the exclusive competence of other NBP bodies.

The term “bank” is the basic notion used by the Banking Act. This term is defined as a legal person established according to the provision of the law, operating on the basis of authorisation to perform banking operations that expose to risk those funds which have been entrusted to the banks and which are in any way repayable. The legal-penal protection of banking operations was maintained by: assigning banks a monopoly to use the terms “bank” and “kasa” and to perform banking operations consisting of collecting funds from other natural or legal persons or other organisational units that do not possess the status of a legal person.

Forms of active banking business were broken down into three categories:

- 1) banking operations that may be performed only by banks<sup>12</sup>,
- 2) banking operations that may be performed also by non-banks; these operations turn to “banking” operations only when performed by banks<sup>13</sup>,
- 3) other forms of business not considered to be banking operations<sup>14</sup> by the Act.

The Act, like the preceding one, forms the regulations to perform certain banking operations. These include: bank accounts, bank settlements, loans, advances, bank guarantees, endorsements, letters of credit and also the issue of bank securities. Generally speaking, the regulations on individual operations were expanded as compared with the previous regulations resulting from the 1989 Banking Act.

Significant changes were introduced into regulations on the particular rights and duties of the banks. The right to issue enforced collection orders was replaced with a privilege to issue enforceable titles. The difference is that an enforceable title requires the appendment of

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<sup>12</sup> These operations include:

- 1) taking deposits payable on demand or at a specified maturity and operating accounts of such deposits,
- 2) operating other bank accounts,
- 3) extending loans,
- 4) extending guarantees,
- 5) issuing bank securities,
- 6) performing bank monetary settlements,
- 7) performing other operations reserved exclusively for banks under separate legislation.

<sup>13</sup> These operations comprise:

- 1) extending cash advances,
- 2) operations on cheques and bills of exchange,
- 3) issuing bank cards and performing operations using such cards,
- 4) forward financial operations,
- 5) purchasing and selling debt,
- 6) safekeeping valuables and securities and providing safe deposit facilities,
- 7) performing foreign exchange operations,
- 8) endorsing bills or notes,
- 9) performing operations ordered by customers, in connection with the issue of securities.

<sup>14</sup> Apart from performing banking operations banks may:

- 1) take up or purchase shares and the rights conferred by shares of other non-bank legal persons or units in mutual funds,
- 2) undertake commitments connected with the issue of securities,
- 3) trade in securities,
- 4) swap debt for assets belonging to the debtor, according to terms agreed with such debtor, provided that the bank shall be required to sell such assets not later than within three years of their acquisition,
- 5) purchase and sell real property and debts collateralised by mortgages,
- 6) provide financial consulting and advisory services,
- 7) provide other financial services.

an enforcement clause by a court to become an enforced collection order. The design of banking secrecy laws was substantially changed. The scope of this was basically expanded to all information on banking operations and persons connected with performing those operations. The person, to which the information applies, is always the disposer of information. The access of other parties to the information is, however, regulated in this way, that the Act provides a detailed list of entities authorised to access the information and situations, in which they shall be provided with the information. A long list of authorised entities does not include tax and fiscal inspection agencies. According to the Banking Act the rights of those agencies to obtain information from banks are regulated by other legislation. Regulations on the banking secrecy were supplemented with provisions that imposed on banks the responsibility for counteracting the using of their operations for money laundering and relieved them from the liability for damages that might result from fulfilling this responsibility and from revealing the banking secrecy under regulations specifying the access to it for authorised entities.

The Act on the Amalgamation and Consolidation of Certain Joint-Stock Banks of 14 June 1996 established foundations for banking consolidation via regulations on banking groups and on a particular method for bank amalgamation. Only banks from the state banking sector may use the solutions contained therein. Solutions entailed by the 1997 Banking Act, extending a possibility of setting up banking capital groups on all joint-stock banks, to a large degree repeat regulations comprised by the aforementioned 1996 Act.

Significant changes were introduced in the organisation of the banking supervision, which was entrusted to the Commission for Banking Supervision, which took over previous competence of the National Bank of Poland and its President. The General Inspectorate of Banking Supervision became the executive body of the Commission, remaining an NBP organisational unit. As compared with the current situation the new act includes solutions that generally do not change the character of activities performed by the banking supervision. The act specifies the principles of CBS cooperation with foreign banking supervision bodies and with other supervisory bodies of individual segments of the financial market.

The design of the licensing process, worked out on the grounds of previously binding regulations, was maintained. The establishment of a cooperative bank and a joint-stock bank requires the founders obtaining the authorisation of the Commission for Banking Supervision, granted in agreement with the Minister of Finance. A state bank may be set up by ordinance of the Council of Ministers at the request of the Minister of Treasury, which should have obtained the opinion of the Commission for Banking Supervision.

The Act specified the capital requirements set to the founders. The initial capital provided by the founders shall not be less than the zloty equivalent of 5,000,000 ECU (euro). A part of the initial capital may be contributed in kind, in the form of equipment and property holdings, if they are directly useful in the banking business; however in any case, the value of non-cash considerations cannot exceed 15% of the initial capital. If the bank's capital is increased, the value of non-cash considerations shall not exceed 15% of the bank's core capital. A foreign bank, the founder of a bank, must annex an opinion of the competent home country supervisor to the application for authorisation to establish banking operations. At least two persons who are put forward as prospective members of the bank's board management must possess the education and professional experience necessary in bank management – this applies to all structures of banking organisations. The appointment of two management board members, including the president, in a joint-stock bank shall be approved by the CBS, while the supervisory board shall give notification of the other persons of the management board and of changes in its composition. The Commission may request information and relevant documents connected with those persons. Previously binding principles of shares' transfer (shareholding composition) were also preserved. Changes refer to:

- the form – previously binding regulations referred to the approval, the new Act refers to the permit,
- the way of setting the criteria, that shall be employed by the CBS when issuing a permit (approval) for a change of shareholder – holder of a qualifying holding; previous regulations specified premises, the existence of which allow issue of an approval; the new Banking Act determines cases, in which the CBS may refuse a permit;
- the specification of legal effects – the invalidity of a resolution of the General Meeting of Shareholders – of the fact, that the voting rights of a shareholder were reduced as a result of not obtaining the required permit of the CBS.

The own funds remained, as before, the basis of calculation of supervisory prudential standards. However, significant changes were introduced in the principles of setting own funds. They were broken down into two tiers: core capital and supplementary capital. The core capital is of permanent character – it comprises capital specified in the Act. The supplementary capital consists of capital included in this category on the basis of CBS approval according to rules defined in the Act. The Commission may additionally define the items of the bank's balance sheet as deductible when calculating its own funds.

The standard for credit exposure was substantially changed. The permissible level of credit exposure was set at the level of 25% of the bank's own funds. This limit included bonds and other securities (formerly bonds were included in the capital holdings standard for banks). The basic standard was supplemented with the limit of large exposures, equal to 800% of those own funds and covering exposure exceeding 10% of those funds. The Act provided for exclusion of certain claims due to the status of the creditor (the Treasury or the National Bank of Poland, an international financial institution, governments or central banks of OECD countries) or the collateral of claims (pledge on the rights in securities issued by the Treasury, the NBP or an international financial institution, cash collateral, the title to which was transferred to the bank). The previously binding act did not include the duty, introduced to the 1997 Banking Act, of the setting by banks of individual exposure limits for claims, taking into account the specific situation of the business sector and of the economic region.

Purchasing by banks of shares and the rights conferred by shares, interests in another legal person or units in mutual funds was included in the changed limit for capital holdings, set at 15% of the bank's own funds. This limit also encompassed additional payments to the capital contributed by shareholders of a limited liability company as well as contributions and amounts in limited partnerships. Funds spent on purchasing shares and rights conferred by shares, interests, making additional payments and contributions as well as (in the original wording of the Act) purchasing and selling of property holdings and mortgage debts, could not exceed in total 60% of the bank's own funds<sup>15</sup>. As the standard for credit concentration and the limit of credit exposure were significantly changed, the legislator, in an interim provision, decided that banks exceeding those standards on the date the Act came into law should concur with the new legislation by 31st December 1999.

The Chairman of the Securities and Exchange Commission, in agreement with the CBS, had to determine limits of credits and other debts concentration, other than those

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<sup>15</sup> Restrictions referred to herein, do not apply to:

- purchasing banks' shares and rights conferred by shares,
- purchasing shares and rights conferred by shares or interests in enterprises providing services, specified by the law, to banks,
- purchasing shares or interests in Pension Funds, Employees' Pension Funds and companies operating broking houses, if 75% of shares or interests are owned by a bank or banks,
- institution established under the law to collect and making available to banks the information on debts and movements in balances on banks accounts,
- purchasing shares and swapping debts into debtor's assets within the proceeding specified in the Act on the Financial Restructuring of Enterprises and Banks and Amendments to Certain Legislation.

presented above, as well as of capital holdings for banks involved in the activity in the capital investments market, and also conditions and scope of this activity. The Chairman of the Securities and Exchange Commission has not used this authority.

According to the previous provisions the risk-based capital ratio was regulated by the regulation of the President of the NBP. In the 1997 Banking Act it became a statutory institution – its new design corresponds with previously binding regulations. Each bank shall maintain the sum of own funds at a level that represents not less than 8% of risk-weighted assets and off balance sheet commitments. A bank starting operations shall maintain the risk-based capital ratio at a level not lower than 15% for the first 12 months of operations, and for the next 12 months at a level not lower than 12%. The CBS was authorised to determine both the method of banks' risk-based capital ratio calculation and the percentage risk weights assigned to individual categories of assets and off balance sheet commitments. The risk-based capital ratio set in the Act was to be achieved by 31 December 1998. In justified cases the CBS could extend this deadline to 31 December 1999.

The prudential standards presented above and specified in the Act may be – as previously – supplemented with liquidity standards and other standards for permissible risk in banks operations, set by the CBS and which are mandatory for banks.

The list of activities undertaken within the supervision was partly changed; however it remained open<sup>16</sup>. Certified auditors were included in the conduct of supervision – banks' accounts may be audited only by certified auditors, who meet standards specified in the Act on Certified Auditors and Their Self-Regulatory Body.

The catalogue of supervisory measures that may be applied to individual banks was expanded, as compared with the previous situation. The CBS won the right to order a bank to cease payouts from net profits and to refrain from opening new offices for a specified time. The sanctions that may be applied by the banking supervision include, according to the Act, the possibility of the recall a member of bank's management board by the CBS and of imposing a financial penalty on a member of banks' management board up to an amount equal three months remuneration of the penalised person.

Regulations on rehabilitation-liquidation proceedings were also substantially expanded and detailed at greater length.

## **E. Summary**

It has been found that the banking legislation in force since January 1998 has ensured a high consistency with the European Union regulations. However, it must be remembered that those regulations are not unchangeable; moreover, they shall be introduced to Polish legislation in such a way as to take into account the level of development of the domestic banking system. In addition to pursuing harmonisation with the European Union the situation in the banking system affects changes in the banking legislation. This situation at the end of the 1990s indicated that the passage of the package of banking laws in June and August 1997 could not be considered as the end of changes in the banking law. Albeit by the decades' end no new law was passed, it turned out to be necessary to amend previously passed legislation, including also that of 1997. For example, the Banking Act was amended four times by the end

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<sup>16</sup> Actions undertaken within the banking supervision in particular consist in:

- 1) reviewing the solvency, liquidity and financial performance of banks,
- 2) checking the extended loans, advances, guarantees and endorsements for compliance with the regulations in force in those respects,
- 3) checking the security taken against loans and advances and the timeliness of their repayment,
- 4) reviewing the interest rates applied on loans, advances and bank accounts, referred to in Art. 79 para. 1,
- 5) assessing the financial standing of banks.

of the nineties. The first three amendments resulted from passing laws that comprised solutions requiring the adjustment of the Banking Act provisions. This legislation included:

- 1) the Act on Old Age and Disability Pensions from the Social Security Fund of 17 December 1998 (Dz.U. No 162, item 1118), the amendment in force since 01.01.1999,
- 2) the Act on Foreign Exchange Law of 18 December 1998 (Dz.U. No 160, item 1063), the amendment in force since 12.01.1999,
- 3) the Act on the Protection of Classified Information of 22 January 1999 (Dz.U. No 11, item 95), the amendment in force since 11.03.1999.

The fourth amendment was introduced by the Act on the Amendment to the Act on the Bank Guarantee Fund and to Certain Other Legislation of 9 April 1999 (Dz.U. No 40, item 399), the amendment in force since 21.05.1999. As opposed to the first three amendments, the fourth one included amendments to the Banking Act that did not result from the merits of the amending act (in this case referring to the Act on the BGF), but aimed at removing defects and flaws of the Banking Act, observed in practice. Changes introduced by this amendment referred to: the standard of the bank's capital holdings, the method of calculating the interest payable on bank accounts, extension of loans to a newly established enterprise, legal persons or organisations that do not have the status of a legal person, the rules of a bank's co-operation with related business, the status of the bank's books, statements from bank accounts, excerpts from those books as well as declarations issued by banks as official documents, the grounds to make entries in land and mortgage registers and in public records, enforcement collection orders, access to the banking secrecy, rehabilitation-liquidation proceedings, and capital requirements set to cooperative banks.

In addition, it must be said that the regulatory environment in the field of banking legislation in place at the end of the 90s was somewhat inadequate for the situation of the Polish banking system. The Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej was in fact never fully implemented, because the individual components of the national group of cooperative banks, a basic structure for the Act, never materialised. So its amendment or replacement with a new regulation on cooperative banks sector was obviously needed. Decisions on the further fate of the Act on the Amalgamation and Consolidation of Certain Joint-Stock Banks seem to be necessary. The object scope of this Act (it applies to banks, which shareholders comprise only state legal persons specified in the Act) and the lack of banks' interest in utilising the institutions regulated in this act (a simplified way of amalgamation and establishment of banking groups) make the application of provisions of this law in the future unlikely. As an aside, it would be worthwhile to settle the issue of provisions on banking capital groups, entailed by the Banking Act, which were *de facto* taken over from the previously mentioned law (the most important difference refers to the object scope – provisions of the Banking Act apply to all joint-stock banks, irrespective of the legal status of their shareholders). The fate of building societies remains unclear; despite the implementation of the Act of 5 June 1997 no building society has been established so far. It should also be remembered that the changes in the banking services market have not been reflected in the provisions of the banking legislation binding in the 90s – the problem is mainly in the use of information technology. Therefore it has become obvious that in the new century the Polish legislator will face the task of continuing changes in the banking law, which will take into account those changing external and internal conditions.

## **2. THE AMENDMENT TO THE BANKING LAW IN 2001.**

The amendment of 23rd August 2001 assumes primarily the adjustment of Polish law to the Directive 2000/12/EC of the European Parliament and of the Council relating to the

taking up and pursuit of the business of credit institutions. This directive replaces previous legislation of the European Community in the matter of banking legislation.

