



The Role of the National Bank of Poland in the Process of European Integration

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Introduction

Membership of the European Union (EU) is one of Poland's strategic objectives. The process of integration has been continuously underway since the signing of the "Europe Agreement establishing an association between the Republic of Poland and the European Community and its Member States" in December 1991. As assumed, the necessary processes of harmonisation was completed in 2002. This date, termed the technical readiness of Poland for the membership of the European Union, was determined by the Polish Government, which has been actively working on implementing an ambitious adjustment programme.

Conditions of EU membership for candidate states were specified at the European Council summit in Copenhagen in June 1993. It was determined that the accession of Central and Eastern European states to the EU should occur immediately after they had met the stated economic and political conditions. The former refer, *inter alia*, to the establishment of an efficient, operational market economy, capable of facing competitive pressure and market forces in the EU single market and of accepting obligations, including sharing Economic and Monetary Union (EMU) objectives. The Treaty on European Union, which took effect on 1st November 1993, set the next requirements for the candidate states – this time referring to the subsequent stage of integration, i.e. joining the EMU. These criteria – the same as for Member States – refer to price stability, long-term interest rates, the foreign exchange rate, the budget deficit, public debt and central bank independence. To fully comply with these convergence criteria – as ratified by the European Council summits in Madrid (1995) and Luxembourg (1997) – the National Bank of Poland (NBP) has been active in paving the way for Polish membership of the EU.

The NBP is playing, and has already played, a particular role in the process of the integration of the Polish banking system with the single EU financial market. Together with the relevant ministries it participated in the negotiation process for EU membership in the field of issues directly or indirectly related to banking. Apart from external activities, the NBP has been undertaking – on its own initiative – numerous internal projects.

Moreover, one of the basic NBP objectives within the integration process is to ensure the stability and integrity of the overall Polish financial system and to adjust it to the requirements binding in the European System of Central Banks (ESCB). This task is being carried out *inter alia*, by proper establishment of a monetary policy, the adjustment of legislation on banking to the *acquis communautaire*, and the adjustment of statistics and the payment systems to ESCB standards. Also considered to be of prime importance is the adjustment of banking supervision to accord with Community regulations and to international standards. In addition the NBP, monitoring the safety of the entire banking system as the central bank, has been carrying out numerous activities connected with the introduction of the euro. In 2003, the NBP became involved in the campaign for the referendum on the accession of Poland to the European Union.

It is envisaged that the process of integration will proceed in three stages: pre-membership, EU membership and entering the EMU. The NBP has been participating or is going to play an active role in each of these stages, through measures taken within the NBP as well as external activity. This paper is limited to the presentation of the role of the NBP during the first of these three stages.

NBP participation in the process of integration and in negotiations for the membership of the European Union

1.1 The external activities of the NBP

Participation in legal screening, distributed in 1998 and 1999 and broken down into 31 areas, of which part refers directly or indirectly to the central bank, is one of the NBP's roles in the process of integration. These points of law lay in the following areas: **Economic and Monetary Union, the Free movement of capital, Freedom to provide services, Consumer and Health protection, Statistics, the Finance and Budget, the Free movement of people.**

In these areas NBP representatives were active in the preparatory work, directly in the screening, as well as in further work resulting from the process of negotiations. The most important provisions included in the negotiation positions are discussed below:

- The negotiation position in the **"Economic and Monetary Union"** area contains a declaration of readiness for Poland to adopt the Community legislation in this field by 31st December 2002. The Polish team did not discuss problems that would require negotiation discussions within this area and did not apply for the establishment of transition periods. Moreover, they undertook to perform adjustments, these being conditions for future EMU membership, of a scope not exceeding the standard requirements connected with EU membership. The introduction of the Maastricht convergence criteria and the obtaining of readiness to join the EMU are considered by Poland as a long-term objective. This area was **preliminarily closed on 7th December 1999.**
- The negotiation position within the **"Free movement of capital"** comprises the following issues related to the NBP: the establishment of banks and bank branches abroad, the establishment of building societies, the issue of mortgage bonds, cross-border transfers, statistical and reporting duties, electronic payments, means to counteract money laundering (the Act on Counteracting the Introduction to Financial Circulation of **Financial Assets** Originating from Illegal or Undisclosed Sources of 16th November 2000). Poland submitted a declaration of readiness to adopt the community legislation in this field by 31st December 2002, excluding issues connected with the movement of capital related to the purchase of real estate by foreigners and with possibilities of direct investments in the air transport sector. For the first issue the EU suggested shorter transition periods than those proposed by Poland. At present the Polish negotiating team has been considering the possibility of giving up an application for a 5-year transition period in respect of land for investment purposes, as this postulate is not economically justified. Poland also intends to modify its position on the purchase of real estate for recreation purposes. The issues connected with the adjustment of the Banking Act and the Foreign Exchange Law in this area are discussed in section 4. This area was **preliminarily closed in March 2002.**
- The negotiation position in the **"Freedom to provide services"** includes issues connected with the setting up and operation of banks, the internal equity of banks, the risk-based capital ratio, the capital adequacy, credit exposure, the netting of assets and liabilities, bank accountancy, the consolidated supervision, and deposit guarantees (detailed in section 4.4.2 on the Banking Act and in section 5). The Polish team submitted a declaration of readiness to adopt the Community legislation in this field by 31st December 2002. At the

same time an application was filed for a permanent exclusion from the community banking directives of the co-operative credit unions and Bank Gospodarstwa Krajowego because of the specificity of those institutions, as well as for the establishment of other transition periods, *inter alia*:

- five years for co-operative banks (by 31st December 2007) in connection with Art. 10 of Directive 89/646/EEC, due to the fact that Polish co-operative banks will not be able to reach the required level of internal funds (not less than 1 million euros) before the assumed accession date
- one year (by 31st December 2003) in connection with Art. 2 of Directive 89/299/EEC on the own funds of credit institutions. This will allow full adjustment to the Community methodology of deducting intangible assets from Polish own funds.

The area was **preliminarily closed on 14th November 2000**.

- The negotiation position in the section on **“Consumer and health protection”** contains a declaration that Poland shares the assumptions and objectives of the Community policy in this area and therefore does not anticipate any negotiation problems and is not applying for the establishment of transition periods. Nevertheless, because of the absence in Polish law of a catalogue of consumer’s rights, included in directives in the area, it was necessary to pass a relevant act on consumer credit (provided at length in section 4).

This area was **preliminarily closed on 19th May 1999**.

- The negotiation position in the **“Statistics”** area contains a declaration of readiness to adopt European legislation in this field by 31st December 2002. The Polish team does not anticipate problems that would require negotiations and does not apply for the establishment of transition periods. This area was also **preliminarily closed on 19th May 1999**.
- The negotiation position in the **“Finance and budget”** area does not require adjustment of domestic legislation. The Polish team fully accepts *acquis communautaire* in this field and will undertake the relevant steps to apply it by the date of EU accession. In respect of the ECB subscription capital and the foreign exchange reserves, the NBP is prepared to transfer appropriate charges, consistent with the legislation in force in that field. This area was **preliminarily closed on 13th December 2002**.
- The negotiation position in the **“Free movement of people”** area contains a declaration to adopt the entire *acquis communautaire* and to undertake relevant actions “such, that the appropriate regulations could enter into force on 1st January 2003”. The most difficult negotiation issues include the access of Polish citizens to the Community labour markets. The other issues in this area arise much less controversy, e.g. the principles of movement of people, mutual recognition of professional qualifications, the system of information on the labour market, and the co-ordination of social security systems. In this area the EU suggested the following transition periods:
 - 2 years – citizens of new Member States will not be subject to the EU legislation and the current Member States will be able to facilitate the access to their labour market to citizens of a selected new Member State by means of a bilateral agreement;
 - a further 3 years – Member States will be able to make a decision about extending the transition period by another 3 years;
 - another 2 years – each of Member States will have a possibility to extend this period by another 2 years maximum, however, only in cases of serious disturbances in the labour market of that country.

In negotiations with Poland this area was preliminarily closed on 21st December.

1

On the day of 13th December 2002 Poland completed accession negotiations with the European Union finally closing 31 negotiation areas.

The NBP was also participating in compiling documentation resulting from the course of negotiations. Those include, *inter alia*, documents containing implementation commitments resulting from individual negotiation positions, reports on the implementation of *acquis communautaire* in individual negotiation areas, the information for a *Regular Report of the European Commission* on individual negotiation areas.

The **National Programme of Preparation for Membership (NPPM)** was the strategic state document, ordering and co-ordinating adjustment processes in the national scale within the negotiations for membership. Ministries and central offices involved in the process of European integration – including also the NBP – participated in the preparation of consecutive versions of the document. NPPM editions were adjusted to the structure of negotiation positions. NBP priorities were included in the chapter “Freedom to provide services” (they refer to the harmonisation of the banking law with the Community legislation) and in the chapter “Economic and Monetary Union” (they referred to the adjustment of the NBP to the operation within the ESCB, in particular they referred to the independence of the central bank, the adjustment of monetary policy instruments, the floating of the zloty exchange rate, and the implementation of regulations on the introduction of the euro). The aforementioned priorities were approved by the NBP Management Board and by the Committee for NBP Preparation for the European Integration.

In 1999 the NBP identified the areas that required appropriate adjustments to achieve harmonisation with membership of the EU, and the situation of later membership of the ESCB. This was the basis for working out two priorities, i.e. “**The Adjustment of the National Bank of Poland for Operation within the European System of Central Banks**” and “**The Harmonisation of Polish Regulations in the Field of Banking Legislation with the Community Legislation**” – both included in the National Programme of Preparation for Membership of the EU.

The first of the aforementioned priorities was directed at co-financing from the EU assistance funds within the **PHARE 2000** programme. The European Commission and the ECB reacted positively to the project. These included: central-banking issues, concerning, *inter alia*, the adjustment of payment, accounting and reporting systems to standards in force in the EU, and also of the IT system, the processing and presentation of statistical information, and alignment of health and safety work regulations and professional risk to the ESCB requirements. Moreover, the assistance funds are to be used for: the improvement of a monitoring system of cross-border capital movements in the field of portfolio investments; the establishment in the NBP of an internal control system and of internal audit according to EU standards and for the completion of preparing regulations on the banking sector within the range necessary for Polish banks and banking supervision operation in the conditions of the single European market.

The above NBP project was accomplished within what is termed a **twinning covenant** with the involvement of EU central banks, led by La Banque de France, with Banca d’Italia as the co-operating bank. The twinning covenant was signed on 12th July 2001 while the undertaking of the project entitled “The Adjustment of the National Bank of Poland to Operation within the European System of Central Banks” was started in September 2001 and lasted until June 2003.

1.2. Activities within the NBP

The establishment of **co-operation between the NBP and the ECB** in July 1999 was one of the decisions intended to effectively align the Polish banking system to the EU requirements. It includes various central-banking issues: harmonisation of the legislation, implementation of the monetary and the exchange rate policies, maintaining financial stability, adjustment of the payment systems, statistics and banking supervision to standards in force within the ESCB. This co-operation is manifested primarily in working contacts between NBP experts and ECB experts, in particular on

legal issues. A complex co-operation between the two banks was started in 2001, manifesting itself in a precise defining by the NBP of problems that would be the subject of consultations and training (at length in section 9).

The NBP attaches a high importance to the adjustment activities. In September 1999 the NBP Management Board adopted *The NBP Work-Plan for the Years 2000 to 2002*, in which the objectives directly and indirectly connected with the process of integration were specified. **Direct objectives** include: the elaboration of a 3-year convergence plan in the field of price and interest rates stability; the adjustment of monetary policy instruments to standards in force in the ESCB; the identification of work on the Polish version of RTGS system; the preparation of a team of staff members for direct co-operation with the ECB. **Indirect objectives** consist of: the introduction of regulations on a consolidated supervision and the working out principles of co-operation in exchange of information between the General Inspectorate of Banking Supervision (GINB) and the domestic and foreign supervisory agencies, the evolution and introduction of a model of internal control within the NBP, the completion of the automation of accounting and reporting activities.

The main NBP objectives (i.e. **monetary stability, financial system stability, initiation and carrying out of scientific research, educational activity, improvement of customer services, improvement of bank management**) were determined in the *NBP Work Plan for 2002 to 2004* adopted in November 2001. They are connected both with the process of Poland's integration with the EU and with other external factors (globalisation, growth of world economy) and internal conditions (excess liquidity in the banking sector, fiscal policy, and structural reforms). The order of individual task accomplishments and the choice of measures to carry them out result both from the necessity of meeting the formal requirements imposed on the NBP (e.g. technical readiness for membership of the ESCB) as well as from the pace of the adjustment to selected standards in other institutions (e.g. budgeting).

- The first objective – **monetary stability** – results from the obligation imposed on the NBP to obtain technical readiness for ESCB membership by 31st December 2002. An improvement of the quality of analyses and forecasts worked out at the NBP was necessary to accomplish this objective. Because of that it has been assumed in the *Plan* that the work on studying the mechanism of monetary policy transmission, building a base of economic knowledge and working out a system of data collection from non-bank financial institutions will be continued at the NBP between 2002 and 2004. Moreover, the *Plan* took into account the necessity of the NBP achieving readiness to collect and transfer statistical data to the ECB – according to specified standards (at length, section 6). Having regard to Poland's future membership of the EMU there is an assumption in the *NBP Work Plan for the Years from 2002 to 2004* that the NBP will continue the work on the adjustment of monetary policy instruments to ESCB standards and on the adjustment of macroeconomic forecasting to ECB practice. In addition, a 3-year convergence plan was worked out at the NBP, connected with the criteria for price and interest-rate stability and with the alignment of investment practices to EU standards in the field of management of foreign exchange reserves.
- The *NBP Work Plan for the Years from 2002 to 2004* assumes that the accomplishment of the next adopted objective, i.e. **financial system stability** – from the point of view of the process of European integration – will consist of the adjustment of Polish legislation to standards in force in the EU in the field of payment systems and prudent-operation regulations and the preparation of a settlement system compliant with the EU standards and ECB requirements.
- In the field of **initiation and carrying out of scientific research** it is planned to modify the analytical instruments of the NBP to be consistent with the methodology used in the ESCB. Analyses of Central-Eastern Europe countries' economies are also developed as a subject of NBP specialisation within the ESCB.

- In connection with the process of European integration **NBP educational activity** focuses on campaigning for information on the EU and the EMU. This aims to disseminate reliable information on the rights and duties resulting from Poland's future membership of the European structures.
- **The improvement of bank management**, i.e. principles of its operation within the NBP and the training of staff for work in the ESCB consists of: the adjustment of the principles of NBP accounting and financial reporting to ESCB standards, the finding of solutions to perform internal checks and audits according to ESCB standards, as well as the preparation of a staff team for direct co-operation with the ESCB and supervisory institutions.

Units operating within the NBP structure (**commissions, committees**) have also been established to **co-ordinate the adjustment activities** undertaken at the NBP. In co-operation with NBP departments, they work in individual areas, e.g. within the monetary policy, payment systems, banking supervision, statistics, and legislation.

For example, the **Commission for Identifying and Performing Responsibilities Associated with the Introduction of the Euro** was established in the NBP in June 1998 in connection with preparations for the introduction of the euro in the EMU. Its tasks included the identification of potential problems for the Polish banking sector in connection with the introduction of the euro currency. The commission accomplished its short-term tasks and completed its activities before 1st January 1999, i.e. the date of the euro introduction. Long-term and continuous tasks were handed over to the **Committee to Prepare the NBP for European Integration**.

- **The Committee to Prepare the NBP for European Integration** started its operation in October 1998, chaired by the President of the NBP and terminated its activity at the end of March 2002. The Committee was established to co-ordinate activities within the NBP, aimed at preparing the Bank for EU membership. The Committee was a consultative body, recommending to the NBP Management Board decisions to be made on issues connected with European integration. Its tasks included, the assessment of developments within the EU from the point of view of the central bank, the initiation and assessment of actions to prepare the NBP for EU requirements, the monitoring of the ECB work in the context of future NBP membership of the ESCB, the evaluation of the effects of euro introduction for the Polish banking system, as well as the analysing of the course and the effects of the negotiation process in areas that relate to the NBP.

In November 1999 the NBP Management Board set up **interdepartmental groups of experts** for each negotiation area, in which the NBP was involved.

- The Interdepartmental Group of Experts on Economic and Monetary Union,
- The Interdepartmental Group of Experts on the Free Movement of Capital,
- The Interdepartmental Group of Experts on the Liberalisation of Short-Term Capital Movements,
- The Interdepartmental Group of Experts on the Freedom to Provide Banking Services,
- The Interdepartmental Group of Experts on the Protection of Bank Customers,
- The Interdepartmental Group of Experts on Finance and the Budgetary Matters,
- Group of Experts on Statistics.

These groups of experts were to be responsible for the work connected with the integration or for participation in such work on behalf of the NBP until the date of EU membership. They were established because of the need to increase the pace of preparation of the documentation necessary for the negotiations and to intensify co-operation within the process of harmonisation and implementation of the Community legislation in the domestic legal system. Members of expert groups participated in the work directed towards producing the negotiation documentation, carried out by inter-ministerial task groups. Moreover, they

took part in the consecutive phases of *screening* and in the negotiation discussions, analysed issues connected with a given negotiation area, as well as where to identify and advise of potential problems and threats that could affect the proper execution of NBP tasks. There were many occasions where the scale of the problems that emerged was beyond the competence of individual experts, departments handling a specific issue, or even the central bank - which in the negotiation process co-operates with the Ministry of Finance, and also with the Ministry of Economy, the Central Statistical Office, the Office for Competition and Consumer Protection, the Office of the Committee for European Integration. Because of these problems, and owing to the fact that the negotiation process had reached the phase where such active NBP involvement is no longer needed, the interdepartmental groups of experts were disbanded at the end of 2001.

2

The Adjustment of NBP Monetary Policy Principles and Instruments to ESCB Requirements

2.1. General comments

In the period from 1990 to 1997 the NBP was using the **concept of so-called intermediate targets** in the achievement of the basic (final) target of the monetary policy – intermediate and operating targets existed apart from the final target. This approach originated from a belief, commonly held until the mid-nineties, that the central bank, designing **price level stabilisation as the overriding target**, within its current operations, should have intermediate targets, the attainment of which would ensure its influence on the accomplishment of the final target. The breakthrough events for the formation of the monetary policy in Poland were the implementation of the Constitution of the Republic of Poland of 2nd April 1997 and the passage of the new **Act on the NBP of 29th August 1997** (taking into account the constitutional provisions).

The basic principles of the state monetary policy are regulated by **Art. 227 of the Constitution**, establishing the National Bank of Poland as the central bank of the state, responsible for the value of the Polish zloty. **Art. 3 para. 1 of the Act on the NBP** specifies this definition, stipulating that the basic objective of NBP activity shall be the maintenance of price stability and at the same time the support of Government economic policy, insofar as this does not constrain the accomplishment of the basic NBP objective. The entering into force of the Constitution and of the Act on the NBP enabled a significant institutional reform and a change in the monetary policy decision system, including the setting up of a new collective decision-making body – the **Monetary Policy Council (MPC)**. The NBP independence is expressed in the fact that the MPC is vested the exclusive right to establish targets (*goal independence*) and to select instruments (*instrument independence*), thus to shape and implement the monetary policy. From its inception the MPC made numerous important decisions, like the broadening of the trading range for the zloty exchange rate, the reduction of the pace of zloty devaluation, and the moving of the focus on the interest rate policy and the changing of the principles of open market operations.

In the *Medium Term Strategy of the Monetary Policy* the MPC determined that **reduction of the inflation rate below 4%** (as measured by the CPI) by 2003 should be a **medium-term target** of the monetary policy. This target is being achieved in stages – by the accomplishment of short-term annual targets. The experience so far in the implementation of the *Medium Term Strategy of the Monetary Policy* indicates that supply shocks strongly affect the inflation level in the short term. Because of this the MPC emphasises that the medium-term target be given priority over annual targets. Despite deviations from short-term targets significant progress was made in the process of de-inflation. This will enable the accomplishment of the medium-term target and the approaching of the level ensuring the possibility of meeting the Maastricht convergence criteria with respect to inflation levels and interest rates. The introduction of a direct inflation target (DIT) and the floating of the zloty exchange rate should allow Poland to make a smooth transition into the ERM2 exchange rate mechanism and then to join the EMU.

2.2. NBP Monetary Policy Instruments

Pursuant to the Act on the NBP and to the existing procedures, the central bank has put in place a series of instruments that correspond with the needs of implementation of the

monetary policy guidelines. The NBP has been monitoring the banking system using a classic triad of instruments: reserve requirement, open market operations and lending-deposit operations. The importance of individual instruments has varied according to the development of market conditions.

2.2.1. Reserve requirements in Poland

The reserve requirement has been in place in Poland since the introduction of a two-tier banking system in 1989 – when nine banks, operating according to commercial principles, separated from the NBP. From the beginning the reserve requirement was an instrument used by the central bank to influence the money supply. Moreover, it was an instrument for depositors' funds protection. Since the introduction of an averaged system it was primarily used to stabilise short-term interest rates in the inter-bank market.

Since 1990 the NBP allowed part of the required reserves to be held in the form of vault cash at commercial banks. Until 1994 the reserve requirement was not averaged during the reserve period and each day banks had to maintain the required amount of funds on account. The **averaged system of reserve requirement** came into force only on 13th August 1994. Regulation No 9/94 of the President of the NBP provided for the possibility of using the reserve held on the account for current settlements, provided that the actual reserve, as an arithmetical average of the balances of funds on the reserve accounts, shall not be less than the reserve requirement. This system imposed on the banks a requirement to show a specific average balance of required reserves during a holding period of around a calendar month. This substantially changed the situation in the inter-bank market, in particular in the periods of tax payments. Formerly, prior to the introduction of averaging, the market was losing liquidity had a greater tax payment occurred, inevitably causing an increase in interest rates of inter-bank loans and hence destabilising the market. As a positive result of the change of the rules governing the required reserve held, the banks obtained access to a way of funding temporary shortages of liquidity.

Starting from 1989, the reserve requirement was computed on the basis of the total deposits as at the end of month. Starting from October 1994, the reserve requirement was based on averaged deposits of three periods, i.e. the tenth day, the twentieth day and the last day of each month. February 1999 saw the introduction of yet another modification to the reserve computation base, whereby the reserve requirement is computed on the average total deposits as at the end of each calendar day.

Pursuant to Art. 39 para 4 of the Act on the NBP of 29th August 1997 the funds held on the required reserve account do not earn interest.

Since the beginning the **required reserve ratios** were relatively high. This was connected with the necessity to absorb high surpluses of liquidity from the banking sector. A substantial reduction of the required reserve ratio (on average, from 12% to 5% for all deposit types) was made in 1999. The liquidity released in this way was absorbed by the **issuance of NBP bonds**. For commercial banks the burden of reserve requirements declined from September 1999 and the required reserve ratio shall be expected to fall gradually to the level in force in the European System of Central Banks. Since 28 February 2002, the required reserve rate has been reduced to 4.5%. With that, the option to hold a part of the required reserve as cash in the vaults of the banks has been terminated. The change did not affect liquidity of the banking sector. The process of continued reduction of the required reserve will be dependent on the conditions of monetary policy implementation.

2.2.2. Open market operations in Poland

As in other countries the open market operations became the **main instrument of NBP monetary policy**.

The **issuance of NBP money-market bills** in 1990 was the first form of open market operations. Reverse operations (repo and reverse repo) were introduced to the NBP instruments only in 1993, when the inter-bank deposits markets was sufficiently developed. The NBP had the possibility of performing

both the **operations supplying** the banking system with liquidity and the **absorbing operations**. After some time, because of increasing liquidity of the banking system, the supplying operations were stopped. The last operation of this type (*repo*) was made on 27th January 1995. Since that time, the central bank has been only performing operations to absorb liquidity from the banking sector.

The **taking by the NBP of deposits from the public** in the period September – December 1997 was an atypical instrument, included in Poland with open market operations. The disturbances in the transmission mechanisms were the cause, resulting from the commercial banks' eagerness, in conditions of over-liquidity, to excessive credit expansion. The taking of deposits resulted in a significant increase of deposit interest rates at commercial banks, consistent with the intention of the central bank. At present the NBP has got no legal capability to take deposits from natural persons. Instead, the central bank may issue and sell securities to the public (*so-called valuable bills*); however, this instrument has not been used so far.

At present the NBP may use the following types of open market operations:

- absorbing operations (reverse sale of Treasury bills, outright sale of Treasury bills, outright sale of Treasury bonds, issuance of NBP money-market bills),
- supplying operations (reverse purchase of Treasury bills, outright purchase of Treasury bills, outright purchase of bonds¹).

Despite the existence of a quite wide range of instruments the issuance of money-market bills of 14-day maturity is the main type of operation employed at present by the NBP. At present, operations supplying liquidity to the banking system are not used due to the surplus liquidity maintained within the banking system. In addition, the operation of reverse or outright sale of Treasury bills by the NBP could not be carried out due to the lack of Treasury bills within the NBP assets, these only being purchasable within open market supply operations, which does not in point of fact apply - the financing of the Budget deficit by the NBP, including the purchasing of Treasury securities directly from the issuer, is forbidden by the Constitution of the Republic.

Since September 2000 the NBP has been selling Treasury bonds from its portfolio. Those are the bonds acquired within the operations of conversion of prior Budget debt to the NBP, which was carried out in two stages: in September and in December 1999. The sale of converted bonds is a structural operation, aimed at the reduction of banking system over-liquidity.

In accordance with the Resolution adopted by the Monetary Policy Council No. 1/2002 of 29 January 2002, basic operation, the issue of the NBP money-market bills of 28-day maturity (and with a 14-day maturity starting from 1 January 2003²), is performed on a systematic basis every Friday. The volume of issue on a given day set on the basis of the state of the market and the settlement of the banking system liquidity prepared by the Domestic Operations Department of NBP and approved by the NBP Management Board, is the main determinant of those operations' scale. Since the setting up of the MPC in 1998 the so-called reference rate was introduced, fixing the minimum yield of 28-day money-market bills. Since January 2003, the reference rate fixes the minimum yield of 14-day money-market bills. The volume issued on a given day is set on the basis of the state of the market and the settlement of the banking sector liquidity. The size of issue suggested by the central bank is advised to the public on the NBP page in the Reuters news service. The money-market dealers and the Banking Guarantee Fund may purchase the money-market bills on the primarily market, while only domestic banks may purchase money-market bills on the secondary market.