The amendment regulates such areas of the community law as:

- 1) making declarations of intent on electronic data media;
- 2) introduction of a definition of electronic money;
- 3) introduction of consolidated supervision;
- 4) modification of regulations on the cooperation and exchange of information with domestic financial supervision authorities and with foreign banking supervision authorities;
- 5) modification of regulations on risk-based capital ratio and introduction of the grounds for the CBS to determine the principles of banks observing the capital requirements against individual risks, including the market risk;
- 6) removing problems connected with the application of bilateral netting in case of insolvency; the amendment aims at protection of the domestic financial system stability in case of bankruptcy of a major financial institution – in relation to deepening mutual relationships between individual institutions;
- 7) introduction of regulations on cross-border transfers; the amendment introduces to the Polish system numerous provisions of the Directive No 97/5/EC of the European Parliament and of the Council relating to the performance of transfer orders within foreign relationships and the Directive 98/26/EC of the European Parliament and of the Council relating to the finality of settlements within the payment and the securities settlement systems;
- 8) introduction, for supervisory purposes, of definitions of: a financial institution, a financial group, a mixed-activity group, a parent undertaking, a significant influence, close links;
- 9) extension of the catalogue of sanctions used by the CBS;
- 10) modification of provisions on the control of joint-stock banks' shares transfer.

As compared with the hitherto legislation the new solutions in this field include:

- specification that the object of the CBS decisions consists of the authorisation to exercise voting rights at a general shareholders' meeting,
- the possibility to issue a decision subject to condition of exceeding on the indicated date a predetermined threshold of votes at a general meeting,
- the definition of the period of 14 days required to submit notification by the bank to the CBS on the purchase of a holding of shares, giving the right to exercise more than 5% votes at a general meeting of bank's shareholders,
- specification of reasons justifying the grounds to refuse authorisation to exercise voting rights at a general meeting of bank's shareholders (Art. 25 para. 5). These include: unfavourable influence of the person intending to acquire or purchase shares on the prudent and sound management of the bank, provisions of the law in force in the place of the registered office or of the residence of the said person preventing the Commission for Banking Supervision from performing effective supervision (a new premise), extending the obligation to obtain a CBS approval or notifying it onto situations in which the number of votes at a general meeting of bank's shareholders varies as the result of amendments in bank's articles of association or the expiry of preferences attached to shares.

Moreover, the amendment entails components necessary for a full implementation of the freedom to provide banking services, and in particular:

1. It introduces definitions of: a credit institution, a branch of credit institution, a branch of domestic bank, providing services within cross-border operations.
2. It defines the principles of the taking up and pursuit of the business by credit institutions in Poland and by domestic banks in the EU.

A credit institution intending to perform the business within Poland must notify competent supervisory authorities of the home country, which shall transfer a notification to the Commission for Banking Supervision. In the case of the business being carried out via a branch, the credit institution may commence business after the passage of time counted since the receipt by the CBS of the notification, while in the case of providing services from directly from the territory of the home country, business operation may open immediately after the receipt of the notification by the Commission. The Act has precisely defined the contents of the notification and each change in information contained herein results in an obligation for the credit institution to disclose that change prior to its execution. The provisions of the Act allow the Commission for Banking Supervision to determine the conditions that must be met by the branch of a credit institution at performing the business. This is a significant supervisory measure, which aims at maintaining the stability of the banking system in Poland. The requirement to retain documentation related to the performed business was imposed on branches of credit institutions, which allows the Commission for Banking Supervision to monitor the activities of credit institutions in the Republic of Poland.

3. Defines principles of supervision over branches of credit institutions operating in Poland (the principle of home country supervision).
4. Defines the CBS responsibilities resulting from Poland joining the EU.

New regulations impose on the Commission for Banking Supervision numerous information responsibilities to the European Commission, required by the aforementioned directive. These are responsibilities of advising the European Commission of every case of:

- authorisation of the establishment of a domestic bank or establishing a branch of a foreign bank,
- authorisation of the establishment of a domestic bank, including by direct or indirect subsidiaries of one or more parent undertakings, subject to legislation of third parties,
- establishment of a branch of a foreign bank in Poland,
- purchase by the parent undertaking, referred to above, a holding of shares in a domestic banks, shall result in the domestic banks becoming its subsidiary.

This part of the amendment shall not come into force before the date of Poland's accession to the European Union.

Moreover, irrespective of the amendment to the Banking Act, certain detailed provisions regulating the issue of the consumer credit is regulated by the Act on Consumer Credit of 20 July 2001 (Dz.U. No 100, item 1081). At the same time further work shall be expected in connection with the introduction of the institution of electronic money.

### **3. THE ROLE OF BANKING SUPERVISION AND THE LEGAL ASPECT OF THE BANKING SUPERVISION OPERATION**

There is no doubt that the operation of an effective banking supervision is one of the most important conditions necessary to ensure the stability and safety of the banking system. This is proven both by the European Union regulations and by recommendations of the Basel Committee on Banking Supervision, including the 25 Core Principles for Effective Banking Supervision.

The first of those principles introduces the minimum conditions that must be met by any banking supervision to be effective. These conditions include, *inter alia*: ensuring an operational independence for the banking supervision by the outlining by legislation of clear and consistent responsibilities, as well as objectives for banking supervision, ensuring

adequate resources for the banking supervision to fulfil the set objectives (such as adequate staff, funds, technical equipment), and introducing cooperation and exchange of information between supervisory agencies, both at the domestic and international level.

Irrespective of the model of banking supervision situation adopted in a given country, its proper preparation to fulfil the entrusted tasks is of crucial importance. The most important elements that shall ensure the effectiveness of the operation of such supervision include: the appropriate organisation structure of the supervision, cooperation and exchange of information between supervisory institutions, both at the domestic and international level, as well as practical exercise of consolidated supervision.

Banking supervision in Poland has been developed for over ten years within the National Bank of Poland. The establishment and development of the new supervisory institution were connected with the transformation of Polish banking, consisting of the liberalisation of the licensing policy, the change of the role of the NBP and its tasks, as well as reducing direct state interference in the banking sector to the minimum. The banking supervision carried out institutionally by the Commission for Banking Supervision and its executive body – the General Inspectorate of Banking Supervision – provides, apart from sound macroeconomic foundations and good banking practices, one of the fundamental conditions for the stability and safety of the banking system.

At present the operation of the banking supervision shall primarily be considered in the context of regulations passed by the Parliament on 29 August 1997: the Banking Act and the Act on the NBP. They took effect on 1 January 1998 and introduced significant changes within the principles of the conduct of banking supervision.

According to the content of Art. 131 of the Banking Act and of Art. 25 para.1 of the Act on the NBP, the supervision over banking activity is conducted by the Commission for Banking Supervision. Its organisation and the way of conduct are specified by the Act on the NBP (till the end of 1997 the banking supervision was carried out by the National Bank of Poland). The institutional change in the subject responsible for the exercise of the banking supervision introduced by the Banking Act and the Act on the NBP has also changed the legal status of the General Inspectorate of Banking Supervision (GINB). According to the 1989 Banking Act the GINB was a department of the NBP. Pursuant to the Act on the NBP of 1997 on 1 January 1998 the GINB became the executive body of the Commission, being at the same time a separate organisational unit within the NBP structure. According to the Act the GINB conducts and coordinates tasks specified by the Commission. The GINB has got dual lines of communication: firstly on the issue of supervision over bank activity it reports to the Commission for Banking Supervision, and, secondly on all other matters, resulting from structural relationships with the National Bank of Poland, the GINB reports to the NBP Management Board.

Individual types of tasks were separated in the new GINB organisational structure by a clear separation of specialised functions: licensing, supervisory policy, analysis, examination and cooperative banks.

The objective of banking supervision, specified by the legislator, consists of ensuring the security of funds held on bank accounts and of ensuring the compliance of banks operations with the provisions of the Banking Act, the Act on the NBP, the articles of associations and the decision on authorisation to establish a bank.

The cooperation with other financial supervision authorities occupies a significant place in the accomplishment of banking supervision objectives. This cooperation is based on the system of already concluded agreements on exchange of information. The CBS has already concluded such agreements with the Securities and Exchange Commission (KPWiG) and the Agency for the Supervision of Pension Funds. Moreover, there is a practical supervisory cooperation through the participation of representatives of one supervisory

agency in another one (the Chairman of the KPWiG is a member of the CBS, while the representative of the President of the NBP is a member of the KPWiG). It is worth of noticing that the amendment to the Banking Act included a provision enabling mutual exchange of information between the CBS and the State Agency of Insurance Supervision (PUNU) (according to the current legal status only the CBS may provide information to the PUNU, having concluded a relevant agreement).

The evolution over more than ten years of the Polish system of banking supervision is part of the move directed towards the strengthening of global safety and stability of financial systems. Recent years have brought an important lesson – that it is not enough to guarantee sound macro-economic conditions in the global economy. To guarantee the sound working of the economy a safety cushion is necessary, in the form of modern banking supervision. In this context the supervisory operations are to be coupled with the role of disciplining the market. The market itself, as the second “supervisor” of the banking system, is to play a significant role within this new arrangement. These conditions assist in a substantial strengthening of banks and the transparency of operations of, other financial institutions where the banking supervision has to play an important role. In Poland the importance of this condition is understood as the establishment of modern principles of accounting, of a financial reporting system, including the supervisory reporting, and following of the capital market operational rules. Since the establishment of the banking supervision, up to date the National Bank of Poland and the CBS have played a key role in promoting uniform accounting and reporting standards for banks, in stimulating greater disclosure on the risk management by banks.

To comply more closely with world standards Polish banking supervision has reformulated its mission. It moved away from the role of a body that only protected banks against taking excessive risks and protecting depositors against incurring excessive losses. It has been evolving towards an institution that imposes on banks only such limits that as closely as possible follow mechanisms of the market discipline, which would be used by market participants. So today this role is defined not only within categories of control and influence (a strong regulatory role), as to make banks comply with provisions of the law and of supervisory regulations and to operate in a way that would not threaten the safety of deposits entrusted to them. The role of banking supervision as a risk-focused institution, collaborating with market forces, the institution that not only analyses banks behaviour *ex post*, but attempts to assess *ex ante* those mechanisms and processes in banks that could contribute to the occurrence of systemic disturbances, is being emphasised increasingly more powerfully. Moreover, supervision in Poland is more and more perceived as the factor affecting the confidence abroad in the way the Polish economy is being run.

A substantial strengthening of the on-site examination process is an example of evolution of the banking supervision role that occurred in the attitude to the methods of banking supervision in Poland in recent years. A system of prudential regulations shall be built, which will also include risks different from the credit risk in banking operations and hence there are plans to implement the CAD Directive in Poland in the near future.

Since it came into existence, banking supervision in Poland has adopted the principle of imposing on banks the internationally recognised prudential requirements (the European Union, the Basel Committee on Banking Supervision). Nevertheless it has avoided taking any actions that could result in interference in the banks’ business decisions.

The role of banking supervision in Poland consists of a gradual balancing of the traditional formula, according to which the banking supervision is responsible for overseeing the compliance by banks with the provisions of the law and of supervisory regulations, by actions aimed at mitigating the risk that may threaten the deposits entrusted to banks. This role is more and more perceived as the building of conditions that would stabilise the banking system through proactive preventive actions. For many years the banking supervision in

Poland has been making efforts to implement in a possibly broad scope the modern supervisory mechanisms that were summarised in 1997 by the Basel Committee on Banking Supervision in the “Core Principles for Effective Supervision”. A definite majority of those principles have been or are being implemented (e.g. staff training, development of the reporting for the needs of the consolidated supervision, performing on-site examinations in the field of more complex risks, such as market, operational, derivatives risks).

It can be now stated that Poland has been very successful in building a modern supervisory agency, meeting the needs of the public sector and that of the economy, and is well placed to face the challenges posed by the increasingly complex global banking industry. Banking supervision was in close cooperation with the central bank during the economic transformation, and this is the foundation of supervision effectiveness in Poland. Without the support of a strong and independent central bank the effective and efficient operation of such an institution in serving the safety of the banking system would not be possible. Both the World Bank and the International Monetary Fund, as well as the Basel Committee on Banking Supervision quote Poland as one of the examples of countries where the establishment of the banking supervision system, practically from scratch, has been successfully completed. Today Polish banking supervision receives requests from other countries for assistance and support in establishing their banking supervision. This illustrates again the strengthening of the banking supervision role in the banking system.

However, the statement that the evolution of banking supervision in Poland has been completed would be too optimistic. The tasks of improving the supervision, in particular the risk-based supervision, creating by the operations of the supervision added value for the banking system as well as the development of regulations and the tools for implementation of control function in connection with dynamic changes in banking, together with the globalisation of banking services, the removal of barriers related to joining the European Union, as well as the likely expansion of Polish banks abroad, continue to be challenging. Banking supervision in Poland, like other supervisory bodies all over the world, continues to seek the most effective institutional form, the most effective methods of actions and of cutting the costs of supervisory operations. The reduction of regulatory, information and examination burdens for banks to the necessary minimum serves this purpose. This is accompanied by an attempt to involve the market to a larger extent in fulfilling a self-regulatory function by undertaking steps towards increasing the transparency of banking operations. As the long-term experience of many countries shows, the costs of poor supervision, albeit less expensive in the short term, are in the long run incomparably higher than those of a well organised and well equipped banking supervision with the right measures in place.

## 4. PRINCIPLES OF LICENSING POLICY IN POLISH BANKING LAW

### A. Establishment of banks in Poland during the period from 1989 to 2001

#### *Principles of the licensing policy based on the provisions of the Banking Act of 31st January 1989.*

The work on a general reconstruction of the banking sector in Poland was started in 1987. The decision made by the Council of Ministers (April 1988) on the approval of the document prepared by the National Bank of Poland entitled “The reconstruction of the organisation and functions of the National Bank of Poland and the establishment of a network of lending banks” was of fundamental importance. It provided the grounds to start legislative and organisational work aimed at creating a new model of Polish banking. This work was crowned with the passage of the Banking Act and the Act on the National Bank of Poland by the Sejm on 31 January 1989. The development of a two-tier banking system (central bank – commercial banks), characteristic of market economies, was started.

If the first phase of the reform consisted in the removal of a monopoly of the banking sector through authoritative decisions, then the continued development of the sector occurred primarily on the basis of bottom-up initiatives. The new Banking Act provided the legal grounds to establish various banks, diversified both in respect to the ownership form and to the type of operations.

In the initial period both the criteria themselves and the policy of issuing bank licences were not overformalised. Attention was primarily paid to the need of preparing a financial plan for new banks, to having the minimum share capital commensurate to the scale of intended operations, to find premises appropriate for performing banking business and to entrusting managerial positions to persons who would by their abilities help to guarantee the correct operation of the bank.

A liberal licensing policy for new banks, both in respect to banks established on the basis of Polish and foreign capital, triggered numerous establishment initiatives, in particular those connected with the establishment of banks with Polish capital.

This process is illustrated by the following specification:

- At the beginning of 1987 there were five nationwide banks operating in Poland (National Bank of Poland, Bank Gospodarki Żywnościowej, Bank Polska Kasa Opieki SA, Bank Handlowy w Warszawie SA, Bank Rozwoju Eksportu SA) and 1,663 cooperative banks affiliated to the BGŻ.
- At the end of 1988 there were seven nationwide banks operating in Poland (Łódzki Bank Rozwoju SA was established and the PKO – Bank Państwowy was separated from the NBP) and 1,663 cooperative banks affiliated to the BGŻ.
- At the end of 1989 there were 25 nationwide banks, including 9 commercial banks established from the NBP operational branches, Bank Gospodarstwa Krajowego reestablished by the Minister of Finance and cooperative banks in an unchanged number.
- 1990 marked the breakthrough in the process of establishing new banks. Numerous founding initiatives were reflected in decisions of the President of the NBP, who in agreement with the Minister of Finance issued 49 authorisations to establish new banks. Among 49 newly established banks:
  - 42 were established as joint-stock banks with Polish capital,
  - 3 were established as joint-stock banks with the participation of foreign capital,
  - 4 were cooperative banks, of which 3 established from existing branches of cooperative banks.

As early as in 1991, when 17 authorizations to establish new banks in Poland were issued (including 6 authorisations for banks with partly foreign capital), numerous negative effects started to be observed, resulting from somewhat liberal principles of licensing, based on provisions of the Banking Act, then in force, which did not eliminate such phenomena as:

- the possibility of one of the founders taking up the qualifying holding of shares (up to 99% of the bank's share capital),
- issuing licences without examination of sources of the origin of funds planned by bank founders to purchase shares),
- the possibility to issue bearer founder's shares.

Moreover, it turned out that many of the established banks were not properly operating for various reasons, which might have primarily included too low own capital (the required minimum was set in 1989 at the amount of 150,000 zloty and then in 1990 increased to 2 million zloty), the lack of professionalism in part of the managerial staff as well as frequently the irresponsibility of the major shareholders.

These facts became the main reasons for setting stricter requirements for founding new banks.

The experience resulting from the evaluation of applications to obtain the authorisation of the President of the NBP to establish a bank and the expansion of the market of banking services as well as changes occurring in Polish economic system and the related opening of banks to new customers (private businesses) were showing the need to modify the provisions of the Banking Act.

***The change in the principles of the licensing policy connected with the amendment to the Banking Act in 1992.***

The amendment to the Banking Act and to the Act on the NBP passed in February 1992 in a substantial way modified the provisions on establishing and organisation of new banks. It conditioned the establishment of a bank primarily on meeting the criteria on: providing the bank with own funds, ensuring prudent management as well provision of appropriate premises. However, these conditions were specified in a more precise and exhaustive way.

The following significant principles were also introduced to the Act:

- one founder could not own more than half of the initial capital (excluding cases of establishing banks by the State Treasury, domestic banks or foreign and international financial institutions);
- founders and persons proposed to hold managerial positions in the bank had to give a guarantee to conduct the business in a way that properly protects the interests of the bank's customers;
- at least two persons proposed for managerial positions in the bank had to possess proper education and professional experience;
- the plan of the bank's operations for at least a three-year period submitted by bank's founders had to show that funds and bank accounts would be secure;
- the initial capital of the bank to be established could not originate from a loan, advance or be liable to any charges (in the second half of 1992 the minimum capital was set at the amount of 7 million zloty);
- the commencement of the bank's operation could occur only after checking the preparations and finding that according to the Act the bank possesses premises prepared for proper safeguarding of the valuables held;
- the licence would expire, if during the year since its issue the bank has not commenced the business.

Taking into consideration a secure, proper development of the banking sector, which in the second half of 1992 and in 1993 featured the occurrence of certain symptoms of a crisis, varied actions were undertaken aimed at the consolidation and restructuring of threatened segments. Detailed criteria for issuing authorisations to establish a new bank were prepared in the NBP and implemented as of May 1993. They were in force until January 1998, that is, until the time when the new Banking Act, passed on 29 August 1997, took effect.

Apart from the aforementioned requirements entailed by the Banking Act in force, the NBP Management Board was responsible for:

- determining the minimum capital indispensable to maintain a bank (according to the European Union standards it amounted at the time to the equivalent of ECU 5 million);
- introducing the principle that the initial capital had to be contributed in cash considerations in Polish zloty, non-cash contributions could be contributed only in the form of equipment and real estate relevant to the banking business;
- paying substantially greater attention to the formal requirements which needed to be met by documents submitted within the licensing proceedings;
- substantially broadening the scope of information collected by the NBP regarding the bank's founders and candidates for managerial positions;
- the obligation for founders to document sources of the origin of funds contributed as the initial capital.

Because regulations were made more stringent the pace of establishing new banks in Poland has definitely slowed since 1992, as can be seen in the following figures:

- in 1992 five authorisations to establish a new bank with Polish capital were granted,
- in 1993 only one bank was established, its setting up was connected with the separation of the commercial activity from the NBP,
- in 1994 one decision was issued on establishing a bank with foreign capital,
- in 1995 seven authorisations were granted, of which 4 were related with banks with participation of foreign capital, mainly German, while 3 were authorisations for regional banks, affiliating cooperative banks pursuant to the Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej and on Amendment to Certain Legislation of 24<sup>th</sup> June 1994,
- in 1996 five new banks were granted authorisations, of which 2 licences referred to banks with foreign capital and 3 to regional banks,
- in 1997 five authorisations were granted, of which 2 for regional banks and 3 for banks with foreign capital.

***Establishment and organisation of banks according to principles based on the Banking Act of 29 August 1997.***

Principles of performing banking business, establishing and organisation of banks, branches and representative offices of foreign banks in Poland are specified since 1998 by the Banking Act of 29th August 1997 and by the Act on the National Bank of Poland (of the same date), as well as provisions of other legislation, *inter alia*: the Commercial Code (as of 1st January 2001 – the Code of Commercial Companies), the Act on the Cooperative Law, the Act on the Restructuring of Cooperative Banks and of Bank Gospodarki Żywnościowej and on Amendment to Certain Legislation (as of 28th January 2001 – the Act on the Operations of Cooperative Banks, Their Affiliation, and Affiliating Banks).

The new Act, like the previous, assumes that banks may be established as state banks, joint-stock banks or cooperative banks.

A state bank may be established by ordinance of the Council of Ministers, at the request of the Minister of State Treasury, which should have obtained the opinion of the Commission for Banking Supervision.

A state bank shall not be subject to entry in the register of state enterprises. By 1st January 2001 a joint-stock bank could be established on the basis of authorisation of the Commission for Banking Supervision granted in agreement with the Minister of Finance, observing the procedure laid down in the Commercial Code (Art. 21 of the Banking Act).

The implementation on 1 January 2001 of the Code of Commercial Companies of 15 September 2000 cancelled the obligation to agree the authorisation to establish a joint-stock bank with the Minister of Finance. At present such a bank may be established on the basis of authorisation of the Commission for Banking Supervision, and the provisions of the Code of Commercial Companies are applicable to the establishment and organisation of a bank to the extent that they are not contradictory with the provisions of the Banking Act.

This change resulted from the fact that the CBS members include two representatives of the Minister of Finance, hence there is no need for a separate agreement on the decision, which affected also the duration of the licensing process.

A cooperative bank may be established – observing the procedure specified by provisions of the Act on the Cooperative Law – on the basis of authorisation of the Commission for Banking Supervision, granted in agreement with the minister competent for public finance issues, at the request of founders, taking into account provisions of the Act on the Operations of Cooperative Banks, Their Affiliation, and Affiliating Banks of 7 December 2000.

Pursuant to principles entailed by the Banking Act in force, a bank may be established, if:

1. It is ensured that the bank will be provided with:
  - a) own funds, at the amount which shall not be less than zloty equivalent of 5 million euro, calculated at the exchange rate published by the NBP on the date of granting the authorisation to establish the bank (in the case of joint-stock banks). For cooperative banks, which since the beginning of their operation will be affiliated to one of regional or affiliating banks, the amount of capital was set at 1 million euro.

One founder shall not own more than a half of the initial capital (excluding cases of establishing banks by the State Treasury, by domestic or foreign banks).

The initial capital shall be contributed in cash considerations (in Polish zloty), non-cash contributions may be contributed only in the form of equipment and property holding related to banking business and subject to the condition that their value shall not exceed 15% of the initial capital, and the capital in the form of cash considerations shall not be less than the obligatory minimum.
  - b) premises equipped with appropriate technical equipment, properly safeguarding the valuables held in the bank, taking into account the scope and type of the performed banking business.
2. Founders and the persons proposed to take up managerial positions in the bank give a guarantee to perform the business in a way that will properly protect the bank's customers interests.
3. At least two persons proposed to take up positions of the management board members possess the education and professional experience necessary to manage the bank and possess a fluent command of Polish language. Two members of the management board, including the president, shall be appointed with the consent of the Commission for Banking Supervision, which have considered the request submitted by the supervisory board.

4. The plan of operations submitted by the founders for the period of at least three years shows that the business will ensure security for funds and bank accounts.
5. The initial capital of the established bank shall not originate from a loan or advance and shall not be liable to any charges.

The commencement of the business by the bank that has been set up may occur after receiving the authorisation of the Commission for Banking Supervision, preceded by a positive result of the examination of the bank's preparation to commence the business. The authorisation shall expire if the bank has not commenced the operations within one year since granting the authorisation.

The number of banks established under the new Banking Act in the following years was:

- in 1998 the Commission for Banking Supervision granted no authorisations,
- in 1999 one authorisation was granted, for the first mortgage bank in Poland,
- in 2000 three authorisations were granted, of which 1 was for a bank with foreign capital and 2 were for mortgage banks, of which one did not commence operational activity in the obligatory period of 1 year, hence the authorisation became void,
- in 2001 three authorisations to establish a bank with foreign capital were granted.

## **B. Establishment of foreign banks' branches in Poland**

Pursuant to Art. 40 of the binding Banking Act the establishment of the branch of a foreign bank in Poland depends on the authorisation of the Commission for Banking Supervision, granted in agreement with the Minister of Finance at the request of the interested bank. Regulations on establishing banks shall be applied as appropriate in the procedure of establishing a branch.

It should be noted that even though the legal possibilities of establishing foreign banks' branches in Poland have in the past and do exist today, authorization to establish a branch in Poland was obtained by only 3 banks (2 banks in 1990 and one bank in 1991), of which one branch of a foreign bank in Poland has been operating so far. From 1992 – 2000 no authorisation was granted to establish a branch of a foreign bank in Poland.

The issue of granting authorisations to commence business in Poland by new branches of foreign banks was the subject of the Commission for Banking Supervision debate in April 2000. It was stated that because of the issues connected with the effective banking supervision the most appropriate form of a foreign organisation in the banking business in Poland would be a joint-stock bank.

At the time when Poland joins the European Union it will have to enable and ensure a credit institution, which has been authorised by the competent supervisory authorities of another Member State, the freedom to provide financial services in Poland.

The Act amending the Banking Act, passed on 23rd August 2001, assumes that a credit institution intending to perform operations in Poland shall notify the competent supervisory authorities of its country of origin, which then shall communicate the relevant notification to the Commission for Banking Supervision. It shall be emphasised here, that the new regulations allow the CBS to determine conditions that shall be complied with by the branch of a credit institution. This is a very important supervisory instrument, aimed at maintaining the stability of the banking system in Poland.

## **C. Establishment of representative offices in Poland of foreign banks**

Foreign banks may also establish their representative offices in Poland. Until 1992 authorisations to establish representative offices of foreign banks were granted by the Minister of Finance in agreement with the President of the National Bank of Poland.

22 authorisations were granted by the end of 1992. In connection with the amendment to the Banking Act in 1992 the power to grant approval to establish representative offices of foreign banks in the territory of the Republic of Poland is within the sole competence of the President of the NBP, who by the end of 1997 was issuing relevant decisions in agreement with the Minister of Finance. After the amendment to the Banking Act in January 1998 authorisation to establish representative offices was sought from the Commission for Banking Supervision, having reached agreement with the Minister of Finance. From 1992 to 2001, 50 authorisations were granted for the operation in Poland of representative offices of foreign banks. The number of actually operating representative offices has changed many times in this period due to various banks' mergers, amalgamations, take-overs or the establishment of new banks in Poland. At the end of December 2001, 27 representative offices of foreign banks were operating in Poland.

Pursuant to Art. 5 and 6 of the Banking Act foreign banks and their branches may conduct business activity connected both with banking operations and also with other activities, the scope of which is defined, in the case of banks, by their articles of associations, and in the case of branches, by authorisations. In contrast, representative offices of foreign banks cannot perform any business activity, including also that connected with banking operations.

The scope of the representative office's operations may include only cooperation and intermediation in setting up and maintaining relationships between its parent bank and domestic banks, enterprises and institutions, conducting activity in the field of advertising and promoting the bank and the arrangement in Polish offices and institutions of issues ordered by the bank to the representative office.

#### **D. Amendment to the Banking Act of August 2001**

The amendment to the Banking Act adjusts the regulations to the EU directives, also in the field of licensing and purchasing holdings of banks' shares. The new regulations anticipate the introduction (when Poland becomes a member of the EU) of different regulations concerning those credit institutions from the EU countries that would be willing to establish a branch in Poland or conduct cross-border operations (directly from abroad). The admission to operation in one of the above forms will occur after passing a relevant notification procedure, so it will not be necessary to obtain a CBS authorisation (the principle of single licence – only that of the home country being necessary). The supervisory authorities of the home country shall notify the CBS of the intent to take up such activity. The Act precisely defines the content of the notification and each change in the information contained therein results in the origination on the credit institution side of the duty to disclose it before introducing it. The provisions of the act allow the Commission for Banking Supervision to establish conditions that shall be complied with by the branch of the credit institution in question. The hitherto existing licensing policy shall be in force in respect to entities from non-EU countries. Provisions in the field of control of banks' shares transfer have also been modified. The changes are aimed at performing more effective supervision.

#### **E. Prospects for further development of the banking sector in Poland**

##### ***Consolidation of joint-stock banks***

The further consolidation of the banking sector in Poland is an important issue, as illustrated by the suggested privatisations of the largest Polish retail bank – PKO BP – and of BGŻ SA. However, it is difficult to assess how proposed privatisation would affect the market due to the undecided form that the future privatisation of those banks would take, and the lack of a decision regarding foreign capital involvement in this operation.

The largest amalgamations of banks operating in Poland are connected with the increasing proportion of foreign investment in Polish banking sector.

The Commission for Banking Supervision has authorised amalgamations of:

- BIG Bank SA with BIG Bank Gdański SA (resolution of the CBS of 20th July 2000),
- Bank Handlowy SA w Warszawie with Citibank (Poland) SA (resolution of the CBS of 11th October 2000),
- Bank Zachodni SA with Wielkopolski Bank Kredytowy SA (resolution of the CBS of 7th March 2001),
- Powszechny Bank Kredytowy SA with Bank Przemysłowo-Handlowy SA (resolution of the CBS of 7th November 2001).