2.2.3. NBP lending-deposit operations

The NBP lending operations were of crucial importance in the centrally planned economy and at that time provided the main source of supplying the central bank branches with funds. From the start of the transformation of the banking sector the role of refinancing loans extended by the NBP

¹ On 3 April 2003, NBP redeemed bonds of nominal value of PLN 5.27 bn. before their maturity. A part of required reserve on deposit was converted into the bonds in 1999.

² Resolution of the Monetary Policy Council No. 20/2002 of 17 December 2002.

to commercial banks was progressively diminishing. Loans connected with financing central government investment projects are the most significant item within the refinancing loans extended by the NBP. However, they are already at the repayment stage and the NBP does not intend to provide loans of this type in future.

At present the role of lending-deposit operations consists in smoothing short-term, in particular one-day (O/N), fluctuations in the inter-bank market interest rates. This objective is achieved through lending-deposit operations, initiated by commercial banks: lombard loans and end of day deposits (deposit facilities). Interest rates used in the lending-deposit operations set the corridor of one-day fluctuations of interest rates in the money market.

The Lombard interest rate in principle fills the role of the maximum rate, specifying the cost of raising money for the shortest period in the inter-bank market. The deposit rate sets the lower limit of short-term fluctuations of inter-bank market interest rates. This rate determines the price offered to banks by the central bank for placing by them a one-day (O/N) deposit at the NBP.

2.3. The Adjustment of NBP monetary policy instruments to the ESCB requirements

After joining the European Union Poland will use the so-called *derogation principle*, consisting of participation in Stage 3 of economic and monetary integration, but without adopting the single euro currency. The NBP will become a member of the ESCB³, however without the right to participate in the decision-making and in the creation of the single monetary policy.

The efforts to enter the single currency area and the Eurosystem⁴ impose on the applicant country a duty to meet specific quantitative conditions in the form of the Maastricht criteria. At the same time technical adjustments are being carried out, aimed at the preparation of appropriate procedures and infrastructure to the efficient joining of and then operation within the uniform structure of the Eurosystem. **The harmonisation of monetary policy instruments is the key component of technical adjustments.**

2.3.1. Conditions

The process of adjusting the NBP instruments to the ECB standards depends on two basic factors:

- the scale of over-liquidity in the money market and the pace of its reduction,
- legal conditions (amendments to certain provisions in the Act on the NBP).

It should be emphasised that the pace of adjustment of individual NBP instruments to the ECB solutions takes into account the specificity of the domestic market and not only the need for technical convergence. These changes should increase the effectiveness of the domestic financial markets and lead to the improvement of monetary policy transmission mechanisms.

Basic differences between the NBP and ECB instruments result from the fact that there is a structural shortage of liquidity in the Eurosystem. This results in a domination of operations supplying the banking system with liquidity and in the strong dependence of commercial banks on refinancing at the central bank. Because of the fact that **the NBP has been operating in conditions of over-liquidity in the money market**, those instruments have a different form than those used by the ECB. This is reflected in the type and direction of performed open market operations and in the system of reserve requirements.

³ The ESCB include the ECB and all EU national central banks (15 NCBs). It has no jurisdiction in the field of the single monetary policy.

⁴ The Eurosystem consists of the ECB and 12 national central banks that have adopted the single euro currency. The single monetary policy is implemented in the territories of those states.

The use of monetary policy instruments by the NBP in such form, as is the case in the euro area, is impossible in conditions of over-liquidity. A surplus of liquidity means that banks are not interested in central bank refinancing. The NBP – wishing to maintain the influence on the development of market interest rates – has been carrying out operations aimed at absorbing liquidity.

This does not mean that a country cannot enter the single money market with over-liquidity, this theoretically being possible. The money market of the euro area is deep enough and the scale of liquidity shortage high enough that the market can absorb the liquidity of a single (national) market. A lot also depends on the size of that over-liquidity. As provided for in “The Monetary Policy Strategy after 2003”, the NBP will aim at unification of the open market instruments with their Eurosystem equivalents; however, the selection and rate of adjustment will be dependent on market conditions and, in particular, on the scale of liquidity in the banking sector. Commercial banks play a significant role in this process. So far they are accustomed to surplus liquidity in the market and to the sterilising operations carried out by the NBP. A sudden and single change at the moment of entering the euro area would expose those banks to “shock therapy”. A gradual introduction of new instruments in the domestic money market would be beneficial for effective harmonisation, enabling the banks to align their procedures to the new conditions and to the new type of contacts with the central bank. The preparation of the NBP for operating in different conditions and the use of new instruments is only one side of the problem – the other point to be considered is the commercial banks’ readiness to participate. Banks will be allowed a period of time to adjust their procedures.

For the above reasons, the **work on the reduction of liquidity sources** and on the absorption of part of the already existing surplus of money in the market **was considered as priority**.

Since 1999 the NBP has been undertaking numerous actions aimed at the reduction of the main source of liquidity creation, which was the increase of gross official reserves. This objective has been accomplished by a **gradual shift in the exchange rate policy**, consisting of the widening of the band of zloty exchange rate fluctuations, the liquidation of the fixing mechanism in force and a halt to direct intervention in the foreign exchange market. These activities were crowned with the change of the exchange rate regime – the introduction of a floating rate of exchange in April 2000. The central bank did not intervene in the foreign exchange market and the zloty exchange rate was developing under the influence of mutual relationships between supply and demand in the domestic foreign exchange market.

In the situation of the floating exchange rate the official reserve assets (formerly gross official reserves) are no longer an important factor causing changes in the domestic money market liquidity. An agreement by and between the Ministry of Finance and the NBP on the opening and operating by the NBP of a foreign currency account of the MF additionally contributed to the solving of the problem. The agreement provides that this account is credited with funds in foreign currencies from privatisation, designed to execute foreign payments by the State Treasury. The Ministry of Finance can also use draw the funds accumulated in this account for the purposes other than foreign debt servicing. The establishment of a MF foreign currency account with the NBP was aimed at avoiding substantial fluctuations of the exchange rate, caused by an inflow of funds from abroad in connection with privatisation contracts of the State Treasury. At the same time this results in the reduction of the balance of NBP foreign exchange operations with commercial banks, as part of funds to repay foreign liabilities is held in the foreign currency account.

The **conversion of non-negotiable liabilities of the State Treasury to the NBP into negotiable securities** was another step towards the liquidity reduction in 1999. These securities were in turn sold to the banking sector within open market operations. The outright sale of bonds was expected to allow absorption of liquidity from the market in the long term. However, the success of the operation and the reaching of a state of liquidity deficit in the market were difficult. The obligations to purchase foreign currencies by the NBP from the State Treasury continued to be the basic source of liquidity. The Government did not hold all foreign currency receipts on the foreign currency account – a part was sold to the NBP.

2.3.2. The direction of changes within the NBP monetary policy instruments

Reserve requirements

The system of reserve requirements in Poland, like in other EU candidate countries, substantially differs from the European system. The necessity to reduce the scale of over-liquidity in the domestic money market meant that the required reserves ratio is higher than in the Eurosystem and the funds do not earn interest.

Basic changes which require adjustment of the reserve requirement parameters to the Eurosystem standards include:

- a reduction of the required reserves ratio to 2%,
- applying interest to the funds held by banks in accounts with the NBP,
- changing the method of reserves calculation – on the basis of the balance of specified liabilities as on the last day of the month,
- the ending of allowing the holding of part of required reserves in the form of vault cash at banks,
- changing the period of reserve holding,
- excluding deposits with maturity dates longer than 2 years from the basis of required reserves calculation,
- introducing 0% ratio for reserves calculation on *repo* operations.

The first two changes are the most important ones, consisting of the reduction of the required reserves ratio and the introduction of interest on the reserve funds. These changes are particularly important not only because of the adjustment to the Eurosystem requirements, but also for the competitiveness of the Polish banking system with foreign banks.

The changes are planned to be distributed in time because their introduction in one move would be connected at the present stage with significant costs to the NBP and then to the State Budget. They require also appropriate legislative actions – the amendment to the Act on the NBP.

Open market operations

Differences between the open market operations system in the NBP and in the Eurosystem result from the over-liquidity in Polish banking system. Therefore the NBP does not use short-term (14-day) and long-term (3-month) refinancing operations but conducts only absorbing operations.

Nevertheless open market operations are and will remain the basic instrument enabling the central bank to respond in a flexible way to changes in the liquidity of the banking system and to interest rates fluctuations in the market. Because of the over-liquidity in the market the central bank has been performing only holding operations, consisting in the issuing of 14-day NBP money-market bills. However, there is a possibility to perform operations similar to the basic refinancing operations within the Eurosystem (2-week operations) and short-term fine-tuning operations.

Within its long-term operations the NBP does not exclude the use of longer maturities instruments. Because of over-liquidity these may include the issuance of NBP money-market bills. If those operations had a 3-month maturity and auctions for them were to be organised in a regular way, then they could be regarded as equivalent to 3-month ECB operations (longer-term operations). However, because of over-liquidity, they would continue to be absorbing operations.

The NBP has also been performing outright sale operations (the sale without simultaneous repurchase agreement) – at present of converted Treasury bonds. These correspond with the ECB structural operations. These operations were carried out until the portfolio of those bonds is expended i.e. 2nd half of April 2003.

Lending-deposit operations (standing facilities)

Lombard loans

Lombard loans in the NBP play the role of a *standing credit facility*. At the request of a commercial bank the NBP extends a lombard loan, collateralised with Treasury securities. All banks with adequate collateral may participate in those operations. With the harmonisation with the ECB system, since April 2000 the time period for the lombard loan was shortened to 1 day (O/N), like in the euro area. The lombard rate sets the ceiling for market interest rate fluctuations, being the marginal cost of raising money in the market.

End of day (O/N) deposits

In December 2001 an end of day deposit was introduced in the NBP. Art. 51 of the Act on the NBP provided the basis to introduce this instrument. If at the end of day a bank has free funds, it has an opportunity to place one-day (O/N) deposit with the central bank. This instrument allows the absorption of surplus liquidity.

The NBP assumptions of the regulations on end of day deposits are convergent with ECB assumptions and are as follows:

- 1) all banks having current accounts with the NBP may access the deposit;
- 2) time of deposit placing – before the end of business day; time of repayment – the beginning of the next business day;
- 3) a deposit earns interest according to a predetermined rate, lower than the reference rate; in this way the lower limit of interest rate (O/N) changes in the money market is set automatically;
- 4) deposits placed by commercial banks with the central bank do not require collateral from the central bank (the working out of procedures. The instrument was introduced on 1 December 2001).

Pursuant to the Act on the NBP in force NBP lending operations may be guaranteed (backed by collateral) only by Treasury securities. This provision limits the scope of eligible collateral within the open market and lending operations as compared to collateral recognised in the Eurosystem.

The bill amending the Act on the National Bank of Poland, approved by the Council of Ministers on 12th December 2000 and sent to the Sejm on 8th January 2001 introduced a change in Art. 48 para. 2 of the Act on the NBP connected with the list of collateral for open market operations carried out by the NBP. The term “Treasury securities” was replaced with “securities”. This provision complies with the provision of Art. 18.1 of the ECB/ESCB Statute. The implementation of this provision will create a possibility to expand the list of eligible collateral for NBP refinancing operations, when the conditions in the domestic financial market allow it.

2.3.3. *Interest rates policy*

Within the euro area the ECB determines the range for O/N interest rates by its interest rates: the marginal lending rate, the repo rate and the deposit rate.

Because of the forecast direction of NBP interest rates evolution it is possible that the current NBP reference rate is no longer a useful instrument for determining the level of interest rates in the deposit market. However, it has retained the role of an instrument giving notification of the current direction of NBP policy. The reference rate determines the present minimum interest rate on basic open market operations.

It seems that the function of the lombard rate will remain unchanged and it will be the limiting cost for commercial banks to raise money from the central bank.

To determine the lower limit of interest rates fluctuation in the inter-bank market the NBP introduced the **deposit rate** of the central bank. Providing the banks with a possibility to place a surplus of funds at the end of the clearing day (introducing *standing deposit facilities*) allows the “control” of the O/N rate. The lombard rate and the rate of end of day deposit placed with the

central bank are automatically the upper and lower limits of one day (O/N) deposits fluctuation in the inter-bank market. So the O/N rate fluctuations are restricted to the range defined above. In the future, the weighted average of O/N rates may become a rate declared officially by the NBP at the end of the clearing day – as the EONIA rate in the euro area.

In the case of achieving a state of operational shortage of liquidity in the banking system, only the direction of the basic refinancing operations would change. Commercial banks would refinance at the central bank within e.g. 14-day operations (and 7-day operations in the future, in accordance with the objectives of the European Central Bank for the 1st quarter 2004⁵). That would make the in place operational system closer to that currently in force in the Eurosystem.