Consolidation also took place in 2001 within the group of Bank Śląski SA, which took over ING N.V. Branch in Warsaw. A similar solution can be expected in the case of Polski Kredyt Bank SA (formerly Prosper Bank SA), which is linked with Kredyt Bank SA. Also BRE Bank plans to build a strong universal group, a decision which might have come about as a result of the take over of Bank Częstochowa SA, and the establishment of the division of virtual banking (mBank) and the division of retail banking, known as Multibank.

### ***Consolidation of cooperative banks***

Consolidation activities taking the form of bank amalgamations will continue in the near future in the cooperative banking sector (even though the pace will probably weaken).

It is anticipated that the number of cooperative banks will have further fallen in 2001 by about 100. Those banks will probably not have been able to achieve, on their own, the minimum capital level, that at the end of 2001 amounted to 300,000 euro.

The necessity to reach capital thresholds set by the Act on the Operations of Cooperative Banks is the factor driving the process of banks amalgamations. The deadline to reach the next capital threshold, set at 500,000 euro, is to be reached on 31st December 2005 (at the moment this threshold is met by 252 banks), while the next threshold – set at the level of 1 million euro – comes into play on 31st December 2010.

So the number of cooperative banks will successively decrease, and this number will depend on the amalgamation processes and on banks' earnings, as well as on the effects of external assistance (organisational and financial assistance of affiliating banks, and assistance from the cooperative banks restructuring fund in the BGF).

The number of banks that will affiliate cooperative banks will also fall. At present there are 10, and BGŻ SA, which obtained the right to affiliate cooperative banks on the basis of the Act on the Operations of Cooperative Banks, Their Affiliation, and Affiliating Banks of 7th December 2000. Their amalgamation in three affiliating banks is likely.

The ultimate decision on the number of affiliating banks and the course of their amalgamation will be made by cooperative banks, which according to the provisions of the Act are free to choose the affiliating bank.

## **5. POLISH SUPERVISORY REGULATIONS**

The Banking Act and the Act on the National Bank of Poland of 29th August 1997 changed the formal-legal conditions of the banking supervision operation in Poland. The conduct of the supervision was entrusted to a collective body of public administration – the Commission for Banking Supervision. The GINB is its executive body, separate in organisational terms, but remaining within the NBP structure. The main objective of the supervision over banks consists of ensuring the security of savings and deposits held in banks and the compliance by banks with the law, articles of association and other regulations. The

supervisory policy is reflected in the prudential regulations issued, in decisions made in the licensing process and in actions vis-à-vis banks in connection with the supervision conducted over them.

Since the beginning of the nineties, Polish banking supervision models its prudential regulations (these included, in turn: recommendations of the President of the NBP, regulations of the President of the NBP and at present resolutions and recommendations of the Commission for Banking Supervision) on the European Union directives and on recommendations worked out by the Basel Committee on Banking Supervision. Polish supervisory regulations were based on international standards not only to ensure the safety of funds held in banks and the strengthening of the financial system stability, but also to build a modern and well-managed banking system. In addition, the introduction of common regulatory standards creates good conditions for competitiveness, which is extremely important in the case of Poland's joining the European Union. With expanding integration the Polish banking market will benefit from greater openness. At the moment of accession Polish banks will enjoy the benefits of the single banking licence, which will allow them to establish branches and subsidiaries abroad and to offer their services to EU customers. From the banks customers' point of view EU membership will result in a higher standard of information on available products and services.

Prudential standards may be of qualitative or quantitative nature – depending on the type of related risk. Typical quantitative standards include: the level and the structure of own funds, the risk-based capital ratio, foreign exchange risk limits or debt concentration limits. These standards are entailed by the regulations in force. On the other hand, qualitative supervisory standards refer mainly to those risks that are difficult to measure, that are complex and do not occur independently, but that determine the risk profile or refer to other issues affecting the scale of risk taken by banks. In respect to qualitative standards Polish banking supervision has specified the supervisory expectations and transferred them to banks in the form of recommendations. That applies in particular to the system of monitoring the liquidity, managing risks associated with derivative transactions, mitigating risks of capital investments, managing risks connected with large exposures, managing risks connected with IT systems, managing the interest rate risk, the internal control and managing the foreign exchange risk. Recommendations may be used by banks to: set out their own regulations, limits or procedures, define the strategy and methods of liquidity monitoring or monitoring various risks typical for banking operations and connected with the introduction of new products and services by banks, as well as to determine the tasks of internal control in those areas. Recommendations strongly emphasise those elements that – according to the assessment of the banking supervision – are important for safe banking operation.

It must be emphasised that the prudential standards set in the first half of the nineties by Polish banking supervision were not an exact reflection of solutions adopted in the European Union or solutions recommended by the Basel Committee on Banking Supervision. They were an attempt to adapt those principles to the specific situation, prevailing conditions and the stage of transformation in Poland.

The implementation in 1998 of the new banking legislation imposed on the Commission for Banking Supervision the requirement to issue numerous executive provisions. The Commission, taking the position that the conditions of a banks' business shall not be changed in the course of a fiscal year, issued regulations maintaining the regulations previously in force in the second half of 1998. At the same time the work was continued on changing prudential regulations so as to ensure that they cover new areas of banking operations, and to harmonise them with the recommendations of the Basel Committee on Banking Supervision and the European Union directives (in connection with the planned accession of Poland to the EU). The recent changes in the field of prudential regulations in

Poland aimed primarily at adjusting Polish solutions to the European Union legislation. The most important regulatory areas are briefly described below.

#### **A. The banks' own funds**

At present the own funds of banks are regulated by the Banking Act (Art. 127) and by the CBS Resolution on own funds of banks.

The method of calculating own funds in Poland is entirely based on the Directive 2000/12/EC. Slight differences between solutions suggested by the EU and the solutions adopted in Poland result from the specificity of the Polish banking sector:

- a) The Polish resolution does not provide for inclusion of interim profits to own funds (which under certain requirements is allowed by the Directive),
- b) The resolution orders the deducting of any current losses from own funds (while the Directive orders such deduction only in the case of significant losses).

Moreover, at present the intangible assets are deducted only partly – a full deduction according to the Directive 2000/12/EC will be in force from 2004. This solution was discussed during the screening in the area 'Freedom to provide services' and approved by the European Commission.

The amended Art. 127 of the Banking Act abolished the following aberrations of Polish regulations on own funds, as compared with the requirements of the Directive 2000/12/EC:

- the lack of regulations on the possibility of early payment, at CBS consent, of taken subordinated loans,
- the obligation, existing in the current wording, to obtain CBS consent to include the revaluation reserve (or fund) in the supplementary capital.

Moreover, part of the regulations entailed so far by the executive provisions was moved to the Act, i.e.:

- including retained profits within the components of the core capital,
- limiting the subordinated loans and the supplementary capital on the basis of the adjusted core capital.

#### **B. Risk-based capital ratio – capital adequacy**

The issues of the risk-based capital ratio and the capital adequacy at present are regulated by the Banking Act (Art. 128) and by the Resolution of the Commission for Banking Supervision on the capital adequacy.

According to the Banking Act in force, banks are obliged to maintain the risk-based capital ratio at a level of at least 8%, and for a bank commencing operations, at a level of at least 15% during the initial 12 months of operation and 12% during the next 12 months.

Polish regulations on the risk-based capital ratio, apart from the lack of admissibility of derivatives' pricing according to mark-to-market method, are entirely consistent with the EU Directive.

The amendment to the Banking Act imposed on banks the obligation to maintain own funds at a level not lower than the sum of capital requirements. Principles of calculating those requirements are specified in prudential regulations issued by the CBS.

The capital base to calculate the capital adequacy was determined as own funds plus the short-term capital (as determined by the Commission for Banking Supervision) and less the excess of the capital holdings ceiling (so-called soft limit for capital holdings).

The resolution executing the delegation for the Commission for Banking Supervision in the field of capital adequacy specified that banks would be obliged to apply a full or a limited capital adequacy scheme (depending on to the scale of trading activities). According to the resolution the risk-based capital ratio is calculated as the ratio of the capital base to the

sum of total capital requirements multiplied by 12.5 including the excess of the limit for debt concentration in the trading and banking books altogether (in the case of banks where the scale of trading activity is not significant).

### **C. Market risk**

At present the market risk is regulated by the Resolution of the Commission for Banking Supervision on the capital adequacy.

A change in the attitude to market risk was initiated by the Resolution No 2/2000 of the CBS on determination of standard for permissible foreign exchange risk in banks' operation, which was in force by 31st December 2001, and introduced the obligation to maintain separate capital to cover this risk.

The basic deficiency of the Resolution No 2/2000 of the CBS was the limitation of its scope to only one risk – the foreign exchange risk, while the CAD Directive applies to the total of banking operations.

The CBS resolution on the capital adequacy is based on a design similar to that implemented in the Resolution No 2/2000 of the CBS on the foreign exchange risk. Banks shall maintain the capital base at a level adequate to the risk incurred as the result of performed operations. The total capital requirement is the sum total of capital requirements resulting from the bank's exposure to individual risks in banking operations. The resolution specifies those risks, as well as the method of calculating the capital requirements.

The division of the bank's operations into trading and banking activities, i.e. into trading and banking books, is the crucial component of the Resolution. The Resolution specifies types of transactions that shall be included in the trading book (simplifying, it may be stated that the trading book comprises speculative transactions). Like in the CAD Directive, the banking book was not defined directly – it comprises transactions not included in the trading book.

The Resolution also introduced the notion of the scale of trading activities as the share of the trading book in the overall bank's activity. It is the scale of trading activities that determines whether a bank will be subject to a simplified calculation regime of the total capital requirement (in principle covering the credit risk, foreign exchange risk, commodities risk) or to the regime comprising the full range of risks in the performed operations.

The Resolution provides for calculating the capital requirement to cover each risk according to methods of varied level of complexity – from simplified methods to the method using the methodology of Value at Risk (VaR). At the same time it enables use of the VaR method for more than one risk.

The solutions entailed by the Resolutions are consistent with the methodology adopted in the CAD Directive. However, in the standard methodology higher rates of capital charges against some risks have been adopted, which shall take into account the specificity of Polish market (higher market risk) and also shall ensure a lesser relative restriction of sophisticated methods. The adoption of an identical level of requirement, as in the European Union directive, both for standard and sophisticated methods, would lead to the situation that the application of the sophisticated method (VaR), precisely measuring the actual level of market risk, would result in higher capital charges for the bank that has applied it. So to ensure the equivalence of those methods and not to discourage banks in the use of modern methods of risk management it was necessary to increase certain ratios of charges in standard methods. This approach is not contradictory to the requirements of the directive. Such a design enables each bank to choose the option best suited to its own needs and at the same time option, which favors a higher precision of risk management.

Contrary to the Resolution No 2/2000 of the CBS, banks are obliged to obtain the approval of the Commission for Banking Supervision for using the VaR method or the mixed

method and shall submit detailed information in that respect. Presentation of the description of the method to determine the capital requirement against one or several risks based on the VaR method is aimed at enabling the Commission for Banking Supervision to reach an assessment of the principles used by the bank in the context of the whole bank's operation, and to eliminate evident possible mistakes in method and organisation which have resulted in making the proper management of market risk impossible. This design, consistent with provisions of the CAD Directive, was also adopted in respect to models for the determination of delta coefficient for OTC foreign exchange options used by banks and to consider selected foreign exchange balances as structural balances.

The aforementioned Resolution has introduced all the provisions of the European Union directive on capital adequacy (CAD) and the amendment to that directive (CAD II) and its passage completed another phase of adjusting the prudential regulations to European Union legislation.

#### **D. Large exposure**

The issue of large exposure is at present regulated by the Banking Act (Art. 71) and the CBS Resolution on large exposures. The Banking Act in force provides that the total of a bank's claims and extended off balance sheet commitments incurring the risk of one entity or entities linked by capital or management shall not exceed:

- 20% of the bank's own funds – in the case where any of those entities is for the bank a parent or a subsidiary undertaking or is a subsidiary undertaking for the bank's parent undertaking,
- 25% of the bank's own funds – in the case where those entities are not entities linked with the bank. The sum total of bank's claims and off balance sheet commitments extended by the bank exceeding 10% of bank's own funds shall not exceed 80% of those funds (the above restrictions shall not be applied to funds placed at the National Bank of Poland or at other banks).

The bank's management board shall immediately notify the Commission for Banking Supervision of each case of the exceeding of the limit of 10% of bank's own funds in respect to bank's claims or off balance sheet commitments extended by the bank incurring the risk of one entity or entities linked by capital or management.

The total sum of loans, advances, bank guarantees and endorsements extended to members of bank bodies and persons holding managerial positions in the bank shall not exceed 10% of the bank's core capital (in the case of cooperative bank 25% of bank's core capital). These solutions are consistent with the Directive 2000/12/EC.

The amendment to the Banking Act extended the basic list of exclusions. It includes also the delegation for the Commission for Banking Supervision to determine the method of taking into account balance sheet and off balance sheet items when calculating large exposures and to specify other exclusions.

The standard of large exposures included in the amendment allows excess, resulting in a necessity to maintain an additional capital requirement (a soft limit for large exposures), referred to in the amended Art. 128.

The CBS Resolution, executing the amended statutory delegation, specified the method of taking into account, in the calculation of large exposures, the individual claims and extended off balance sheet commitments as well as other listed claims and extended off balance sheet commitments, to which large exposures standards shall not apply

## **E. Limits of the bank's capital investments**

Pursuant to the regulations entailed by the amended Banking Act, the amount in excess of the large exposure ceiling (reducing the capital base) is the larger of amounts specified as:

- the sum of amounts, by which individual qualifying holdings exceed 15% of the bank's own funds,
- the amount by which the sum of qualifying holdings exceeds 60% of the bank's own funds.

When calculating the excess over the capital holdings ceiling, the qualifying holdings: in banks, financial institutions, insurers, clearing houses, in organisations where the bank holds shares and interests in connection with its participation in the rehabilitation proceedings of those entities, as well as qualifying holdings taken over in connection with the execution of agreement on service sub-issue, are not taken into account.

The above limit also does not apply to qualifying holdings of inter-bank telecommunication companies, entities for which the sole object of activity is providing services in the field of bank staff education and companies of auxiliary banking services – provided that banks hold at least 75% of shares and interests in those entities.

Polish regulations on bank's capital investments are fully compliant with requirements of EU directives.

## **F. Specific provisions**

At present the specific provisions are set out by the Regulation of the Minister of Finance on principles of provisioning against the risk connected with banking activity (by 31st December 2001 the issue of specific provisions was regulated by the resolution of the CBS, however with the amendment to the Accounting Act the authorisation to issue executive regulations on specific provisions was moved from the CBS to the Minister of Finance). At present banks in Poland are obliged to offset the effects of risk resulting from their operations by establishing and maintaining specific provisions to ensure safety of funds held by customers. Banks shall establish specific provisions against:

- claims, excluding interests (also capitalised),
- extended off balance sheet financial (unconditional) commitments and guarantees.