2.3.4. Summary

In the pre-accession period the harmonisation of NBP monetary policy instruments with Eurosystem instruments is becoming increasingly important. After Poland joins the European Union the NBP will become a member of the ESCB. At this stage the adjusting actions within the procedures and technical parameters of individual instruments will have to be finalised, so that at the moment of entering the euro area (2 years after joining the EU, at the earliest) the NBP and Polish banks could effectively join the common monetary policy of the Eurosystem. In this context it seems legitimate to **adapt European solutions well in advance**, to the extent of taking into account the current conditions of the Polish market. The aim is to allow the required changes to be implemented in time. This is particularly important in respect of the fact that the adjustments refer not only to **internal changes within the NBP**, but also require **legislative changes** (e.g. in the Act on the NBP). Some of those adjustments will result in substantial costs for the NBP (as in the case of reserve requirements) that will affect earnings and contributions to the Budget.

The adjustments of commercial banks are also important. It is vital that the NBP is able to adjust the instruments well in advance, providing the banks with an incentive to change their procedures and at the same time establishing conditions similar to those that they will encounter in the common euro market. This will give them time for appropriate adaptation, which is important for the process of monetary policy transmission.

⁵ In accordance with the material of the European Central Bank "Public Consultation. Measures to Improve the Efficiency of the Operational Framework for Monetary Policy", October 2002

3

The NBP exchange rate policy in the process of Poland's preparation for membership of the EMU

3

3.1. The NBP objectives and tasks

The statutory objective of the NBP is to ensure a stable value of domestic currency, which in practice means maintaining the rate of increase of the price index as low as possible. The accomplishment of this objective is a condition of Poland's membership of the EMU. Only an adequately low inflation level will meet the Maastricht criterion connected directly to the inflation rate. The meeting of the criterion on interest rate levels depends also on the reduction of the rate of price growth and on convincing market participants of the durability of the achieved stabilisation. This in turn is connected with the acceptability of the economic policy and with the credibility of the central bank in particular. However, the relationship between the NBP objective – low inflation – and interest rates, especially long-term interest rates that are the subject of the criterion, is not direct and in certain conditions may be relatively loose. Moreover, a low inflation rate is an essential condition for the maintenance of a stable level of the nominal exchange rate, which is the subject of another Maastricht criterion. However, this relationship is even weaker than in the previous case – even permanently low inflation and credible, future low inflation is not a sufficient mechanism but is regarded as a necessary condition to maintain a stable exchange rate.

It can therefore be seen how important it is to determine a monetary policy direction from the point of view of aspirations to EMU membership, including primarily the establishment of a relationship between the inflation target and the exchange rate target. In other words – it is important to specify the character of an exchange rate policy and its place within the monetary policy.

The NBP monetary policy is carried out in conditions of substantial liberalisation of capital transactions of the balance of payments.

Summing up, it may be stated that further **reduction of the inflation rate**, being the main statutory responsibility of the NBP, is the **basic NBP task** in the process of preparation of Poland's economy to the EMU membership. So the exchange rate policy shall be carried out in such a way as to serve as efficiently as possible the **stabilisation of price level** via monetary policy. In the period directly preceding the accession to the EMU the issue of exchange rate stability will, however, become more important and will become an equivalent target of monetary policy. The implementation of monetary policy in that period will also have to take into account its influence on the level of long-term interest rates.

3.2. The exchange rate policy evolutions

The present character of monetary and exchange rate policy was defined in the *Monetary Policy Strategy for the Period from 1999 to 2003* (hereinafter referred to as *Strategy*). It entails a programme of further quick **deflation** and the preparation of the Polish economy for membership of the EU and the EMU. A postulate of the periodic floating of the zloty before including it in the ERM2 system was formulated in the *Strategy* with reference to the exchange rate policy.

The solutions adopted in the *Strategy* result from the **evolution of the monetary and exchange rate policy** that occurred within the past decade. The NBP exchange rate policy was systematically modified in that period. Starting from January 1990 the zloty exchange rate was a **fixed rate**, initially set against the dollar, then against a basket of currencies. In October 1991 the system of a **crawling**

exchange rate against the basket of currencies was introduced; this system existed till May 1995. In that period the pace of crawling devaluation was reduced a few times; two corrective steps of devaluation of the zloty were also made. Such exchange rate policy managed the stabilisation of the price level (nominal *exchange rate peg*), however the objective of monetary policy was expressed in monetary aggregates. That was possible in conditions where the scope of liberalisation of capital transactions of the balance of payments was narrow, the volume of trade in zloty was small and only in the internal market, and the monetary policy was highly autonomous despite a tight control of the exchange rate level.

The increasingly wide opening-out of the Polish economy resulted in those conditions no longer being met. In particular since the beginning of 1995 the inflow of capital was increasing, tempted by high interest rates and the prospects of a stable exchange rate and even a revaluation. That caused problems with the simultaneous maintenance of the exchange rate at the assumed level (in this case counteracting the inflationary pressure to protect economic competitiveness) and with implementing the monetary policy according to the adopted objectives. Significant foreign exchange interventions and their neutralisation were necessary, however, which did not prevent the emergence of surplus liquidity in the banking sector. By 1995, stemming from these altered circumstances, the extant exchange-rate policy resulted in the monetary policy becoming costly and at the same time inefficient.

The operation of an autonomous monetary policy required changes to the exchange rate system, which occurred on 16 May 1995, when a 7% band of fluctuations around the **crawling central rate** determined against the basket of currencies was introduced. At the end of the year a one-off revaluation was also made. In the subsequent years the pace of interest-rate change was reduced and the band of fluctuation gradually widened, amounting to $\pm 15\%$ before the ultimate floatation. Changes in the exchange rate regime since 1990 are presented in the annex.

The above exchange rate policy had positive effects. The stabilising action of the *exchange rate peg* was utilised, destabilisation of the exchange rate and the forex market was avoided and, despite the very weak development of this market in the initial period, an appropriate level of Polish economic competitiveness – depending on the real exchange rate – was maintained. The subsequent relaxing of the exchange rate regime allowed – despite the increasingly wide opening-out of the Polish economy and the decreasing risk of investing in Poland – to retain an autonomy of monetary policy, to maintain its stabilising character and to continue avoiding the destabilisation of the forex market and sudden exchange rate fluctuations, even in the face of serious external shocks.

An important change in the way of defining the monetary policy objective occurred in 1999: the NBP adopted the strategy of direct inflation target. The adoption of direct inflation target was announced and justified in the *Medium-Term Monetary Policy Strategy for the Years from 1999 to 2003*; the necessity of a further increase of the zloty exchange rate degree of floating was also indicated. The **zloty exchange rate was finally floated** on 12th April 2000.

The zloty floating was a systemic change, crowning the consistently implemented strategy. It was achieved irrespective of the pressure of the payment situation and of the situation in the foreign exchange market. The zloty exchange rate was floating *de facto* earlier within a broad band of fluctuations and in conditions of the absence of foreign exchange interventions by the NBP since August 1998⁶.

3.3. The objectives and effects of the zloty floatation

The maintenance of exchange rate fluctuation limits meant that the monetary policy had two objectives, which potentially could be contradictory⁷. This could adversely affect the **credibility of the monetary policy** directed towards the **direct inflation target** or could result in the need, in response to market pressures, to change the exchange rate. The existence of the fluctuation band could also influence the formation of exchange rate expectations and thus indirectly affect

⁶ However, it shall be noted that till changing the principles of the NBP *fixing*, i.e. till 7th June 1999, the NBP was obliged within its framework to make deals with commercial banks.

⁷ In fact, at the beginning of May 2001 the zloty exchange rate against the basket would have violated the limits of the crawling band, determined according to principles directly preceding the floatation.

conditions of the monetary policy objective implementation (by movements of capital). So the floatation was to be conducive to an undisturbed formation of exchange rate expectations by market participants and due consideration of foreign exchange risks.

The conviction, that it is the only effective way of **determination of the level of the equilibrium exchange rate**, is the second reason for submitting the zloty to market forces. The knowledge of the equilibrium exchange rate will in turn be necessary to determine the zloty parity against the euro at the time of Poland's accession to the ERM2 system. In the *Strategy* it was expressed as follows: *"The introduction of a fixed exchange rate would have occurred (...) in defiance of the logic of gradual floating of the zloty exchange rate taken into account so far and could have postponed prospects of including the zloty in the ERM2 system, which should occur at the equilibrium rate, difficult to identify without the involvement of market forces. The use of a fixed exchange rate to a small degree guarantees the achievement of this objective"*.

The belief that the fixed exchange rate system would bring – in conditions of an increasingly open economy and increasing instability of global financial markets – a **risk of sudden exchange rate movements** on a large scale was the third reason to increase the flexibility of and the final floating of the zloty exchange rate.

The introduction of the floating exchange rate system shall serve a development of the zloty market, in particular of the derivatives segment. The introduction of **external convertibility of the zloty** at the beginning of 2000 was also very important in this case. A quick development of the zloty market within the international foreign exchange market has occurred since. The development of the domestic currency market creates conditions for its more efficient operation and constrains the susceptibility to shocks and attacks and hence contributes to the determination of the exchange rate level that reflects the situation of the economy in a better way and is more stable.

There is no doubt that the floating zloty exchange rate will **fluctuate substantially**. This results from the processes that will occur in the Polish economy during the next few years, specifically a **rapid increase of the productivity of the Polish economy** and hence the **improvement of its competitiveness** at a given exchange rate being the most important of them. It may be expected that in the next few years this process will continue to be significant. A higher pace of productivity growth in the sector of goods and services which are not the subject of international exchange (*the Balassy-Samuelson effect*) might be an additional factor connected with an increase in productivity and a strengthening in the tendency for zloty appreciation. However, it is difficult to verify this hypothesis empirically. A further **change in the structure of the Polish economy**, including also a change in the structure of **trade exchange**, is another factor that may significantly affect the exchange rate level in the coming years.

3.4. The development of an exchange rate policy in the future

EU membership will largely affect the payment situation of Poland and the zloty exchange rate in the future. This problem applies to many issues connected with **Poland's participation in the Union budget management**, including the level of membership contributions, the amounts of payments from structural funds, the shape of the common agricultural policy and the amounts allocated within its framework to Poland, the amount of direct payments to farmers. Poland's accession to the Union will also affect the balance of payments by an **increase of investment flow** to Poland. However, the amount of foreign investments may fluctuate strongly leading to the destabilisation of the zloty exchange rate.

Potential changes in the macroeconomic proportions of the Polish economy may be another process with a possible significant influence on the zloty exchange rate in a few years and on the further perspective. This primarily relates to the development of the relationship between domestic investments and savings, hence the **development of the deficit on the current account**. Because of the quick changes occurring in Polish economy the pace of change of spending and savings may be high and difficult to forecast.

The **character of fiscal and monetary policy** is of key importance in this respect. Firstly, a higher budget deficit implies commensurately higher expenditure (lower domestic savings) and a higher deficit on the current account, which may cause depreciation of the domestic currency. Secondly, a restrictive monetary policy through high interest rates constricts domestic expenditure, however, at the same time it leads to an increased inflow of capital. In the conditions of a floating exchange rate tightening of monetary policy results (*ceteris paribus*) in the appreciation and increase of deficit on the current account. It is desirable that **substantial changes occur in the nearest years within Polish fiscal and monetary policy** of the used policy mix. The hitherto policy mix features a high budget deficit and high real interest rates, which expressed the central bank's desire to achieve the inflation target despite the deficit in public finance and external shocks (e.g. increase of oil prices). It is difficult to consider such a mix as an optimal one. It means the maintaining of internal balance (the continuation of deflation) at the cost of the payment balance.

Only an autonomous reduction of domestic expenditure level, in particular public expenditure, allows the simultaneous achievement of a stable payment situation and low inflation without the need to maintain high real interest rates, which would be accompanied by an overvalued exchange rate of the domestic currency⁸. The National Bank of Poland, carrying out the monetary policy from the point of view of the adopted direct inflation target, recognises the consequences of the hitherto policy mix for the exchange rate and the payment situation and **postulates more radical cuts of the deficit in public expenditure**.

The **continuation of the privatisation process** is another factor that may affect the zloty exchange rate in the next few years. The sale of the few large enterprises that may be privatised and at the same time – because of their scale – affect the zloty exchange rate, is likely to take place within two years. However, the influence of this factor is diminished due to directing foreign currency inflows from privatisation to the **Government foreign currency account with the NBP**. The final effect for the exchange rate depends on the extent to which those funds are used for current spending and to which they are used for prepayment of Government foreign liabilities.

There is a mutual relationship between the payment situation – the deficit on the current account, its funding with the inflow of capital and the exchange rate level – and the relation of domestic savings and investments. The amount of capital inflow to Poland – in particular directly before and after the European Union accession – depends only partly on the economic policy. It is worth noting that if the reduction of the budget deficit may improve the balance of domestic savings and investments by decreasing the demand for foreign savings, then it may also reduce the risk perceived by investors and cause an increase of foreign savings inflow.

Current opinion is that capital investment will continue to flow into Poland for a long period of time, which will allow for quicker economic growth. However, that does not mean that it would be proper to accept the value of the zloty against the euro exchange rate – which would probably result from very high inflow of capital in the period directly preceding European Union membership – as the equilibrium rate. A high inflow of capital would be accompanied by a relatively strong zloty exchange rate and a high deficit on the current account. This deficit in turn – resulting not as much from the “suction” caused by a high domestic expenditure but from the “pumping” at certain level of domestic expenditure – could be seen as the negative influence of foreign trade on GDP creation, and thus on domestic savings (an adverse relationship between the pace of GDP and GNP growth would also reflect such a situation). That would make the growth of the economy dependent on the inflow of capital, the amount of which would not in the least have to be permanent. The decline of foreign savings “pumping” at a fixed exchange rate (in the conditions of a common currency) and a nominal rigidity of prices and wages would result in a necessity to cut domestic expenditure through a fall of revenue. Such a situation would result from adopting an overvalued parity of domestic currency, reflecting a high wave of foreign investments in the period preceding EMU membership.

⁸ The interest rates reduction without a previous autonomous drop in domestic expenditure (deficit in public finance) would mean the easing of anti-inflationary direction of the monetary policy and – to maintain the required risk premium – the depreciation of domestic currency, contributing to the creation of inflationary pressure.

It shall also be noted that significant **movements in the euro against US dollar exchange rate** are an important source of the **zloty against euro exchange rate fluctuation**. Although the European Union is the main business partner for Poland, the dollar retains a significant function as a transactional currency, at least for purchasing energy and fuels. It seems that the zloty / dollar exchange rate is also of great psychological importance and a more stable euro / dollar exchange rate would help to stabilise the zloty / euro rate.

3.5. Summary

To summarise this first section of the report it should be stated that – firstly – the **system of floating the exchange rate** was adopted to make possible the implementation of an autonomous monetary policy, aimed at curbing inflation at the assumed pace. Secondly, the system of a floating rate allows the **obtaining of a view on the equilibrium exchange rate** that could be the basis to determine the zloty / euro parity in the future. However, for correct determination of parity on the basis of market equilibrium exchange rate it would be necessary that the economy remains in a long-term internal and external equilibrium. Thirdly, the floating exchange rate allows **adjusting the rate to the current situation in the economy and its environment**. By such measures serious tensions in the payment situation, which could be a potential source of a currency crisis are avoided. However, we need to take into account the fact that the floating rate may deviate from the level of long-term equilibrium. A very high deficit on the current account, and then a currency crisis may occur also in this system.

The system of a floating exchange rate serves as the best preparation – at the current stage – for Poland's entry to the Economic and Monetary Union membership. EMU accession will require a prior **linking of the zloty exchange rate with the euro** within the ERM2 system for two years.

However, it seems that making such a decision should be preceded by a substantial reduction of the budget deficit, as a condition to achieve a policy mix necessary to maintain a macro-economic balance. Monetary policy preceding the fixing of the zloty exchange rate and the establishment of the parity, will ensure the NBP interest rate shall not permanently and significantly exceed the ECB interest rates. There is not even a problem of meeting the Maastrich criterion on interest rates, because it refers to long-term interest rates. The achievement of a low inflation rate through to high interest rates would be accompanied by a relatively high zloty exchange rate. The establishment of parity as a result of observations of exchange rate developed in such a way could lead then to a permanent overvaluing of the zloty. Joining the EMU under such conditions would lead to a poor competitive situation for Poland that could worsen as a result of inflationary phenomena connected with the introduction of lower ECB interest rates after joining the Economic and Monetary Union.

4

The adjustment of Polish banking law to accord with EU Requirements

4.1. The scope of legislative changes

The necessity to establish an efficient banking system adapted to EU standards determined the direction of changes in Polish banking legislation. The Polish team declared, in its relevant negotiating positions (Economic and Monetary Union, Freedom to provide services, Free movement of capital), a full adjustment of banking regulations by the end of 2002 (excluding the transition periods referred to in section 1.1.). In principle, the requirement of adjusting Polish law was fulfilled, save for a few exceptions, e.g. vis-a-vis the Law Banking Act and the Law on the National Bank of Poland. Therefore, upon the closing of negotiations on 13th December 2002, the representatives of the European Union acknowledged that the Polish law was brought into compliance with the *acquis communautaire*.

The NBP is playing and has played a specific role in the process of integration of the Polish banking system with the single EU financial market; it was vested not only the responsibility to ensure the stability and integrity of the entire financial system in Poland (*inter alia*, by adjusting the legislation) but also to perform internal institutional-structural changes that would ascertain the proper operation of the NBP within the ESCB.

The adjustment of legislation in the field of banking entailed the duty to amend the legislation in force or to pass new legislation. The legislative changes included basic law that establish the framework for the banking sector operation in Poland, such as the **Banking Act of 29th August 1997 (amended by the Act of 23rd August 2001 Amending the Banking Act and other Legislation)** and the **Act on the National Bank of Poland of 29th August 1997** (still at the stage of legislative work). Other laws crucial for Polish banking legislation, subject to adjustment to the Community regulations include:

- the Act on the Bank Guarantee Fund of 14th December 1994,
- the Act on the Mortgage Bonds and Mortgage Banks of 29th August 1997,
- the Act on the Operations of Cooperative Banks, Their Affiliation, and Affiliating Banks of 7th December 2000,
- the Act on Counteracting the Introduction to the Financial Circulation of Financial Assets Originating from Illegal or Undisclosed Sources and Counteracting Financing Terrorism of 16th November 2000,
- the Consumer Credit Act of 20th July 2001,
- the Foreign Exchange Law of 27th July 2002.

4.2. The Banking Act

The Banking Act of 29th August 1997 that is in force was evaluated after its implementation as “ensuring high compliance” with the EU regulations. This was confirmed by the European Commission’s opinion included in the *Avis* of 1997 and in subsequent *Regular Reports*. The act included, *inter alia*, provisions on: principles of licensing, own funds, risk-based capital ratio, limits for credit exposure and other debts, the acquirey of qualifying shareholdings, and access to confidential banking details.

Those provisions comply with the EU banking directives, included in what is known as the so-called codified banking directive (2000/12/EC). The introduction of the Community legislation provisions, that so far have not been covered by the Polish legal system, was the basic impetus for amending the Banking Act with the Act of 23rd, August 2001. The provisions of the amended act regulate such issues as:

- making declarations of intent on electronic data media,
- electronic money,
- control of bank shares transfer by the Commission for Banking Supervision,
- requirements set to banks' founders, establishment of banks and Polish banks' branches abroad, and position of branches of foreign banks in Poland,
- design of own funds and of supervisory prudential regulations (credit risk concentration, capital requirements),
- consolidated supervision,
- cross-border transfers,
- mutual netting of claims in case of insolvency,
- consumer credit,
- co-operation and exchange of information with domestic agencies of financial supervision and foreign banking supervisory agencies.

The main benchmark to evaluate the compliance, and then to fully adjust Polish banking law to *acquis communautaire*, was the codified 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. The act introduced also provisions of the Directive of the European Parliament and of the Council No 97/5/EC of 27th January 1997 relating to cross-border transfers and the Directive of the European Parliament and of the Council No 98/26/EC of 19th May 1998 relating to the finality of settlement in payment systems and in securities settlement systems. It introduces also a new, expanded catalogue of definitions and notions resulting from the Community law, e.g.: "financial institution", "credit institution", "electronic money", "ancillary banking services undertaking", "cross-border activity", "qualifying holding", "significant influence", "close links". The provisions of the amending act took effect in four stages:

- the main provisions took effect three months after the promulgation of the act, i.e. 7th January 2002,
- some provisions took effect on 1st January 2002,
- one provision took effect on 1st January 2003.
- still, some provisions – e.g. referring to the domestic performance of operations by a branch of a credit institution, a domestic bank in the area of EU countries business by the branch office of the loan institution in Poland or by a domestic bank in the area of EU countries or cross-border transfers in the amounts in excess of 50 000 EUR – will take effect on the day of obtaining by the Republic of Poland of the membership of the European Union.

The ensuring to credit institutions from EU countries the right to provide services within the scope determined in Annex 1 to Directive No 2000/12/EC was one of the more significant provisions of the amended act. From the point of view of the amended act provisions, the establishment of a bank abroad by a domestic bank and the establishment of a foreign branch of a domestic bank will require the authorisation of the Commission for Banking Supervision (CBS) only, and not as is the case up to date – of the Minister of Finance (in agreement with the CBS). This is consistent with Poland's commitment to a full liberalisation of capital movements before joining the EU. After joining the EU, domestic banks will be able to take up business activities in EU countries in the form of a branch or cross-border activity. Business start-up will only require a written notification

of the CBS, which within three months will transfer necessary information to the competent supervisory authorities of the host country. The obtaining of authorisation to carry out a banking business in Poland requires the meeting of conditions specified by the act: possessing funds to an amount not less than the equivalent of euro 5 million, and in the case of co-operative banks – at least euro 1 million. There are no legal-formal obstacles for foreign persons, which have obtained the CBS authorisation granted in agreement with the Minister of Finance, to establish in Poland a joint-stock bank, to be its shareholders or to establish a foreign bank branch or representative office.

The new act imposed on the CBS information responsibilities to the European Commission and also – in specified cases – the duty to seek opinion of competent supervisory authorities of EU member states prior to granting authorisation to establish a domestic bank. The Act also contains provisions on supervision over branches of credit institutions operating in Poland. The provisions of the amendment, aimed at the protection of stability of the country's financial system in the case of bankruptcy of a large financial institution, become especially important in the view of deepening mutual relationships in the financial sector. To this end provisions on the monitoring and control of large exposures and other debts concentration of credits institutions and consolidated supervision were included as well as problems connected with the application of the principle of netting in case of insolvency were eliminated.

Until the recent amendment to the Banking Act there was no legal act in Poland that would in a comprehensive way regulate the issues of consolidated banking supervision – like Directive 2000/12/EC. Only a few regulations were included in the Banking Act in force so far and in the Accounting Act and in the CBS resolutions. New provisions introduce a totally new category of “consolidated supervision”, applicable to a domestic bank, being the parent undertaking for another domestic or foreign bank, credit or financial institution or ancillary banking services undertaking. In addition this bank shall have so-called close links – defined in the aforementioned Act – with another entity (entities) and operate in a financial group or mixed-activity group. The exercise of consolidated supervision does not exclude the application of relevant provisions of the Act, that regulate the operation of a bank, as an entity subject to supervision on a solo basis. Because of that the introduction to the Act of provisions regulating the issue of consolidated supervision not only enables a full implementation of the aforementioned directive, but also increases the safety and stability of the Polish banking sector.

The work of interministerial team on yet another draft of amendment to the law Banking Act is under way. The amendments may be divided into three groups:

- statutory regulation of new developments in the banking system (outsourcing and securitisation of banking liabilities),
- provisions adjusting the Banking Act to the provisions of other acts (e.g. the Act on Electronic Signature, the Code of Commercial Partnerships),
- amendments absorbing the so far accumulated experience stemming from the application of the effective provisions (including e.g. provisions amending the Civil Code).

The draft also contains the provisions correcting the provisions of the act directly coming under the regulation of the Directive 2001/12 and solutions which aim at the implementations of the provisions of the Directive 2001/24 of EP and EC of April 4th, 2001. on the reorganisation and liquidation of credit institutions. Moreover, the draft provided for the amendments compliant with the requirements stipulated by the Basle Committee on Banking Supervision in 25 Principles of Effective Banking Supervision.

4.3. The Act on the National Bank of Poland

The Constitution of the Republic of Poland of 2nd April 1997 and the Act on the NBP of 29th August 1997 guarantee the relatively high independence of the NBP. In the light of their provisions the central bank is vested, *inter alia*, the exclusive right to issue the currency and to determine and implement the monetary policy, which annual guidelines are formulated by the Monetary Policy

Council. Personal independence of the NBP is ensured by provisions stipulating that the President of the NBP is appointed by the Sejm at the request of the President of the Republic of Poland. The term of office lasts 6 years and may be shortened only in statutory specified circumstances.

The *bill amending the Act on the National Bank of Poland* aims primarily at final adjustment of the NBP legal status to the Community legislation. The duty of full harmonisation of Polish regulations on the central bank with the Treaty on European Union and the Statute of the European System of Central Banks and of the European Central Bank, in particular in the field of institutional, personal and financial independence of the NBP (Art. 105 to 115 of the Treaty and Protocol No 3 on the Statute of the ESCB and ECB) was taken up as one of the conditions in the area "Economic and Monetary Union" during negotiations for Poland's membership of the EU.

The legislation work under way, aimed primarily at strengthening the central bank independence, is connected with the issue of the Government's representative attendance in the Monetary Policy Council meetings, the NBP financial management and an independent, external audit of the central bank. They are consistent with decisions and declarations made during the *screening*, as well as with those included in the Polish negotiation position in the area "Economic and Monetary Union". The necessity to perform the above adjustments was also confirmed by the European Commission in the "Regular Report on Poland's Progress towards Membership" for 2000 and 2001.

The draft amendment to the Act on the NBP continues to provide for the Government's representative attendance at the Monetary Policy Council meetings, without the voting right and without the right to submit motions to be considered by the Council. Because of the need to adjust the Act on the NBP to the Statute of the ESCB and ECB – the first deputy president of the NBP and the deputy president of the NBP are forecast to be vested the right to attend the MPC meetings, without the voting rights. In fact, Members of the ECB Management Board, being members of the ECB Governing Council, are responsible for the monetary policy. A similar solution is not possible in Poland due to provisions of the Constitution, however, the suggested change in the operation of the NBP directing bodies would adjust them in practice to the ESCB standards. Moreover, to strengthen the personal independence further, the introduction of a provision referring to the term of office of MPC members, and not of the Council term of office, was suggested.