The obligation to establish provisions applies to claims and off balance sheet commitments specified as the following categories:

- regular – in the field of claims on consumer loans and advances extended to natural persons,
- special mention,
- classified (including substandard, doubtful and loss).

Banks are obliged to establish specific provisions also against other assets and off balance sheet commitments, if they may threaten the security of funds held by customers or in a significant way affect the bank's financial standing. According to the regulations in force the specific provisions shall charge costs.

As compared with the principles of provisioning in force by the end of 2001 the new regulation includes the following changes:

- 1) Housing loans and loans for small businesses – a requirement was introduced to apply the criterion of evaluation of financial standing at least once a year.
- 2) The criterion of the borrower's financial standing evaluation – in the case of purchasing debts with recourse (in particular in factoring) banks may evaluate the financial standing of the debt seller, instead of the debtor.
- 3) Doubtful claims – according to the previous legal status any impairment of the primary capital of the borrower meant a necessity to classify the claim to the 'doubtful' category

(with the exception of that category known as ‘greenfields’, towards which a milder attitude was anticipated). The new regulation introduced certain exceptions to financing the investment projects.

- 4) The endorsement of local self-governments was abolished – this was the restriction of reducing the base of provisioning by the value of endorsements of local self-government entities up to 80% of initially secured amount.
- 5) The alienation and registered pledge by registration on a movable – the possibility to accept the book value for valuation was removed, leaving only the market value.
- 6) Mortgage – restriction of size of mortgage by the initial amount of loan was ended.
- 7) The requirement of collateral value updating was introduced.

### **G. Acquiring and selling qualifying holdings**

The issue is regulated in the Banking Act. According to the regulations a person intending directly or indirectly to take up or acquire the bank’s shares shall in each case file an application with the Commission for Banking Supervision for approval to exercise voting rights at a general meeting of the bank's shareholders, if the taking up or acquisition of those shares would result in that person being entitled to over 10%, 20%, 25%, 33%, 50%, 66% or 75% of votes at a shareholders’ general meeting of that bank. The obligation of obtaining such approval shall also apply to a person who – having obtained approval from the Commission for Banking Supervision to exercise voting rights at a general meeting of the bank's shareholders at the level specified in the approval – as a result of disposing of the shares or for other reasons, had subsequently lost the right to exercise that proportion of voting rights (while granting the approval the CBS may define in its content a condition that non-exceeding the specified threshold of voting rights at a general meeting of the bank’s shareholders by the date indicated in the approval results in the expiration of the approval). A person that has taken up or acquired shares in a bank shall immediately notify the bank concerned of the taking up or acquisition of its shares, where these shares – together with any taken up or acquired previously – give that person a holding entitling him to exercise over 5% of votes at a general meeting of the bank's shareholders. The bank shall forward this notification to the Commission for Banking Supervision within 14 days of receipt. The Commission for Banking Supervision may refuse to grant approval, if the influence of the person intending to take up or acquire shares may turn out to be detrimental to the sound and prudent management of the bank, or if the funds assigned to the acquisition of the shares constitute the proceeds of a loan or advance, or the sources of such funds are undocumented, or if the provisions of law in force in the place where that person has the registered office or residence prevent the Commission for Banking Supervision from performing effective supervision. The above provisions shall also apply to the situation where a change occurs in the number of votes at a general meeting of the bank’s shareholders as a result of an amendment to the bank’s articles of association or due to the expiry of shares preference.

A person intending to dispose of a shareholding entitling him to exercise more than 10% of voting rights at a general meeting of the bank’s shareholders, as well as of a shareholding, having disposed of the which the remaining shareholding would entitle the holder to exercise less than 10%, 20%, 25%, 33%, 50%, 66% and 75% of voting rights at a general meeting of the bank’s shareholders, shall notify the Commission for Banking Supervision of that intention. A person that has taken up or acquired shares without the relevant approval shall be entitled to exercise 5% of voting rights at a general meeting of the bank’s shareholders or to such number of voting rights that results from the previously obtained approval. The Commission for Banking Supervision may withdraw the previously granted approval, at the same time setting the date for selling the shares, if the influence of the person that directly took up or acquired shares may turn out to be detrimental to the prudent

and sound management of the bank or if the provisions of law in force in the place where that person has the registered office or residence prevent the Commission for Banking Supervision from performing effective supervision (in such case the shareholder shall be entitled to exercise 5% of votes at a general meeting of the bank's shareholders, irrespective of the number of shares held). The obligation of notification shall be duly applied in the case of acquiring or disposing of bonds convertible into bank shares, depositary receipts as well as other securities to which the right or obligation to acquire bank's shares are attached. The aforementioned measures have resulted in Polish regulations on the acquisition or disposing of qualifying holdings of banks shares being at present generally consistent with similar Community regulations, in some cases even stricter and more detailed. Further adjustments and a full implementation shall occur by the end of 2002.

## **H. Principles of bank accounting**

The introduction of Regulation No 1/91 of the President of the National Bank of Poland on uniform principles of bank accounting of 12 February 1991, and on introduction of a model bank chart of accounts, the BPK 91, was of great importance for the unification of principles of accounting in banks in the nineties, including in particular the method of presenting economic operations in financial statements and in the reports submitted by banks to the National Bank of Poland. The principles of prudence and of accrual accounting shall be included in the basic accounting principles obligatory for banks at that time.

The fulfilment of reporting duties by banks towards the NBP resulted in the necessity of uniform grouping of economic operations. The banking reports in force until 1997 included line codes, defining the way of attributing the data of operations recorded in appropriate BPK 91 accounts to individual reporting items. That ensured a uniform method of presenting economic operations and results of those operations by banks in their financial statements.

It must be emphasised that the introduction of the BPK 91, based on French patterns, was accompanied by interpretations issued by the General Inspectorate of Banking Supervision, referring application of prudence principles to: how particular operations are to be recorded, the classification of claims into individual categories, establishing specific provisions and depreciation reserves (write-offs updating the value) applicable to other assets as well as a prudent approach to including interest on claims in banks income.

The passage by the Sejm of the Republic of Poland of the Accounting Act in 1994 and issuing regulations based on it had a crucial importance for the development of principles of bank accounting in the nineties. The regulations specifically concerned here are No 1/95 of the President of the NBP on particular principles of bank accounting and the preparation of additional information of 16 February 1995 and No 10/95 of the President of the NBP on particular principles of drawing up consolidated financial statements by banks of 29 December 1995. The regulations were adjusted to the European Union requirements, including the Directive 86/635/EEC.

On the basis of provisions of the Accounting Act, requirements on bookkeeping for banks, the drawing up of financial statements, assets and liabilities valuation and determination of earnings were specified in the regulations of the President of the NBP. The scope of information presented as notes to the financial statements was also defined. The requirements on auditing and publishing the financial statements were also specified.

Regulations of the President of the NBP on bank accounting were replaced in 1998, because of formal requirements, with resolutions of the Commission for Banking Supervision, which has not substantially changed the principles of bank accounting.

Another amendment to the Accounting Act was made in November 2000. Its implementation at the beginning of 2002 coincided with the issuance of specific provisions adjusted to it in the field of bank accounting. New regulations were to a larger extent adjusted

to International Accounting Standards (IAS). The issues connected with the valuation and presentation of financial instruments were regulated in a more precise way. The accounting principles for hedging consistent with the concept provided in IAS 39 were admitted to use. The scope of notes to the financial statements was also expanded, e.g. by the information on hedging by banks against individual risks resulting from the banking operations.

### **I. The draft of ‘New Capital Adequacy Framework’**

Polish banking supervision has been working very intensively on the consultative paper published in 2001, entitled ‘A New Capital Adequacy Framework’. The ‘Framework’ aims at increasing the safety and stability of the banking system by putting greater emphasis on internal risk-control systems in banks and risk management, and on the process of supervisory analysis and market discipline. Setting capital requirements against individual risks will result in banks being more effective in their operations.

The setting out and implementation of adequate methods of risk evaluation for each individual exposure as well as the state-of-the-art solutions in the field of operational risk and interest rate risk in the banking book will be the challenge for Polish banking supervision and banks. It will be necessary to ensure the reliability and correctness of such systems operation in the banking sector as well as to determine in what way and by whom those systems will be verified and validated. The imposing on the banking supervision the responsibility for verification of banks’ risk assessment systems will require serious changes within the supervision itself; in the field of resources, organisation, skilled staff and training. It might appear, that the responsibility of supervision for the assessment of systems is very controversial – as today banks in Poland are independent organisations and bear the responsibility for their operation and its effects themselves. So it is not proper to transfer the responsibility from banks to the banking supervision in any area, and this is also true in the field of internal systems of risk assessment.

Assigning a high priority to the process of supervisory analysis, which was adopted in new methodology, is another challenge for Polish banking supervision. The carrying out of this process to a large extent will enable early detection of problems within risk management and capital adequacy, as well as making possible supervisory intervention at an early stage. This will help prevent negative consequences for the bank itself or the banking group as well as the spread of the problem hitherto confined to the bank in question, to the entire banking system.

### III. THE SITUATION OF BANKS IN POLAND

#### 1. THE OWNERSHIP CHANGES, RESTRUCTURING AND CONSOLIDATION PROCESSES IN THE BANKING SECTOR

Until 1989 the banking system in Poland was a part of a centrally planned economy. Interest rates were determined in an administrative way by the government, like the directions and the scale of banks' lending; that resulted from an annual credit and cash plan. The system lacked legal provisions regulating the operation of the banking system (*inter alia*, prudential standards).

The main role in the banking system was played by the National Bank of Poland, combining the functions of a commercial bank with some of the functions of a central bank. This was a mono-bank system and state enterprises were linked with its branches. A few other, specialised (and non competitive) banks were also operating, namely:

- Bank Handlowy w Warszawie SA (joint stock company, 100% state owned), the oldest bank in Poland, operating since 1870, servicing all Poland's foreign turnover;
- Bank Polska Kasa Opieki SA (joint stock company, 100% state owned), performing mainly foreign currency operations for the public<sup>17</sup>;
- Bank Gospodarki Żywnościowej – a state-cooperative bank, servicing the food and agriculture industry, established in 1975 and in 1994 transformed into a joint stock company;
- Powszechna Kasa Oszczędności – a state bank, on the basis of an administrative decision separated from the National Bank of Poland in 1987 to service retail customers<sup>18</sup>;
- Bank Gospodarstwa Krajowego, established in 1924, between 1945 and 1989 operating limited business.

After the economic transformation to a market oriented economy the above banks retained their dominating position in the sector by means of diversification of operations and transformation into universal banks. Apart from traditional deposit-lending activities they introduced new types of services: brokerage in stock exchange operations, investment and trust banking, and during the last two years services connected with pension and investment funds as well as with electronic banking, to this end establishing separate entities or separating retail divisions within the organisational structure.

The Banking Act<sup>19</sup> of 1982 allowed the establishment of new banks. Before 1989, two new commercial banks were granted authorisation and obtained entry to the register; however, only one of them – Bank Rozwoju Eksportu SA (at present BRE Bank SA) took up the operations (in 1987). The co-founders of the bank included: the Ministry of Foreign Economic Cooperation, the National Bank of Poland, the Ministry of Finance, Bank Handlowy w Warszawie SA, Bank Polska Kasa Opieki SA, BGŻ and state enterprises (foreign trade enterprises). The second of them, Łódzki Bank Rozwoju SA, took up operations in 1989.

At the end of 1988 the banking sector comprised of: 3 state banks, 2 joint-stock banks 100% state owned, one state-cooperative bank and a network of 1663 small, local cooperative banks, obligatory affiliated to Bank Gospodarki Żywnościowej, providing services mainly to the population of villages and small towns. A few of them were operating in cities, providing services primarily for handicrafts.

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<sup>17</sup> Established in 1929, reactivated in 1954.

<sup>18</sup> Established in 1919, as a state bank started operations in 1987.

<sup>19</sup> See the Banking Act of 26 February 1982 (Dz.U. No 7, item 56).

## **A. The development of commercial banks after 1989**

After 1988 changes in the Polish banking system were driven by numerous factors, the most important of them including:

- the establishment, on the basis of 400 NBP branches, of nine universal state banks (known as ‘the nine’), who took over the NBP’s deposit-lending operations<sup>20</sup>;
- the development of a network of commercial banks with involvement of mixed capital, initiated by new regulations in this field;
- bank privatisation;
- the increase of foreign investor share in the development and ownership transformation of the sector;
- bank liquidations and bankruptcies as well as consolidation processes within the sector.

## **B. The years from 1989 to 1992**

The establishment as of 1st February 1989 of nine commercial banks with head offices in main regions of Poland was the main factor in the removal of the banking sector monopoly. The nine banks were assigned the network of previously NBP branches, usually in a given region, although efforts were made to provide establishments in Warsaw and in other big cities. These banks included:

- Powszechny Bank Gospodarczy w Łodzi,
- Powszechny Bank Gospodarczy w Warszawie,
- Wielkopolski Bank Kredytowy w Poznaniu,
- Bank Śląski w Katowicach,
- Bank Zachodni we Wrocławiu,
- Bank Gdański w Gdańsku,
- Bank Przemysłowo-Handlowy w Krakowie,
- Bank Depozytowo-Kredytowy w Lublinie,
- Pomorski Bank Kredytowy w Szczecinie.

Initially these were state banks, equipped with capital (own funds) by the NBP and in 1991 they were transformed into sole state shareholder companies. Head offices were located in the cities of the greatest business activity because it was considered that such situation would provide the banks with a high development potential and at the same time would stimulate the economic development of those regions.

The 1989 Banking Act also created the legal grounds for the establishment of new banks, because it specified conditions necessary to receive a licence to conduct banking business. These conditions included:

- a) the minimum amount of the initial capital,
- b) the competence of persons put forward as prospective bank management,
- c) the set and the contents of documents (articles of association and internal rules, the organisational structure, the target market, the business plan, forecasts of balance sheets and profit and loss accounts for the following years).

The liberal licensing policy of the NBP in the period 1989-1992 (on the basis of 1989 Banking Act) resulted in the establishment of 70 banks of mixed capital. However, few of them retained up to now the original status and composition of shareholders.

Both public and private capital participated in establishing new banks. Initiatives to establish banks were originating in various circles and for various reasons. A certain role was played by state administration units, which saw the possibility of accomplishing their social-economic goals by establishing banks. After almost 40 years of dormancy Bank

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<sup>20</sup> In 1993 the tenth bank – Polski Bank Inwestycyjny SA was separated from the NBP.

Gospodarstwa Krajowego (a state bank) was reactivated by the Minister of Finance to conduct state business transactions. Bank Rozwoju Budownictwa Mieszkaniowego SA was established as a result of the initiative of the Ministry of Building Industry to finance the housing construction industry. Bank Inicjatyw Społeczno-Ekonomicznych SA, established under the aegis of the Ministry of Labour, was entrusted with the mission to create new jobs for the unemployed by supporting development of small and medium enterprises; the capital originated primarily from the Labour Fund. Bank Ochrony Środowiska SA had a similar character, it was aimed at financing pro-ecological investment projects from the funds of the National Fund for Environmental Protection, likewise Bank Własności Pracowniczej SA, was established to support privatisation and the employees' ownership. Those banks – being non-competitive when compared to large universal commercial banks – were forced to transfer into institutions of more commercial and universal character.