Regulations on the NBP funds are changed to ensure full financial independence. The bill of the Act suggests the **liquidation of special NBP funds** and other special funds, for which the amount of annual charges had to be agreed with the Minister of Finance. The draft amendment forecasts that the funds for bonuses and awards for NBP staff will be determined in annual budgets, approved by the Monetary Policy Council, while the company social benefits fund will be subject to the provisions of a separate law.

Financial independence will also be strengthened by the **raising of the bank's registered equity** from 400 million zloty to 1,500 million zloty, as well as by **increasing the charge to the reserve capital** to a minimum 5% of the annual profit (previously 2%). After Poland's accession to the EU, the NBP shall transfer the share in the ECB capital, calculated according to the key adopted in Art. 29 of the Statute of the ESCB and ECB, and in the foreign exchange reserves of the ECB. Taking into account the existing criteria and assuming that the ECB capital will not be raised, the predicted **NBP share in the ECB capital** at the stage prior to the adoption of the euro would amount to **about EUR 13.2 million**, i.e. 5% of its (Poland's) total contribution (EUR 264m), according to the obligation imposed on countries remaining outside the euro area. The suggestion to increase the percentage share of the charge to the reserve capital results from the comparison of charges to similar funds of other central banks. The **NBP share in the ECB reserves** – prior to the adoption of the euro – is difficult to forecast at present, as pursuant to the Statute of the ESCB and ECB (Art. 30) it is possible to pay the foreign exchange reserves in instalments. The Polish team has submitted such a postulate in the negotiation discussions in the area on 'Finance and Budget'. It has been estimated that the total NBP share in the ECB reserves – after Poland joins the euro area – would amount to **about EUR 2.6bn**. The NBP is fully aware of the necessity to incur the above liabilities and is fully prepared for it.

The draft amendment to the Act includes a provision introducing the principle that the NBP accounting shall comply with the standards used in the ESCB. It has been determined that the calendar year will be a reporting (accounting) year. The requirement for the auditing NBP annual accounts to be carried out by an **external auditor** was also introduced; the external auditor who would replace the commission appointed so far by the Council of Ministers would be selected by the MPC. At the same time the Government's competence on approving NBP annual accounts has been retained.

To adjust NBP operations to tasks performed by central banks – the ESCB members (including also so-called “Member States with derogation”) – the draft amendment imposed a new task on the NBP of operating monetary and banking **statistics**, the balance of payments and the balance of foreign assets and liabilities of the state. The NBP shall provide this data after Poland's accession to the EU. It is also planned to introduce regulations adjusting the NBP operations to the ESCB and ECB functions and tasks in the area of **open market operations**, which are related not only to Treasury securities. The changes result from the pursuit of harmonisation of NBP monetary policy implementation methods with standards in force in the ESCB. The EU principles on responsibility of observing the secrecy of information protected on the basis of provisions on the protection of classified information and **banking secret** are also going to be introduced.

4.4. The Bank Guarantee Fund

The guarantee of **bank deposits** is a significant component in the construction of a secure banking system. The establishment of the Bank Guarantee Fund (BGF) contributed to the adjustment of Polish law to the EU standards. The Act on the Bank Guarantee Fund of 14th December 1994 (the last amendment was made in January 2001) specified its two basic functions. The first function is connected with the implementation of a **universal and obligatory system of deposit guarantees**, the second consists in the **provision of assistance to banks in the situation of their solvency threatened**. In addition, the Act introduced the principle of a uniform protection system of deposits held on accounts of natural and legal persons for all banks operating in Poland, irrespective of their ownership form. Such a system aims, *inter alia*, at providing an atmosphere where bank customers feel secure. Banks collect resources for the protection fund of guaranteed funds in the form of securities (issued by the State Treasury or the NBP). In case of need there is also a possibility to take a loan from the NBP. However, there has been no such need so far.

Frequent amendments to the above Act resulted from the necessity to adjust its solutions to Community law (primarily to the Directive 94/19/EEC on the deposit guarantee system), as well as were taking into account the needs of the developing Polish banking system. One of the last, basic adjustments was connected with the raising of the upper limit of the **amount guaranteed** at 90% (as of 1st January 2002 it is equivalent to EUR 18,000 and from 1st January 2003 it shall amount to EUR 22,500). Funds that on the basis of a final judgement were ruled as originating from criminal activity, e.g. from money laundering, have been excluded from the guarantee system. The new provisions obliged the banks included in the guarantee system to inform persons using their services on the bank's financial position, on the participation in the obligatory guarantee system and on the principles of its operation. The amended Act defined the “**date of funds inaccessibility**” as the date of the suspension of the bank's operations by the Commission for Banking Supervision (to date this was the date of the court declaration of bankruptcy). This is particularly important for customers of the bankrupted bank, because it shortens the time for waiting for the payment of guaranteed deposits. Moreover, pursuant to provisions of the Directive 94/19/EEC, regulations clearly separating the Fund from the state institutions were introduced to the Polish Act. The BGF therefore became a part of the safety system of Polish banking. In the case of declaration of bank bankruptcy the payment of guaranteed deposits is secure and the operation will be carried out quickly and with competence.

4.5. Mortgage Bonds and Mortgage Banks

The Act on the Mortgage Bonds and Mortgage Banks of 29th August 1997 is important legislation for the operation of the banking sector in Poland. It determines the principles of issue of, purchase, redemption, and security of mortgage bonds as well as principles of establishment, organisation, operation and supervision over mortgage banks that can be established as joint-stock banks only.

Rights and responsibilities of mortgage banks, operating in the form of joint-stock companies established in Poland do not discriminate between residents and non-residents, or banks other than the mortgage banks or bank branches. The rights and responsibilities specified by the law result from the nature of mortgage bank operation as specialised institutions, performing the business charged with high risk and therefore subject to more stringent prudential regulations. A specific privilege, vested only in mortgage banks, is the priority of claims satisfaction in an enforcement proceeding on a real property.

The Act of 5th July 2002 on the amendments to the Mortgage Bonds and Mortgage Banks Act and on the amendments to some other Acts (Journal of Laws, No. 126, item 1070) extended the scope of mortgage banks' activities, *inter alia*, by taking fixed term deposits, taking loans and credits, issue of bonds, custody of securities, purchase and subscription of stocks or shares of other entities.

4.6. Co-operative Banking

The Act on the Operations of Co-operative Banks, Their Affiliation, and Affiliating Banks of 7th December 2000, in force since January 2001, regulates the issues of co-operative banking. The new Act, apart from the change in the organisational model of the co-operative banking sector, also contains legal grounds for its financial restructuring, using the principles of economics.

The act implemented a two-tier organisational structure and obliged co-operative banks with funds less than EUR 5 million, to affiliate. However, this provides the co-operative and regional banks with a choice of their mode of operation, retaining principles of competition and the freedom to make agreements about association with another bank and the possibility to change affiliation. Certain forms of grouping are not be available to co-operative banks, e.g. a banking group or a consolidated structure.

Pursuant to the Act, the regulations on the control of articles of association and the required consent of the CBS for the appointment of bank chairmen (presidents) will be the same in co-operative banks and commercial banks. The expanded range of operations that may be performed by co-operative banks was conditional on CBS consent. The co-operative banking sector continues to be linked with the ownership changes of the Bank Gospodarki Żywnościowej SA. The reasons consist primarily of capital requirements of the affiliating banks, resulting in the reduction of the number of banks capable of meeting this requirement, and provisions of the Act connected with the BGŻ privatisation through so-called *co-operativisation*.

The Act specified the required level of capital for co-operative banks and the amount of owned funds as well as the deadlines to reach them. It assumes that the capital minimum at the end of 2001 was to amount to EUR 300,000, by the end of 2005 – EUR 500,000 and by the end of 2010 – EUR 1 million⁹. It is anticipated that in the new legal situation, consolidation activities will be continued in the near future, which *in fact* will only be taken up by strong co-operative banks, possessing high capital assets.

⁹ In reference to the deadlines and amounts required for the co-operative banks to reach the volume of own funds, negotiations resulted in establishments different than those provided for in *the Co-operative Banks Operation, Their Association and Associating Banks Act and the Banking Law Act*. Pursuant to the provision of the Accession Treaty, own funds of co-operative banks should reach at least EUR 300,000 until 31 December 2005, while in the period from 1 January 2006 to 31 December 2007, funds owned by co-operative banks would have to reach at least EUR 500,000, moving up to an obligatory EUR 1 m. as of 1 January 2008.

4.7. Counteraction of Money-Laundering

Having signed the Europe Agreement establishing an association, Poland became obliged to adjust its law – in the field of counteracting money-laundering – to requirements of the Directive 91/308/EEC. The EU regulations have been transferred to the Polish legislation by the **Act on Counteracting the Introduction to the Financial Circulation of Financial Assets Originating from Illegal or Undisclosed Sources and Counteracting Financing Terrorism of 16th November 2000**. This determines the principles and the method of counteracting money-laundering as well as competent Government administration bodies responsible for counteracting this practice.

The Minister of Finance is the chief body of financial information. Moreover, the **General Inspector of Financial Information** was appointed to accomplish the tasks, with the assistance of an organisational unit of the Ministry of Finance, to which staff may be delegated from units and bodies subject to: the Office of State Protection, the Ministry of the Interior and Administration, and the Ministry of National Defence. The basic responsibilities of the General Inspector of Financial Information include: the obtaining of, collecting, processing and analysing of relevant financial information, as well as taking appropriate actions to counteract money-laundering. After 11th September 2001, the tasks of the General Inspector of Financial Information include counteracting financing terrorism.

The duty to record transactions and persons performing transactions involves those known as **obliged institutions** (pursuant to the Act these include: banks, foreign banks' branches, brokerage houses, entities conducting the brokerage, insurers, insurance agents, investment and trust funds and companies, gambling establishments, notaries, and real estate agencies). For the moment, the National Bank of Poland and the Commission for Banking Supervision are among the co-operating entities. The Act stipulates the **recording of every gross transaction exceeding the amount of EUR 10,000**. Such a responsibility concerns not only a single transaction but also an order carried out within interrelated operations. This applies to all transactions, irrespective of their amount, where there is a suspicion that the funds used originate from illicit sources. In case of well-founded grounds for suspicion that the transaction may be connected with possible criminal activity, the General Inspector of Financial Information may request that it be postponed for 48 hours. Any entity, which obtains some benefit as a result of the transaction, is considered as a beneficiary. Any data obtained is to be transferred to the General Inspector of Financial Information and must be retained for a period of 5 years.

The provisions of the Act have already been implemented, except for the regulations on recording the transactions: beginning from 1st January 2004, recording transaction exceeding 15 000 EUR will be obligatory, whereas the transactions exceeding 10 000 EUR will have to be recorded beginning from 1st July 2004. Meanwhile, the duty to record cash payments and withdrawals started on 1st April 2002. In connection with the Act banks and other financial institutions (brokerage houses, investment funds, leasing and factoring companies, entities running the business of gambling and mutual bets, etc.) shall be equipped with an appropriate infrastructure.

4.8. Consumer Credit

The passage of the Consumer Credit Act resulted both from the need to adjust Polish regulations to the Directive 87/102/EEC, as well as from the lack of sufficient regulations in domestic legislation. The existing provisions controlling consumer-credit were dispersed and fragmentary. The Consumer Credit Act of 20th July 2001, taking effect on 19th September 2002, adjusts Polish law to the provisions of the above directive, also having regard to the existing regulations in Polish law. This specifies the principles and the method of making consumer credit agreements and introduced regulations aimed at consumer protection. Pursuant to the EU directives, broad criteria of "*consumer credit*" and "*consumer credit agreement*" have been introduced, covering not only consumer credit granted by banks or other financial institutions, but also any financial facilities offered by entrepreneurs. The Act applies equally to retail shops and to entities involved in financing hire-

purchase as well as to co-operative credit unions. As in the Community regulations, the Act introduced numerous exemptions from the scope of binding regulations, e.g. in respect of loans involving small (up to 500 zloty) or high (exceeding 80,000 zloty) amounts, of maturity not exceeding three months, or such that are not connected with any additional costs to the consumer, like processing charges and interest, unless the subject of the agreement consists of consumer credit intended to finance the purchase of movable goods, handed over to the consumer prior to the total repayment of the credit. The provisions of the Act shall be applicable to overdrafts on a current account of mortgage loans and even to loans linked with a real property.

The Act defines information which the creditor is required to supply to the consumer. Any omission in respect of this may result in loan repayments in equal instalments without interest, and ultimately in the right of the borrower to take legal action against the lender. Moreover, the creditor is obliged to show an actual annual interest rate calculated for the total credit cost in informational material about consumer credit. The borrower is also given the right to repay the loan more quickly and to withdraw from the agreement within 3 days of its signing. Procedures and exceptions from the principle have been specified. Reciprocally, the creditor is entitled to terminate the agreement only in the case of default of payment of two loan instalments, subject to a prior demand to the borrower for payment.

4.9. Foreign Exchange Law

Starting from 1 October 2002, the **Foreign Exchange Law** of 27th July 2002, has taken effect, which introduced far going changes, abolishing most of the previous restrictions on foreign exchange trading and adjusting the Polish provisions to the Community law. Those above mentioned amendments were so considerable and far-reaching that it was impractical to restrict oneself to amending the Act of 18 December 1998. The new Act introduced primarily a clear cut division of foreign exchange trading with foreign countries into current trade (not liable to currency restrictions) and the capital trade (in this area the restrictions have been formulated and are still in force). Generally, the Act does not stipulate **any restrictions on the movement of capital and payments between Poland and EU Member States**, apart from those provided for in the Treaty. It also fully guarantees free foreign exchange operations with OECD and European Economic Area countries. In the field of foreign exchange law those countries were considered as on a par to the EU Member States. Thereby restrictions in foreign exchange operations with third countries are also not applied in trade between Poland and these countries. The Act provides that the restrictions in the foreign exchange operations with third countries may be abolished by individual and general foreign exchange permits. The former are granted under the governance of previous Acts, by the President of the NBP, while the latter are granted by the regulation of the Minister of Finance and apply in particular to making foreign exchange operations easier with the countries with which Poland have signed agreements on investments support and mutual protection, and which are not EU, EEA or OECD members.

Two of the restrictions anticipated in the Act are of general character and also apply to the operations with EU, EEA and OECD member countries. The first refers mainly to the conditions according to which foreign exchange operations with foreign countries are to take place: to the duty of determination and acceptance by and from non-residents of claims in currencies other than convertible currencies or the Polish currency. Pursuant to the second restriction, the export and transfer abroad of means of payment or gold bullion of total value exceeding the equivalent of EUR 10,000 shall require a foreign exchange permit. This restriction, as compared to exemptions anticipated for non-residents, applies in practice to residents only. The restriction is specifically concerned with the requirement to perform money transfers abroad and domestic settlements with non-residents in amounts exceeding EUR 10,000 – via authorised banks. Because residents are obliged to provide banks with justification for transfers or settlements, these provisions make it possible to obtain statistical data on the volume and the direction of capital movement from the banks relatively quickly. The provisions also contribute to the increase of financial operational safety by the reduction of cash operations.

Other responsibilities predicted in the bill for the Act (e.g. the notification by residents and non-residents of the import to Poland of specie or gold bullion of total value exceeding EUR 10,000; the submission of statistical data on foreign exchange operations with foreign countries, sending means of payment and gold bullion abroad by post) do not restrict the free movement of capital, because they comply with the exemptions specified in Art. 58 para. 1(b) of the Treaty.

In addition, the Act forecasts a possibility to introduce, by way of ordinance of the Council of Ministers, extraordinary restrictions to the freedom of capital movements and payments. These restrictions will be able to be implemented – in a similar way to Art. 58 para. 1(b) of the Treaty – to ensure public order or public security as well as to execute international obligations, binding for Poland, e.g. resulting from a resolution of the UN Security Council or a decision of the EU Council.

4.10. Summary

The specified Acts are of key importance for banking operations. However, they do not make a complete and comprehensive catalogue of regulations providing standards for the Polish banking sector operation. Legislation of systemic character: the Code of Commercial Companies, the Civil Code, the Act on Co-operative Law, the Law on Public Trading in Securities and Trust Funds is very important to determine the principles of banks operations.

Regulations applicable to the banking sector have been basically adjusted to the *acquis communautaire*. No restrictions in the field of performing the business of banking were introduced, apart from those resulting from the Community regulations. Banks established in various forms (e.g. joint stock companies or state banks) may conduct business according to the same principles. The elements restraining the development of the Polish banking sector result from the underdeveloped organisational structure and from the lack of appropriate technical facilities rather than from the failure to adjust the domestic provisions to the Community law.

5

The Adjustment of Polish Banking Supervision to the European Union Requirements

5.1. General Comments – the Role of Banking Supervision

The operation of an effective banking supervision is one of crucial elements of stability and safety of the global banking system. It is shown by recommendations of the Basel Committee on Banking Supervision and by regulations of the European Union.

The first of 25 Core Principles for Effective Banking Supervision introduces the minimum conditions that shall be met by a banking supervision to be effective. These conditions consist of:

- ensuring that the banking supervision has an operational independence, through clear and consistent responsibilities and objectives for the banking supervision set by the legislator,
- providing the banking supervision with adequate resources, such as adequate staff, funds and technical facilities, to accomplish the determined objectives,
- introducing a system of co-operation and exchange of information with supervisory agencies, both domestic and foreign.

The banking supervision in Poland has been being developed within the **structures of the National Bank of Poland** for over ten years. The establishment and the development of a new supervisory institution was connected with the transformation of Polish banking that consisted of the liberalisation of the licensing policy, the change in the NBP role and responsibilities and the reduction of direct state intervention in the banking sector to the minimum. The banking supervision, carried out from the institutional point of view by the **Commission for Banking Supervision (CBS)** and its executive body – the **General Inspectorate of Banking Supervision (GINB)**, is one of fundamental conditions for banking system stability and safety, apart from sound macro-economic foundations and good banking practice.

At the present stage of financial market development in Poland, the operation of the Commission for Banking Supervision is the optimum solution; it takes into account the most recent world trends, aimed at the separation of the monetary policy from the exercise of the banking supervision without giving up the link between the banking supervision and the central bank. For banking supervision in Poland it is important that the General Inspectorate of Banking Supervision is an organisational unit of the National Bank of Poland while the President of the NBP is the Chairman of the Commission. A close co-operation with the central bank is the foundation of the banking supervision effectiveness during the period of economic transformation in Poland. The operation of an effective and working for the safety of the banking system supervisory agency would be impossible without the support of a strong and independent central bank.

Examples of the **evolution of the banking supervision role** include: a substantial strengthening of the process of bank supervision by the Inspectorate, the building of a system of prudential regulations enabling a more individualised approach to individual banking risks, a modern design of the risk-based capital ratio and a serious involvement in the work on the CAD Directive now being implemented.

5.2. International Standards governing the Operation of the Banking System

The Basel Committee on Banking Supervision – principles for effective banking supervision.

The “Core Principles for Effective Banking Supervision” issued by the Basel Committee on Banking Supervision in September 1997 was a new chapter in the world-wide harmonisation of financial regulation and banking supervision systems. The adoption of those principles gives credence to a given banking system vis-à-vis the international financial community and at the same time simplifies the operation of local banks outside the territory of the home country. The implementation of the provisions of that document may also lead to an increased rating and assessment of the given country by the main international financial institutions, such as the World Bank and the International Monetary Fund and may therefore contribute to the cutting of financing costs in international markets.

Poland has already implemented most of the 25 principles for effective supervision. However there are areas which have not been harmonised with the principles. These include: the insufficient regulation of the issue of internal control in the Banking Act, including the independence and the professionalism of bank internal audit units. During the last few years the General Inspectorate of Banking Supervision has been pursuing the elimination of such deficiencies via an amendment to the law, and the improvement of banking and supervisory practices.

The New Capital Adequacy Framework – effects for the Polish banking system.

The implementation of the New Capital Adequacy Framework will be very important for the Polish banking system. Its principles and operation have been analysed by Polish banking supervision and a particularly broad scope of adjustments will be necessary in the field of principles of the supervision exercise set by Pillar 2 of the Capital Adequacy Framework.

Macroeconomic consequences

a) **Costs of external finance** in consequence of abandoning the OECD membership criterion in favour of a criterion based on rating-agencies’ ratings, Poland will no longer be approached as a lower risk partner. An increase in the capital charges on foreign institutions in virtue of their claims on Polish Government (from 0% to 20% or to 50%), as well as the indebtedness of Polish financial institutions will be reflected in an increase of the cost of capital raised by Polish financial institutions on the foreign markets. This may cause a decline of Polish banks’ competitiveness combined with higher costs of finance from abroad, It will affect not only the banking or, more general, financial sector, but also the Polish economy as a whole.

The effect of amendments to the Capital Accord suggested by the Basel Committee, and at the same time the greatest drawback of these amendments from the point of view of not only the Polish banking sector, but also that of the Polish economy as a whole may be the establishing and even the deepening of the division into well and poorly developed countries, both in respect to the cost of raising capital and financing. In this context, there is little doubt that despite OECD membership the situation of Poland, including the situation of Polish banks and other financial and non-financial entities, will be less favourable than it is at present.

No sooner the competitiveness of the Polish economy in terms of costs of external finance can grow than improvement in the economic situation of Poland and the anticipated membership in the EU are reflected in the ratings of recognised international rating agencies.

b) **The “Pro-cyclical”** nature of solutions offered by the New Capital Accord (NCA). High level of “sensitivity” to the risk embedded in the methods of defining capital requirement has some adverse side effects of macro-economic character. The nature of such methods is “pro-cyclical”, i.e. they increase the amplitude of economic cycle fluctuations (register low risk during the growth phase, thus encouraging towards continued credit expansion, during low market phases indicate high level of risk, increasing the banks’ prudence in economy financing projects).

For the reason of specifics of the Polish banking sector on the eve of the NCA implementation i.e.:

- in the initial period of the NCA being in force, an anticipated narrow applicability of the most advanced (therefore, the most risk-sensitive) risk measurement methods (the internal rating method),
- narrow applicability of external ratings,
- high coverage of overdue debt with specific provisions,
- the “pro-cyclical” nature of solutions brought by the NCA should not be particularly painful directly after the introduction of the new capital adequacy principles.

At the same time, targets of the banking supervision in the so-called Pillar 2 will have to account for the cyclical nature of economic processes in the methodologies applied to determine capital requirements of banks.

Quantitative consequences for the banking sector.

The third quantitative survey (QIS3) conducted in Poland at the turn of 2002/2003 shows that an overall increase of capital requirements in the banking sector (by approx. 10%) will occur, resulting in an average drop in the solvency ratio of approx. 1.2 percentage point. However, in view of the current level of capital in the banking sector, the increase in the required statutory capital should not undermine business opportunities of the Polish banks.

Qualitative consequences for the banking sector.

Internal competition in the banking sector:

The acceptance of applying lower risk weights to a bank, whose rating is higher than the rating of the country of authorisation, may result in a situation where claims on Polish banks with a majority of foreign capital will be treated on preferential terms. This would come about because their ratings may be higher due to the capital involvement of foreign credit institution with a high rating. It may lead to a pronounced differentiation of banks with limited foreign capital shares in terms of effectiveness and competition.

Introduction of the NCA principles should considerably enhance the quality of risk management process in the Polish banks. The enhancement can be attributed to the following factors:

- Methodology of calculating solvency ratio in accordance with the new principles seems more sensitive to an actual size of a bank's risk, thus increasing reliability of this type of measure in assessing financial credibility of the bank.
- Under the NCA, new areas of banking risk (operating risk) will be subject to the capital regime and inspection procedures, forcing the banks to develop methodologies applied in measurement and control of such risk.
- It may be anticipated that, in the first few years following introduction of the new capital adequacy methodology, a sizeable part of the remaining Polish banks will abide by the NCA in its simplified version, where risk weights are determined by prudential regulations. The reasons behind their decision include both a relative simplicity of the approach in question and lower capital requirements generated by this method. At the same time, the banks will show increasing demand for ratings of financed entities. It is expected to stimulate rating activity in Poland.
- Directions of methodological changes noticeable in the draft versions of the New Capital Accord prepared so far indicate that, in a long-term perspective, the banking practice will be generally oriented towards developing internal risk assessment methods, as they are more effective in terms of the use of capital. Economic revival in Poland should lead to a decrease in the risk assessment performed by such methods and, in consequence, reduce capital requirements generated by internal methods in favour of capital requirements calculated with the use of a standard method. In parallel, foreign banks will press the Polish banks to adopt more advanced methods (the internal rating methods) following the requirement of a uniform (in terms of the

method adopted by a bank: internal rating method or a standard method) approach to the whole portfolio of a bank, also in its consolidated form, subsidiaries included.

– In accordance with the principles expressed in so-called Pillar 2, the approach of the banking supervision towards specific banks will be individualised to a much larger extent than it is the case today, including even separate capital requirements determined for each bank on the basis of supervisory assessment of risks taken by the bank, which are not included in the Pillar 1 of the New Capital Accord, as well as on the basis of evaluation of risk management process in a given bank.

Organisational and personnel changes.

Introduction of the above-mentioned solutions will require substantial organisational and financial effort on the part of the Polish banks. The scale of effort in Poland appears to be considerable albeit difficult to estimate. For example, the estimated costs of the NCA introduction at a global scale will reach approx. USD 25 bn.

The Basel proposal coincides with the anticipated European Union membership of Poland and it follows that the coming years will bring more and more serious challenges for the banking system. Quantitative risk management methods are starting to penetrate not only a separated area of trade activities of a bank (market risk) but also in traditional areas of banking activity such as crediting (credit risk). Bank management will require more specialised expertise and so risk measurement, monitoring and management can no longer remain the exclusive province of a small group of experts in risk management departments, but must attract the attention of the people at the highest levels of bank management.