Numerous banks were established to provide the servicing and financing of selected sectors of the economy (e.g. sugar industry banks, CUPRUM Bank SA, Bank Energetyki SA, Bank Morski SA) or/and support the development of a given region (Bank Częstochowa SA, Bank Komunalny SA in Gdynia). Those banks established as results of local initiatives were usually financially weak (because of low capitals and the dependence on the economic situation in the given sector) and in numerous cases became the targets for take over by larger institutions.

The period from 1990 till the first half of 1992 was also favourable for the establishment of foreign banks. Tax relief (up to the amount of the contributed capital) during the initial three years of operations, as well as the possibility of contributing and holding the capital in foreign currency, and the freedom of transferring 15% of profit, were an additional factor encouraging foreign investors. In that period foreign capital investment was mainly in the form of joint-stock companies with a majority shareholding of foreign investors. Seven such institutions were established. Bank Amerykański w Polsce SA /American Bank in Poland/ (today Bank Amerykański w Polsce AmerBank SA) was the first foreign bank, established pursuant to the decision of the President of the NBP of December 1989, 20% Polish owned and 80% American owned. The next banks were: Raiffeisen Centrobank SA (today Raiffeisen Bank Polska SA), Citibank (Poland) SA (in 2001 merged with Bank Handlowy w Warszawie SA), IBP Bank SA (today Credit Lyonnais Bank Polska SA) with 70% foreign investment, Polsko-Kanadyjski Bank św. Stanisława SA (today Danske Bank Polska SA), a *joint venture* with the participation of the Credit Union of Polish Canadians and Polsko-Amerykański Fundusz Przedsiębiorczości /Polish-American Enterprise Fund/, Bank Creditanstalt SA (later Bank Austria Creditanstalt Poland SA, in 2001 merged with Powszechny Bank Kredytowy SA) and Pierwszy Komercyjny Bank SA.

Controversy connected with the conduct of supervision over the operation in Poland of foreign banks' branches, treated by the National Bank of Poland as Polish entities, contributed to the small number (3) of such establishments set up in this period (SOCIETE GENERALE, ING Bank NV Oddział w Warszawie /then ING Bank Warsaw/ and American Express (Poland) Ltd.). The desire to service hitherto customers – such as international companies – within the scope and on the level that could not have been provided by fledgling Polish banks was an important motive for the presence of foreign banks on the Polish market. The number of commercial banks rose quickly after the ending of the state monopoly, peaking in 1993 at 87 banks. In the years following the number of banks was falling, despite the establishment of new banks.

**Table 1**The number of commercial banks <sup>a</sup> as of 31 December

	1993	1994	1995	1996	1997	1998	1999	2000	09.2001
Banks with a majority of state capital	29	29	27	24	15	13	7	7	7
Banks with a majority of private capital	58	53	54	57	68	70	70	67	65
of which with the majority of capital:									
– Polish	48	42	36	32	39	39	31	20	17
– foreign	10	11	18	25	29	31	39	47	48
<b>Total commercial banks</b>	<b>87</b>	<b>82</b>	<b>81</b>	<b>81</b>	<b>83</b>	<b>83</b>	<b>77</b>	<b>74</b>	<b>72</b>

<sup>a</sup> Excluding banks declared bankrupt and put into liquidation, including banks in the course of organisation (since the moment of entering the company into the register).

### C. The years of 1993 and 1994

In 1993 and 1994 the pace of increase in bank numbers was reduced as a result of a restrictive licensing policy that was implemented by the central bank, faced with the weak financial standing of many banks, which was threatening the stability of the banking sector. In this period only one licence was granted in each of the two years. The main objective of the National Bank of Poland at this time was the strengthening of the domestic banking sector through the restructuring of banks threatened with bankruptcy and by rehabilitation with the assistance of foreign capital.

The process of establishing new banks by foreign capital was stopped for fears of excessive increase of competition against financially weak Polish banks. At the same time there was a trend to create a level playing field for Polish and foreign banks, *inter alia*, by removing benefits resulting from the possibility of the foreign banks maintaining capital in foreign currencies<sup>21</sup>.

### D. The years between 1995 and 1998

The increase of bank numbers in the period from 1995 to 1998 was much slower. The initiative in this field was totally taken over by foreign capital, which established 10 new banks and took over control of 7 banks that needed providing additional capital.

**Table 2**

Banks taken over by foreign investors, who were committed to rehabilitate them or/and to provide additional capital

No	Name of the taken over bank	Name of the taking over bank (institution)	Take over year
1	INTERBANK SA – today ABN AMRO BANK (Polska) SA	ABN AMRO BANK N.V	1994
2	Solidarność Chase D.T. Bank SA – today GE Capital Bank SA	GE Capital Corporation and the Selective American Financial Enterprises.	1995
3	PETROBANK SA – today LG Petro Bank SA	LG Investment Holdings BV	1996
4	Bank Rolno-Przemysłowy SA, today Rabobank Polska SA	Rabobank International Holding Nederland	1996
5	Bank Ogrodnictwa „Hortex” SA, later Polbank SA and OPEL BANK SA, today GMAC Bank Polska SA	General Motors Acceptance Corporation	1996
6	Bank Przemysłowy SA	Union Group AS	1997
7	Bank Podlaski SA, today AIG Bank Polska SA	AIG Consumer Finance Group, Inc.	1998
8	Bank Rozwoju Energetyki i Ochrony Środowiska „MEGABANK” SA	Bayerische Vereinsbank AG	1998

<sup>21</sup> The problem was ultimately solved by relevant provisions of the 1997 Banking Act.

9	BWR Bank Secesyjny SA, today DaimlerChrysler Services (debis) Bank Polska SA	DaimlerChrysler Services (debis) AG	1999
10	Bank Własności Pracowniczej SA – today BWP – Unibank SA	Unibank A/S	1999
11	Bank Komunalny SA, today NORDEA BANK POLSKA SA	Nordbanken AB	1999
12	Bank Współpracy Regionalnej SA, today Deutsche Bank 24 SA	Deutsche Bank AG	1999

The capital minimum necessary to obtain banking authorisation, equivalent to 5 million euro, and the competition in the banking services market, reduced the opportunities for Polish entities to enter the marketplace by employing solely Polish capital. The central bank policy implemented in those years made the granting of banking authorisation or of the approval to acquire a control holding of domestic bank shares by a bank applying to enter the market dependent on its participation in the restructuring of the Polish banking sector (by taking over a bank threatened with bankruptcy, supporting a bank in trouble or a bank involved in the rehabilitation of other banks).

Also in this period 8 regional banks, affiliating cooperative banks, were established, connected with the restructuring of the cooperative sector, which is the subject of the next part of the paper.

### E. The situation since 1999

In accordance with the obligations assumed by Poland when joining the OECD, at the beginning of 1999 formal restrictions against foreign banks in respect of establishing branches were abolished.

**Table 2**  
Changes in the ownership structure of the banking sector

	1995	1996	1997	1998	1999	2000	09.2001
	million zloty						
Equity capital <sup>a</sup> (registered equity)	3 247	4 733	6 224	7 530	7 698	8 500	9 099
owned by:							
– State Treasury, directly	1 109	1 366	1 304	1 351	1 037	977	1 261
– National Bank of Poland	273	352	175	8	8	0	0
– state legal entities <sup>b</sup>	277	488	332	319	250	225	222
– other domestic entities <sup>c</sup>	262	393	589	690	866	1 405	976
– foreign entities	588	1 330	2 462	3 561	4 089	4 575	5 225
– dispersed shareholders <sup>c</sup>	546	537	1 069	1 243	1 056	896	973
– members of cooperative banks	192	268	294	357	392	423	442
	% share						
Equity capital (registered equity)	100.0	100.0	100.0	100.0	100.0	100.0	100.0
of which owned by:							
– State Treasury, directly	34.2	28.9	20.9	17.9	13.5	11.5	13.9
– National Bank of Poland	8.4	7.4	2.8	0.1	0.1	0.0	00.0
– state legal entities	8.5	10.3	5.3	4.2	3.2	2.6	2.4
– other domestic entities	8.1	8.3	9.5	9.2	11.3	16.5	10.7
– foreign entities	18.1	28.1	39.6	47.3	53.1	53.8	57.4
– dispersed shareholders	16.8	11.3	17.2	16.5	13.7	10.5	10.7
– members of cooperative banks	5.9	5.7	4.7	4.7	5.1	5.0	4.9

<sup>a</sup> Formerly share capital

<sup>b</sup> State enterprises and banks, sole shareholder companies of the State Treasury, commercial companies with majority shareholding of the State Treasury, state agencies, etc.

<sup>c</sup> Including capital owned by municipalities that in 1996 and 1997 amounted to 11.1m zloty, while in the following years 11.6m zloty, 10.4m zloty, 7.5m zloty and 7.9m zloty.

<sup>d</sup> Banks show only shareholders holding 5% of more voting rights in a general meeting of shareholders, while shareholders holding less votes are shown together in the item “other shareholders”. The capital owned by the latter is usually defined as “dispersed capital”. In the case of listed companies banks usually do not have information on all shareholders.

At the end of September 2001 the share of foreign capital (5.2 bn zloty) in the equity capital of commercial banks in Poland stood at 57.4%. The largest amounts were invested by German capital (14.6% of the equity capital), primarily by German banks, such as e.g. Deutsche Bank AG, Commerzbank AG, Bayerische Hypo- and Vereinsbank AG and by American capital (12.2% of the equity capital), represented mainly by the Citibank Overseas Investment Corporation, the AIG Consumer Finance Group, the Bank of America National Trust and the General Electric Corporation. Relatively high contributions were provided by Dutch (8.0%), Irish (5.9%) and French (5.1%) capital among the remaining foreign investments. Assets controlled by the foreign capital as of the end of September 2001 amounted to 78.3% of the total assets of the sector.

## F. Bankruptcies, take-overs and mergers

Numerous commercial banks, established in the early period of the new market conditions (1989-1991), went bankrupt, were liquidated or lost their independence as a result of take-over by other entities. This resulted from a difficult financial situation, originating from their capital weakness, the ignorance of risk assessment methods and the shortage of skilled staff or the wrongly selected strategy.

**Table 4**

Changes in the number of commercial banks in the period 1992 – 2000

	1993	1994	1995	1996	1997	1998	1999	2000	09.2001	Total
Bankruptcy	-	-	3	-	-	-	1	1	-	5
Liquidation	-	-	-	-	1	1	-	1	--	3
Take over	1	6	2	2	1	-	1	2	--	15
Amalgamation	1	-	1	2	2	1	5	1	5	18
<b>Total reductions</b>	<b>2</b>	<b>6</b>	<b>6</b>	<b>4</b>	<b>4</b>	<b>2</b>	<b>7</b>	<b>5</b>	<b>5</b>	<b>41</b>
<b>New banks <sup>a</sup></b>	<b>2</b>	<b>1</b>	<b>5</b>	<b>4</b>	<b>6</b>	<b>2</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>26</b>
<b>Net change</b>	<b>0</b>	<b>-5</b>	<b>-1</b>	<b>0</b>	<b>2</b>	<b>0</b>	<b>-6</b>	<b>-3</b>	<b>-2</b>	

<sup>a</sup> According to the date of the entry in the commercial register.

In the later period the reduction in bank numbers resulted mainly from consolidation, initiated by Polish banks, to strengthen their market position. A model example of building a position in this way is Kredyt Bank SA, which successively consolidated by absorbing: Bank Ziemski SA, Powszechny Bank Handlowy GECOBANK SA, Bank Regionalny SA in Rybnik, Bank Depozytowo-Powierniczy GLOB SA and finally Polski Bank Inwestycyjny SA. Also Bank Polska Kasa Opieki SA amalgamated in 1999 with three banks that had separated in 1989 from the NBP<sup>22</sup>. The amalgamated bank adopted the name Bank Polska Kasa Opieki SA.

Within the past two years consolidation in the sector has resulted additionally from the amalgamation of foreign banks' subsidiaries and branches operating in Poland. Amalgamations of Bank Austria Creditanstalt (Poland) SA with Powszechny Bank Kredytowy SA, Bank Handlowy w Warszawie with the Citibank (Poland) SA, HypoVereinsbank Polska SA with Bank Przemysłowo Handlowy SA, ING Bank NV Oddział w Warszawie with ING Bank Śląski SA are examples of this.

<sup>22</sup> Powszechny Bank Gospodarczy w Łodzi SA, Bank Depozytowo-Kredytowy w Lublinie, Pomorski Bank Kredytowy w Szczecinie SA. From 1996 to 1999 those banks operated as the Grupa Pekao SA

**Table 5**

Market mergers (not caused due to weak financial position of the amalgamated bank)

No	Name of the amalgamated bank	Name of the amalgamating bank	Year of amalgamation
1	Polski Bank Inwestycyjny SA	Kredyt Bank SA	1997
2	Bank Gdański SA	Bank Inicjatyw Gospodarczych BIG SA (renamed BIG Bank Gdański SA)	1997
3	Polski Bank Rozwoju SA	Bank Rozwoju Eksportu SA (today BRE Bank SA)	1998
4	Powszechny Bank Gospodarczy SA	Bank Polska Kasa Opieki SA	1999
5	Bank Depozytowo-Kredytowy SA	Bank Polska Kasa Opieki SA	1999
6	Pomorski Bank Kredytowy SA	Bank Polska Kasa Opieki SA	1999
7	HypoVereinsbank Polska SA	Bank Przemysłowo-Handlowy SA	1999
8	Bank Austria Creditanstalt Poland SA	Powszechny Bank Kredytowy SA	2000
9	BIG BANK SA	BIG Bank Gdański SA	2001
10	CITIBANK (Poland) SA	Bank Handlowy w Warszawie SA	2001
11	Wielkopolski Bank Kredytowy SA (now BZ WBK SA)	Bank Zachodni SA	2001
12	ING Bank NV Oddział w Warszawie	ING Bank Śląski SA	2001
13	Bałtycki Bank Regionalny SA	Gospodarczy Bank Wielkopolski SA	2001

### G. The privatisation of the commercial banking sector

The establishing of private banks with mixed capital resulted in an increase of private ownership in the banking sector. However, substantial changes in the ownership structure of this sector occurred as a result of the privatisation of large state banks, started in 1991.

The privatisation was aimed at increasing bank operational efficiency by way of handing the new bank entity, the management boards, and the supervisory boards full responsibility not only for the accomplishment of the mission and of the adopted strategy, but also for the day-to-day management and restructuring. It was also expected that privatisation would contribute to the modernisation of management methods and technology, as well as would ensure access to new capital sources, raise the effectiveness of banks and thereby would increase their competitive capability.

The assumptions of the privatisation programme of ‘the nine’ banks that were set out in 1991 forecast two stages of the process, namely: commercialisation and capital privatisation, i.e. making bank shares available to third parties.

In 1991 the Council of Ministers decided on how to commercialise the banking sector, or how to transform them into commercial companies. Connected with this was the bestowing of articles of association to banks and with the appointing of supervisory boards, whose task it was to assist in the preparation of banks for privatisation, asset restructuring, increasing operational effectiveness, and the reconstruction of organisational structures.

The adopted privatisation strategy forecast the winning for banks of foreign strategic partners, that would take over the holding of no more than 30% of the total shares issued, but (on the basis of a managerial contract) that would actively participate in bank management<sup>23</sup>. It was also assumed that the State would retain about 30% of shares with voting rights limited to strategic decisions (with the option to dispose of this interest in the future) and the remaining shares (about 30%) would be offered to individual investors in a public offer and to employees, on privileged terms. These principles were used in the privatisation of the first

<sup>23</sup> To modernise banks and to win potential strategic investors – seven of “the nine” bank separated from the NBP participated, in the period 1992-1994, in carrying out twinning agreements, connected with the programme of assistance financed from a World Bank loan.

two banks – Bank Śląski SA and Wielkopolski Bank Kredytowy SA – in 1993-1994, with the participation of strategic investors, namely the Dutch ING Bank NB and the European Bank for Development and Reconstruction. In both cases the interest of foreign investors did not exceed 30%. However, the assumed continued presence in privatised banks of a powerful state shareholding resulted in problems with winning foreign banks as strategic investors. Therefore the privatisation deals that followed during the next two years were carried out without their involvement.

The change of the government's policy versus foreign capital was reflected in 1998 by the selling to foreign investors (Bayerische Hypo- und Vereinsbank and Bank Austria AG) of significant equity holdings (representing 36.72 % and 33.3% of capital, respectively) in two of the banks of the group of nine – these being the Bank Przemysłowo-Handlowy w Krakowie SA and the Powszechny Bank Kredytowy SA, which were state owned. This resulted in the take-over of control over these banks by foreign institutions. The following two privatisations, those of Bank Zachodni we Wrocławiu SA and Bank Pekao SA (2<sup>nd</sup> stage), carried out in 1999, were connected with sale to foreign strategic investors, namely AIB European Investment Limited (Ireland), and an Italian-German consortium, UniCredito-Italiano and Allianz AG, majority holdings of 80% and 52.09%, respectively.

**Table 6**

## Privatisation of the biggest commercial banks in Poland in the period 1990 – 2000

Name and registered office of the bank	Year	Privatisation method	Shareholders structure during the privatisation (share in the capital)	Changes of shareholders in the following years
<b>“The nine” banks</b>				
Wielkopolski Bank Kredytowy w Poznaniu SA	1993	Stock market launch	European Bank for Reconstruction and Development 28.5%; State Treasury 30.00%; dispersed shareholders 34.75%	1995: Allied Irish Bank European Investment 16.26%, 1996: 36.3%; 1997: 60.14%; State Treasury 5.10%; dispersed shareholders 34.8%
Bank Śląski w Katowicach SA	1994	Stock market launch	ING Bank NV 25.9%; State Treasury 33.2%	1996: ING Bank NV 54.98%; State Treasury 5%; dispersed shareholders 35.0%
Bank Przemysłowo-Handlowy w Krakowie SA	1995	Stock market launch	State Treasury 46.61%; dispersed shareholders 53.39%	1998: Bayerische Hypo- und Vereinsbank. 36.72%; 1999: 86.06%; State Treasury 3.69%
Bank Gdański w Gdańsku SA	1995	Stock market launch	BIG SA (Polish entity) with subsidiaries 24.07%	1996: BIG 31.23%, 1997: 63.42%; merger with BIG SA and the establishment of BIG Bank Gdański SA
Powszechny Bank Kredytowy SA w Warszawie	1997	Stock market launch	State Treasury 33.3%; Individual investors 66.7%	1998 Bank Austria AG and Bank Austria’s subsidiary Creditanstalt International AG 15%. 1999: 43.5%, 2000: 57.13%; State Treasury 14.26%; dispersed shareholders 35.65%
Bank Zachodni SA	1999	Take over (sale of majority interest) to a selected foreign investor	AIB European Investment Limited (Ireland) – 80%; State Treasury – 4.29%; Other shareholders – 15.71%	
Powszechny Bank Gospodarczy w Łodzi SA	1999	Amalgamated with Bank Polska Kasa Opieki SA		
Bank Depozytowo-Kredytowy w Lublinie SA	1999	Amalgamated with Bank Polska Kasa Opieki SA		
Pomorski Bank Kredytowy w Szczecinie SA	1999	Amalgamated with Bank Polska Kasa Opieki SA		
<b>Banks operating before 1989</b>				
Bank Rozwoju Eksportu (later BRE Bank SA)	1992	Stock market launch	Individual private and institutional investors – 85%; State Treasury 15%	1995 Commerzbank AG bought in the market 21%; 1997: 48.7% (taking up new issue); 2000: 50%; other shareholders 50%
Bank Handlowy w Warszawie SA	1997	Stock market launch	State Treasury 7.9% ZC Netherlands BV 6.2% Sparbanken Sverige AB 5.0%;	2000: 87.83% buy out of shares by City Group’s subsidiary the Citibank Overseas Investment Corporation

			JP Morgan & CO 14.8%; Bank of New York 16.9%; Other shareholders 49.2%.	
Bank Polska Kasa Opieki	1989	Stock market launch	Individual investors 15.0%.	
	1999	2nd stage Selection of a strategic investor	1999 UniCredito Italiano and Allianz AG (together) 52.09%; EBRD 5.25%; State Treasury 13.9%	2000: 53.17% UniCredito Italiano ; EBRD 6.63%; State Treasury 7.98%; other shareholders 32.22%

The sale of majority interests in Bank Polska Kasa Opieki SA and Bank Zachodni SA by the State Treasury in 1999 completed the privatisation of the 9 banks that emerged from the NBP structure. At the end of September 2001 the State controlled directly only PKO Bank Polski SA, Bank Gospodarki Żywnościowej SA and Bank Gospodarki Krajowej, which enjoy state bank status. The latter bank is not included in privatisation plans, because its business focuses on carrying out government transactions. The percentage of banking sector directly controlled by the State against the total banking assets as of the end of September 2001 amounted to 21.9%.

## **H. The restructuring of the commercial banking sector**

The lack of uniform principles of recording and reporting in the period directly after the transformation of the system made the monitoring of the quality of banks' assets by the central bank impossible. Prudential standards implemented later on were not yet in force. In August 1990 the President of the NBP addressed the recommendation to the banking sector to carry out periodical reviews of assets and to specify them as regular, difficult, doubtful and contentious. A model chart of accounts, adapted to the recording of assets pursuant to this scheme, and the obligation of periodical reporting to the National Bank of Poland was introduced only at the beginning of the next year. Significant in that respect was the Regulation of the President of the NBP on offsetting the banking risk by establishment specific provisions, which came into force in 1992<sup>24</sup>.

The introduction of the obligation of a uniform classification led to the disclosure in the 1992 and 1993 of the dramatically poor quality of banking assets. The share of classified assets in 1993 stood at 31%. That resulted primarily from financial problems of state enterprises, them being the most important customers of state banks, their weakness being caused by their non-adjustment to the changing economic system (*inter alia*, the liberalisation of bank interest rates and the reduction of budget subsidies) and by the recession, triggered by the slow down of domestic demand and by the restriction of access to hitherto markets abroad. The increase of classified assets was also the consequence of poor risk management in the banking sector, resulting from the shortage of skilled staff and the lack of knowledge of risk assessment methods.

In connection with the disclosed crisis, to solve the problem of bad debts in the state sector a programme of financial restructuring of enterprises and banks was worked out in 1993.<sup>25</sup> The execution of the programme was entrusted to state banks and to the banks in which the State held a controlling holding of more than 50% of the total equity. The Minister of Finance provided them with restructuring bonds totalling 4 billion zloty to increase the reserve capital and the specific provisions against classified assets<sup>26</sup>. Those bonds, accruing interest from the issue date according to the rediscount rate of the central bank, were to be redeemed between 1995 and 2008.

According to the assumptions of the programme, the banks participating in it made a detailed review of classified assets. On the basis of this review borrowers were broken down into two groups: those auguring hopes for improvement and those providing grounds for such optimism. The banks were obliged to recover as large a part of their assets as possible through

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<sup>24</sup> Regulation No 19/92 of the President of the National Bank of Poland on offsetting the banking risk by establishing specific reserves of 18 November 1992.

<sup>25</sup> The Act on the Financial Restructuring of Enterprises and Banks and on Amendments to Certain Legislation of 3 February 1993 (Dz.U. No 18 of 1993, item 82).

<sup>26</sup> The Regulation of the Minister of Finance on the specification of banks that will be provided Treasury bonds and on the division of the amount designed in the Budget Act to increase banks' own funds and reserves of 27 July 1993 (Dz.U. of 1993, no 69, item 332); the Regulation of the Minister of Finance on the specification of banks of 16 December 1993 (Dz.U. of 1993, no 126, item 578); the Regulation of the Minister of Finance amending the regulation on the specification of banks of 29 December 1993.

bankruptcy proceedings, filing petitions for liquidation or selling assets of enterprises, which were technically insolvent.

The bank arrangement proceeding was the most important solution made available to banks to employ in respect to state enterprises, sole state shareholder companies and companies with state majority interest. It enabled banks to restructure a given debt (e.g. to defer repayment dates, to cushion the debt repayment, or to write off part of the debt), subject to the submission by the borrower of a rehabilitation programme aimed at improving the enterprise's financial position. Another way of solving the problem, forecast by the legislator, consisted in swapping debt for shares and part ownership, connected with the possibility of more active bank participation in managing the enterprise.

**Table 7**

Bank assets included in the restructuring in the period 1994 – 1995 (million zloty)

	1994	1995	1996
Arrangement proceedings	272.2	1 198.5	906.3
Court composition	45.8	168.2	166.5
Debt for equity swap	774.4	157.9	179.2
Public sale of assets	1 173.0	487.2	319.3
Putting into liquidation or declaring bankrupt	36.8	1 113.2	1 649.3
Other forms	1 274.2	902.5	862.7
Total to be restructured	3 576.4	4 027.5	4 083.3

Source: Paweł Wyczański, *Sytuacja finansowa banków w 1995 (Banks financial standing in 1995)*, Materiały i Studia (Materials and Studies), Nr (No) 57, Warszawa 1996, NBP; Paweł Wyczański, Marta Gołajewska, *Sytuacja finansowa banków w 1996 (Banks financial standing in 1996)*, Materiały i Studia (Materials and Studies), Nr (No) 65, Warszawa 1997, NBP.

The low quality of portfolios substantially burdened the banks' earnings with the cost of provisions, which were particularly high in 1993. As a result that year finished with a loss for the sector. In the years following earnings were dynamically improving, with a declining percentage of classified assets in the portfolio. The ROA and ROE indicators, negative in 1994, in 1996 amounted to as much as 2.5% and 66.6%, respectively. The number of banks with a risk-based capital ratio below 8% fell from 18 in 1994 to 7 in 1996. This contributed to the capital strengthening of banks, enabling their subsequent privatisation. An improving economic situation was conducive for this development, reflected in a high pace of economic growth, as a result of which the financial standing of enterprises has substantially improved. Moreover, the importance of state enterprises, which had particularly great problems with the servicing of their debts, has fallen in banks' credit exposure.

Banks have also benefited from restructuring in another way. As a result of cooperation with experienced analysts of auditing companies banking staff have also gained skills in the analysing and assessment of financial and market standing of enterprises.

Numerous enterprises obtained a reduction of the burden of the servicing of loans and opportunities for further development, but were implementing rehabilitation programmes.

### **I. Restructuring and consolidation in the cooperative banks sector**

Until 1990 all cooperative banks were affiliated to Bank Gospodarki Żywnościowej, and in the years following, also to three affiliating banks that they established<sup>27</sup>. In 1993 rehabilitation programmes were started in 680 banks, more than 250 of these banks being technically bankrupt. The bad financial standing of the sector created the need to take action to restructure the sector.

<sup>27</sup> These included: Gospodarczy Bank Wielkopolski SA w Poznaniu, Bank Unii Gospodarczej SA w Warszawie and Gospodarczy Bank Południowo-Zachodni SA we Wrocławiu.

Systemic solutions aimed at establishing a three-tier structure of the sector were introduced in 1994<sup>28</sup>.

Various forms of financial and technical assistance were implemented, planned initially at rehabilitating the situation of the entire sector and then at supporting structural transformations that had been inaugurated. These included: series D restructuring bonds, designed for the purchase by affiliating banks of the bad debts of cooperative banks (practically completed in 1998), a loan from the Bank Guarantee Fund for independent rehabilitation and for taking over banks in a difficult situation, a re-finance loan from the NBP (bearing an interest rate of 1% p.a.) for commercial and cooperative banks for taking over poorly performing cooperative banks and an exemption from the reserve requirement for maintaining and transferring. In addition, tax exemption were implemented in 1995 for banks affiliated to the National Group of Cooperative Banks, and in 1996 for the sector as a whole, subject to the allocation in 1996 of 75% and in 1997 of 80% of the balance surplus to an increase of the members' share fund.

As a result of those policies the number of banking failures were reduced. Consolidation processes, which became stronger in 1996, also contributed, consolidation in the sector being connected with the increasing competition of commercial banks. Levels of consolidation suddenly accelerated in 1999 with the resolution of the Commission for Banking Supervision of 5 August 1998<sup>29</sup>, setting the capital minimum for cooperative banks established before 1 January 1999 at a level of 300,000 euro.

**Table 8**

The number of cooperative banks in the period from 1993 – 2000

	1993	1994	1995	1996	1997	1998	1999	2000	09.01	Total
Reduction in the total number of banks	10	41	102	116	99	106	408	101	20	1 003
Due to:										
– bankruptcy	10	23	57	30	6	4	-	-	1	131
– liquidation	-	5	9	12	15	6	1	-	-	48
– amalgamation	-	13	37	74	78	96	406	99	17	820
– take over by another bank	-	-	-	-	-	-	1	2	2	5
Resumption of the operation	-	-	1	-	-	-	-	-	-	1
Number of banks at the year end	1653	1612	1510	1394	1295	1189	781	680	660	

New principles for cooperative banking operations and affiliation were introduced at the end of 2000<sup>30</sup>. Pursuant to them, those banks and the affiliating banks will create a two-tier structure.

## **2. THE ESTABLISHMENT OF BANKING GROUPS AND FINANCIAL CONGLOMERATES**

### **A. Premises for establishing banking groups and financial conglomerates in Poland**

The increasing domestic and foreign competition is the basic premise for establishing banking groups and financial conglomerates. It forces financial intermediaries and their customers to pursue the reduction of transaction costs. Without guaranteeing a competitive,

<sup>28</sup> The Act on the Restructuring of Cooperative Banks and Bank Gospodarki Żywnościowej and on Amendments to Certain Legislation of 24 June 1994 (Dz.U. of 1994, No 80, item 369).

<sup>29</sup> Resolution of the Commission for Banking Supervision on particular principles of equipping banks with the initial capital of 5 August 1998.

<sup>30</sup> The Act on the Operations of Cooperative Banks, Their Affiliation, and Affiliating Banks of 7 December 2000 (Dz.U. No 119, item 1252). The act took effect in January 2001.

reduced level of transaction costs, it is impossible to match the competition – neither in the domestic market nor in international markets.

The reduction of transaction costs may be achieved in various ways, both by increasing the effect of market mechanisms on the operation of the banking sector and by expanding the capital and organisational concentration. In 1989, at the beginning of the transformation, a mono-bank system dominated, within which the entire issuing activity and the basic part of the deposit-lending operations were concentrated in the NBP and so-called specialised banks. The dismantling of this mono-bank structure required an authoritative introduction of competition between the 9 deposit-lending banks separated from the NBP. Political changes meant that after the 4<sup>th</sup> of June 1989 real market competition could come about and a two-tier banking system was introduced, characteristic of a market economy. That meant a separation of deposit-lending operations from the issuing activity – since that time the former has been carried out by commercial banks and the latter by the NBP.

The approval of the establishment of numerous private banks and the broadly planned privatisation of existing banks, those that were wholly state owned, resulted in the removal of the initial disproportion of forces between capital and organisational concentration and the mechanism of competition in the inter-bank market. The process was carried out at as fast a pace as the depth of the domestic capital market and the confidence of the international financial markets in the strength of the Polish zloty would allow. The agreement with creditors that was reached in the Paris Club and in the London Club was a breakthrough in the reconstruction of this confidence. As a result of an individualised approach to banking privatisation and using a decentralised approach to the restructuring of bad debts inherited from the bureaucratic economy, it was possible to avoid the break-down of ownership supervision in the banking sector as well as it being possible for monies from the International Fund for Banks Privatisation in Poland to be employed in the sector's privatisation.

It was only possible to carry out a cost-benefit analysis and to consider the possibility to use capital and organisational concentration for a significant reduction of transaction costs when the market was liberated from the pressures of the remnants of State control. The concentration in the banking sector, measured by the share of 5, 10 or 15 banks, within the recent five years has not changed significantly and in net assets amounted to about 47%, 67%, 79%, respectively. The second half of the 1990s was marked with the consolidation of the banking system. The establishment of Grupa Pekao SA and a drastic reduction of the number of cooperative banks were examples of these new trends; clearly today and in the foreseeable future the sector is free to select the proportion of 'hierarchy' or the 'market' at shaping the form of financial intermediation. Poland may follow an Anglo-Saxon or a continental model of financial system. However, present decisions must take into account any foreseeable realities of the European Unions' domestic market and the trends in international financial markets.

The size of the capital market and the other European Union financial markets help to create preferences for economies of scale and the range of provision of financial services. These variables appear in the EU in multi-level financial systems, with the significant presence in them of banking capital groups and financial conglomerates.

The expansion and deepening of European integration creates strong incentives for cross-border provision of financial services without a commercial presence and supra-border mergers and take-overs of joint-stock banks. Due to the potential competition that at any moment may enter the market, dominated by large banks and capital groups, there are no longer fears of increasing capital concentration in the banking sector, apart from a situation where there would be illegal misuse of a monopolistic position. As the result of universal consolidation trends in the banking sector, new financial groups are being established,

operating subsidiaries or even offshoots of those subsidiaries outside the borders of the home country – in third countries – including Poland.

There is a universal trend to establish new banking capital groups and financial conglomerates. Poland, in transforming its economy, will be no different as the domestic financial system stabilises. The diversification of systemic risk and the appearance of benefits of size are factors in this stabilisation. Too high a number of small and non-specialised banks may adversely affect the stability of the financial system in the economic reality of an open economy with the liberalisation of the currency regime and greater access to the domestic market. However, the establishment of capital groups and financial conglomerates requires professionalism from the banking supervision and from the risk management staff in various financial markets.

## **B. Legal regulations for the establishment and operation of banking groups and financial conglomerates in Poland**

The passage by the Sejm of the Act on the Amalgamation and Consolidation of Certain Joint-Stock Banks on 14 June 1996 (Dz.U. No 90, item 406) may be considered as an attempt to overcome any fear of employing the capital and organisational concentration for privatisation and for expanding the market of banking services. Including those solutions in the Banking Act in force (Dz.U. No 140, item 939) meant that those regulations became accessible to all joint-stock banks.

The Polish legal system did not and does not have a uniform statute regulating the holdings' operation in a uniform way. At the same time it was difficult to consider the legal regulations in force as an impassable barrier for establishing banking groups and financial conglomerates. On the grounds of the Commercial Code in force until 2000 it was possible to concentrate rights of ownership rights in such a way that one bank was a shareholder of another bank or banks with a holding large enough to award it the position of a dominant shareholder. The Commercial Code of 15 September 2000, in force since 1 January 2001, includes a definition of a linked company. Taking into account the legislation in force it shall be considered that banking groups make forms of permanent capital and organisational links between banks. Only domestic joint-stock banks may be group members. A subsidiary bank cannot be a shareholder of the parent bank.

A banking group is established where the parent bank owns more than 50% of subsidiary bank shares and has at its disposal more than 50% of votes at a general meeting of any subsidiary bank. The making of an agreement on establishing a banking group is the second element indispensable for such establishment. The period of the group shall not be shorter than 5 years. A bank may be only a member of one banking capital group. As a result, a banking group, designed in such a way, becomes similar to a financial holding. The liquidity of each bank, the member of a banking capital group, is guaranteed by all other banks of the group. Banks belonging to the same capital group shall use names and trademarks indicating the membership of their group.

The following banking groups were operating in 1999:

- Grupa Pekao – Pekao SA, PBG SA, BDK SA, PBKS SA,
- Grupa PBK-BCA – Powszechny Bank Kredytowy SA, Górnośląski Bank Gospodarczy SA, Bank Austria Creditanstalt SA,
- Grupa WBK-BZ – WBK SA, Bank Zachodni SA, Gliwicki Bank Handlowy SA,
- Grupa BIG-BG – BIG Bank Gdański SA, BIG Bank SA,
- Grupa BPH-HypoVereins – BPH, HypoVereinsbank SA, SBR Samopomoc Chłopska SA,
- Grupa BSK-ING – Bank Śląski SA, ING Barings Oddział w Warszawie,
- Grupa Kredyt Bank – Kredyt Bank SA, PBI SA, Prosper Bank SA,

- Grupa Invest Banku – Invest Bank SA, Bank Staropolski SA,
- Grupa Banku Gospodarstwa Krajowego – Bank Gospodarstwa Krajowego i Bank Rozwoju Budownictwa Mieszkaniowego SA.

In 2000 multinational banking capital groups operating on the Polish market came into the spotlight with the following:

- Grupa Pekao SA was transformed into Bank Pekao SA and was controlled by the Unicredito Italiano and Allianz consortium;
- Bank Zachodni SA was sold to Allied Irish Bank European Investments and the entire WBK Group was thereafter subject to the control of Irish capital;
- Bank Przemysłowo-Handlowy SA w Krakowie was sold, and after a German banking merger, this group is controlled by Bayerische Hypo und Vereinsbank AG;
- Bank Współpracy Regionalnej SA was taken over by Deutsche Bank Polska SA, so gaining control of BWR Real Bank SA;
- Merita Nordbanken and Unibank merged, resulting in the establishment of a capital group with the participation of Bank Komunalny SA and Bank Własności Pracowniczej SA;
- Bank Handlowy w Warszawie was taken over, with 87.7% of its shares being acquired by the Citibank Overseas Investment Corporation, resulting in Citibank becoming the parent bank for BHW and CUPRUM Bank SA and Bank Rozwoju Cukrownictwa SA.

The actual level of organisational-capital concentration in the domestic banking sector needs to be viewed in the light of audited consolidated financial statements of credit institutions. With that proviso we could additionally refer to the BRE SA group and to the mixed-activity holdings represented in Poland by the banks involved in ‘car finance’ such as Fiat Bank Polska SA, Ford Bank SA, Opel Bank SA, Volkswagen Bank Polska SA. At the same time Fiat Bank SA is the pioneer of establishing financial conglomerates in Poland. Through the Petrus insurance company, controlled by the parent Fiat company, it offers products increasing the value of collateral for self extended loans.

The share of banking capital in insurance companies tripled between 1993 and 1997. In 1998 and 1999 the share of foreign capital in the sector of insurance companies was increasing the fastest. As a result the domestic banks hold only 8.42% of the insurers’ equity capital.

Strategic alliances, referred to as *bancassurance*, were relatively rare in Poland and resulted from the situation of foreign capital controlling a given bank, e.g. Nationale Nederlanden and Bank Śląski SA, Allianz and Bank Pekao SA, Kredyt Bank and Heros – Life, Warta and Agropolisa, Powszechny Bank Kredytowy SA and Towarzystwo Ubezpieczeń na Życie Royal PBK. Towarzystwo Ubezpieczeń i Reasekuracji CIGNA STU SA is the exception, being controlled by domestic capital: owners of Bank Współpracy Europejskiej SA and Towarzystwo Ubezpieczeń i Reasekuracji, WARTA SA controlled by the Kulczyk Holding. Krajowa Spółdzielcza Kasa Oszczędnościowo-Kredytowa controls Towarzystwo Ubezpieczeń Wzajemnych SKOK.

At present Polish customers buy about 2 to 3% of insurance products in banks. The change of insurance product distribution channels is being fostered by capital links between credit institutions and insurance companies in their home countries.

### **C. Prospects for banking groups and financial conglomerates in the European Union internal market.**

Two problems deserve special attention among those connected with the operation of the domestic banking sector in the internal European market. The first is the potential susceptibility of parent companies to transform joint-stock banks operating under domestic legislation into branches subject to home country supervision. Such a decision would directly result in lay-offs in the labour market for Polish banking staff and in a possible change in the

attitude to the scale of foreign capital involvement in the banking sector in Poland. The adoption of a legal arbitrage will be a longer-term effect of the ownership and organisational transformations. Poland usually applies more stringent standards of banking supervision than is the case with the home countries of banks having branches in Poland.

The second problem is the organisation and division of tasks between specialised supervisors of individual types of financial institutions that form financial conglomerates. At present a specialisation of prudential supervisors prevails in Poland. Therefore the prospects of quick establishment of one unified supervisor over financial institutions are rather remote.

The initial disproportion between the strategic potential of the banking sector and the life and property insurance sector means that in the foreseeable future the development of the insurance sector will be much quicker than of the banking sector. Therefore the banks will show a higher susceptibility to making strategic alliances with international insurance companies. The reputation they have and network of establishments that the banks can offer will be paramount as insurance companies offer effective sales capabilities and a large number of insurance agents working for the common financial conglomerate.

A fear of accumulating the risk of asymmetric shocks on assets and associated liabilities is a barrier to the development of financial conglomerates in Poland. In conditions of increasing unemployment households try to maintain consumption levels and to reduce future expenses, which often also include the next insurance instalments. The next step is when the insurance policy is sold, resulting in the withdrawal of bank deposits and a reduction in the solvency margin of insurance companies. The quality of the banks' credit portfolio suddenly deteriorates at the same time. As a result, the risks accumulate and are difficult to mitigate. The re-assurance of domestic companies operating abroad is a broadly used tool to mitigate the risk of loss accumulation. Ultimately only a small part of funds collected in the form of commercial insurance premium returns to the country to be invested in development projects.

The elaboration of international standards for supervision of financial conglomerates is a chance for the aforesaid to be developed in Poland. In such a situation the experience of the more mature overseas markets could be used, without the worry of creating disturbances in the domestic financial markets. Banking groups and financial conglomerates with foreign capital both aid the stability of the domestic financial system and make the monitoring the systemic risk simpler.

#### IV. ANNEXES

***The list of prudential regulations in force:***

1. Regulation of the Minister of Finance on particular principles of bank accounting of 10 December 2001 (Dz.U. of 1997, No 149, item 1673),
2. Regulation of the Minister of Finance on principles of provisioning against the risk connected with the banking activity of 20 December 2001 (Dz.U. of 1997, No 149, item 1672),
3. Resolution No 6/2001 of the Commission for Banking Supervision on the specification of detailed principles of determination of own funds of banks, members of a banking capital group, for the needs of the application of the standards and limits specified by the Banking Act, the amount, the detailed scope and conditions to reduce the bank's core capital, other items included in the bank's supplementary capital, the amount and conditions of their inclusion, other deductions from bank's own funds, the amount and conditions of reducing by them the bank's own funds and taking into account banks' links with other subsidiaries or entities operating within the same holding at the determination of the way to calculate the own funds of 12 December 2001 (Dz.Urz. NBP /Official Journal of the NBP/ of 2001, No 22, item 44),
4. Resolution No 7/2001 of the Commission for Banking Supervision on the detailed principles and conditions of taking into account the debts and extended off balance sheet commitments at the determination of the compliance with the debt exposure limits, specifying other debts and extended off balance sheet commitments, to which the provisions on debt exposure limits are not applicable and taking into account links of banks with other subsidiaries or entities operating within the same holding in the calculation of debt concentration of 12 December 2001 (Dz.Urz. NBP of 2001, No 22, item 45),
5. Resolution No 5/2001 of the Commission for Banking Supervision on the scope and detailed principles of determination of capital requirements against individual risks, including those against the exceeding the debt exposure limits, the way and detailed principles of calculation of the risk-based capital ratio, taking into account links of banks with other subsidiaries or entities operating within the same holding and determination additional balance sheet items included together with own funds in the calculation of the capital adequacy and the scope and way of their determination of 12 December 2001 (Dz.Urz. NBP of 2001, No 22, item 43),
6. Resolution No 8/2001 of the Commission for Banking Supervision on the amount and conditions of including a particular part of the additional amount of members' responsibility in own funds of cooperative banks of 12 December 2001 (Dz.Urz. NBP of 2001, No 22, item 46).

***The list of recommendations worked out at the General Inspectorate of Banking Supervision:***

1. Recommendations for banks on the liquidity monitoring system of June 1996.
2. Recommendation A on the management of risks accompanying derivative transactions made by banks of 3 March 1997.
3. Recommendation B on the limitation of banks' capital investment risk of 3 March 1997.
4. Recommendation C on the management of large exposures risks of 3 March 1997.
5. Recommendation D on the management of risks accompanying the IT and telecommunication systems used by banks of 20 October 1997.

6. Recommendation E on the preparation of IT systems to the operation in the year 2000 of 19 December 1997.
7. Recommendation F on the basic criteria used by the Commission for Banking Supervision at the assessment of property appraisal regulations issued by mortgage banks of 12 November 1998.
8. Recommendation G on the interest rate risk management at banks of 23 June 1999.
9. Recommendation H on the internal control at banks of 1 December 1999.
10. Recommendation I on the foreign exchange risk management at banks and on principles of conducting by banks the transactions involving exposure to the foreign exchange risk of 1 December 1999.
11. Recommendation J on the establishment by banks of databases on the property market of 20 July 2000.