Consequences for supervisory bodies

The implementation of the New Capital Accord principles in whole will not only require the introduction of the full consolidation requirement but also the establishment of adequate legal grounds to allow an exchange of information among the institutions supervising banks and banking groups operating at an international level. For Poland, the compliance with those criteria would require amendments in the acts of law that would allow the supervision on a consolidated basis as well as for entering into co-operation agreements to enable the effective exchange of information with banking supervisory institutions abroad (such initiative has been already taken).

Similar changes and amendments will be required in order to apply the Pillar 2 principles in practice. According to the principles, the supervision is obliged to apply individual supervisory standards towards specific banks.

Imposition of a duty to evaluate the banking risk assessment system on the banking supervision will require some serious changes in such supervision, in terms of its material resources, organisation, qualified staff and training.

Summarising, it should be said that works performed by the Basel Committee on the New Capital Accord coincide with the anticipated European Union membership of Poland and it follows that the coming years will present increasingly great challenges to the banking system. Bank management will require more specialised expertise and so risk measurement, monitoring and management can no longer be a subject of interest only to a small group of experts in risk management departments, but shall attract the attention of the people at the highest levels of bank management.

European Union regulations

The principles of the banking system operation in the EU are regulated by directives, aimed at the harmonisation of legislation in individual Member States. Poland, as a European Union candidate, must implement in its legislation the provisions of all EU directives, including those aimed at the banking sector to take effect not later than on the date of Poland's accession to the EU. The NBP and the Commission for Banking Supervision attach high priority to the issue of implementation of EU 'banking' directives to the Polish law, a process which has been ongoing for the last few years. The work aimed at full implementation of the following EU regulations has been completed:

- Directive 2000/12/EC of the European Parliament and of the Council of 20th March 2000 relating to the taking up and business operations of credit institutions. The above replaced numerous banking connected directives that previously regulated the various areas of credit institutions' operations in the EU,
- Directive 96/26/EC of the European Parliament and of the Council relating to the strengthening of prudential supervision (so-called Post-BCCI Directive),
- Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions (CAD) amended by Directive 98/31/EC.
- Directive 2000/46/EC of the European Parliament and of the Council relating to the taking up, pursuit of and of prudential supervision of the business of electronic money institutions.
- Directive 2002/87/EC of the supplementary supervision of financial conglomerates.

5.3. The Process of Polish Supervisory Regulations Adjustment to the Requirements of European integration

After the passage of the Banking Act of 29th August 1997 the regulations on the banking sector in Poland were basically compliant with relevant European Union directives. (Detailed information with a comparative analysis of Polish banking regulations with the provisions of the European legislation is given in the NBP paper 'The Polish Banking System in the Nineties').

However, there were several areas, which either were not regulated at all or their regulation was substantially different from the Community standards. The lack of statutory regulations of full principles of consolidated supervision was one of the most important issues. The exercise of consolidated supervision was possible only in the field of accounting, but there were no regulations that would enable a full application of prudential standards to mixed-activity groups. The statutory principles of the consolidated supervision performance were determined in the amendment to the Banking Act of 23rd August 2001; they took effect on 1st January 2002.

Another area that has not been changed was that connected with banks' capital adequacy, regulated by the CAD Directive, which assumed the introduction of capital requirements to cover risk, i.e. market risk, which is different from credit risk in the banks' operations. The amendment to the Banking Act of 23rd August 2001 formulated new principles of setting the banks' capital requirements for various risks; they were implemented on 1st January 2002. Detailed regulations on capital adequacy were provided in executive provisions to the Act issued by the Commission for Banking Supervision; they also came into force on 1st January 2002.

Provisions on the set-up and operation of banking entities and institutions in the Republic of Poland by credit institutions from European Union countries (via branches or cross-border activities) were a separate issue connected with the adjustment of Polish banking legislation to the EU standards. Polish law today requires the provision of branches of EU credit institutions with a separate capital. According to the Community principles of "single banking licence" and the 'home country supervision', after Poland's accession to the EU the branches of credit institutions will no longer need to be provided with separate capital. The agency that has granted the authorisation for the operation of a credit institution will be responsible for supervision over those branches. The amendment also specified the principles and conditions for Polish banks' operation (in the form of branches and cross-border activities) in the EU countries. The above regulations will take effect on the date of Poland's accession to the EU.

A full adjustment of Polish banking legislation to the European Union requirements took place on 1st January 2002, but certain provisions will only become effective after the accession to the EU by Poland. It is also worth remembering that the Community directives are frequently amended and modified. New prudential standards are being introduced, generally based on proposals presented by the Basel Committee on Banking Supervision. So it is not excluded that even before Poland's EU accession the next changes in supervisory regulations will be necessary.

6

The Adjustment of Monetary and Financial Statistics and the Balance of Payments to EU Requirements

6.1. The Adjustment of Monetary and Financial Statistics to ECB Standards

The single monetary policy carried out by banks within the ESCB meant that the quick collection of reliable statistical information, worked out according to **uniform methodological principles**, became especially important. The relevant data not only make possible correct decisions on the parameters of the single monetary policy, but are also the criterion for: effective supervision over credit institutions, the monitoring of financial market development, and supervision over the system of calculating and transferring the required reserves.

Statistical issues have been precisely defined in the **legal regulations**. Certain powers for collecting statistical information have already been guaranteed in the *Treaty establishing the European Union*. The European Monetary Institute carried out intensive preparation work in this area. A precise description of statistical requirements, planned for implementation at the beginning of what is termed as stage three of the monetary union, is included in the document "*Statistical Requirements for Stage Three of Monetary Union (Implementation Package)*" of July 1996. The ECB have put in place several regulations for regulating the issues of providing the statistical information by the national central banks, as well as setting out numerous guidelines and manuals facilitating the implementation of uniform methodological principles by banks.

Appreciating the importance of statistical issues, the National Bank of Poland, while planning preparatory actions to operate within the ESCB, have been carrying out intensive work in the field of statistics. ECB requirements in this area and the status of the NBP work have been discussed within individual subject groups.

The list of monetary financial institutions

Monetary financial institutions (MFI) include domestic credit institutions and other financial institutions, the business of which consists in taking deposits and/or close substitutes for deposits from entities other than monetary financial institutions and of granting loans and/or investing in securities on their own account.

Monetary financial institutions in the EU countries include credit institutions and so-called Money Market Funds. In a few countries there are sometimes also other, specific institutions that comply with the MFI definition. The European Central Bank puts together the list of monetary financial institutions on the basis of information provided by the national central banks. It aims, *inter alia*, at facilitating the elaboration of a full and consistent balance sheet of the money-creating system within the Eurosystem, at ensuring uniform and reliable reporting and at deciding on a full list of institutions eligible to perform operations with the ESCB.

A **preliminary list of Polish monetary financial institutions**, as of the end of 2000, was transferred by the NBP to the ECB by the required deadline at the end of March 2001. It is updated according to the mode stipulated by the ECB. As a result of NBP discussions and consultations with the ECB, the EU central banks and domestic institutions (Central Statistical Office, Securities and Exchange Commission and others) the MFI list is comprised of the central bank and the operating banks (i.e. excluding banks in liquidation, that are bankrupt or those with suspended bankruptcy proceedings).

The consolidated balance sheet of the monetary financial institutions sector

The ECB places the central banks under an obligation to provide **reporting information** on all MFIs in required analytical cross sections; this will facilitate drawing up a consolidated balance sheet of the MFIs. The reporting requirements in this field were specified in the ECB Regulation (ECB/2001/13) on the consolidated balance sheet of monetary financial institutions and in numerous guidelines. The necessity for full accordance to these standards requires the extension of the scope of information collected from banks and a much faster response time. These changes will be connected with the modification of the IT system servicing the bank reporting.

Monthly and quarterly data, collected now by the NBP from commercial banks, must be supplemented with additional information (e.g. a breakdown by currencies and countries that are counter-parties to operations). The type of statistics known as **transaction statistics** constitute a separate group of information, required by the ECB and not now collected by the NBP. The following phenomena influence, apart from actual financial transactions, the movements in balance sheet balances:

- a) re-classification and other adjustments,
- b) foreign exchange rate fluctuations,
- c) changes in valuation of securities and credit write-offs.

The adjustment resulting from foreign exchange rates fluctuations are calculated by the ECB; the other adjustments are provided by the national central banks.

Because central banks must provide the ECB with the required monthly data within 15 business days after the end of a reporting month and the quarterly data within 28 business days after the end of a quarter, works on the **preparation of methodological assumptions for statistical reporting adjusted to the ECB requirements** carried out in the NBP Department of Statistics has reached their final stage (in March 2002, the first stage of the adjustment work was completed, consisting in the implementation of the requirement that bank reporting of the classification principles of economic operators be consistent with ESA 95 – the European System of Account (1995).

The most important study is focused on including the new reporting in the operating IT system. A **new design of reporting forms** has been developed, which ensures the collection of data according to the requirements of the ECB, along with a design of forms necessary to collect additional information from banks to facilitate the calculation of transactions. Tentative instructions to the new reporting forms have been made available to the banks. At present, works are being conducted to draft and publish a bill introducing the new reporting to come into effect starting from the beginning of 2004.

Interest-rate statistics

The interest-rate statistics are one of the key pieces of information in the conditions of conduct of the single monetary policy. The ECB now requires information on national base interest rates, illustrating the effect of the single monetary policy on the national level, and on the aggregated rates, which are calculated using weighting techniques, reflecting the price of individual components of the M3 money. The ECB Regulation on the interest rates statistics (ECB/2001/18) places an obligation on the monetary financial institutions from the euro area to provide data on interest rates according to harmonised definitions and calculation methods.

The NBP has been collecting the data on deposit and lending rates from commercial banks and publishing this data after appropriate processing. Preliminary modifications are now being carried out – according to the requirements entailed by ECB Regulation – on the method of the groups reporting on bank selection, of the scope of information collected and the method of weighting of the interest rate. Reporting forms for the new interest rate statistics have been presented to the banks. The statistics shall come into effect starting from the beginning of 2004.

The statistics of issued securities

National central banks report to the ECB on securities issues made by residents on domestic and foreign markets on a monthly basis¹⁰. The figures reflect indebtedness status as at the end of a reporting period, new issues and redemption performed within a reporting period.

In the NBP, works are carried out to acquire figures from the above-mentioned subject area. Since March 2002, some selected banks have reported to the NBP on non-public issues of debt securities on domestic market. Figures on Treasury securities issues and on the securities issued by the NBP will be prepared and edited with the use of the securities base, which is being developed in the Domestic Operations Department now.

Statistics of other financial intermediary institutions

The Guidelines for preparing the statistics of other financial intermediaries¹¹ were published for the first time by the ECB in November 2002. At present, national central banks are required to prepare a quarterly statistics on investment funds (other than money market funds, which are included into monetary financial institutions), including selected balance sheet items.

Works are carried out in the NBP to draw up the above-mentioned statistics following the ECB Guidelines.

Financial Accounts

The **Monetary Union Financial Accounts** are important from the point of view of the monetary policy analysis, carried out by the ECB. They contain a wide range of economic, monetary and financial information. The drawing up of quarterly financial accounts is desirable for the ECB; however in Poland only annual accounts are prepared in this area. The Central Statistical Office is the institution responsible for this. At the same time, the NBP carries out preparatory works towards learning an acquisition of information sources in this area for the needs of the ECB.

The remaining statistical requirements of the ECB, previously not covered, which were not included in the Implementation Package, have been decided upon in the course of further discussions on the methods to be employed. The work on these requirements is mostly at a preparatory stage and as yet there are no official requirements, based on legal regulations. They include primarily the following groups of issues: statistics of derivatives, statistics of mortgage loans, and a database of financial markets.

6.2. The Adjustment of Balance of Payment Statistics to EU Standards

Pursuant to the Act on the National Bank of Poland, the NBP is responsible for the drawing up and publication of the balance of payments statistics. The NBP role in the process of European integration in the field of balance of payments statistics consists in the meeting with **reporting requirements** specified by the EU. These requirements are determined by two Community institutions: the ECB and the Eurostat.

The EU guidelines on the balance of payments are more detailed than, or expand on, the IMF and OECD statistical standards. As a result of the work done during the few years on the adjustment to those institutions' standards, the methodology of drawing up the balance of payments has also become substantially closer to EU standards. The present work aims at **achieving a full consistency** from the point of view of deadlines and the scope of data transmission.

It should be emphasized that the work is in progress in Eurostat on the new legal regulation to be binding for all Member States, including Poland, as from its accession to the EU. This regulation provides for statistical requirements concerning the balance of payment. The requirements of the UE institutions are the following:

¹⁰ Annex XIX in the Guideline of 6 February 2003 of the European Central Bank concerning certain statistical reporting requirements of the European Central bank and the procedures for reporting by the national central banks of statistical information in the field of money and banking statistics (ECB/2003/2).

¹¹ Binding guidelines are included in the Annex XVIII in the Guideline.... see footnote 6.

- monthly – key items of the balance of payments, transferred to the ECB by the 30th business day after the end of a reporting month,
- monthly – liquid assets and liabilities in foreign currencies, transferred to the ECB within 3 weeks after the end of each month,
- monthly – official reserve assets, transferred to the ECB within 1 week after the end of each month,
- quarterly – detailed data on the balance of payments, transferred to the ECB and Eurostat within 3 months after the end of a reporting quarter,
- annually – international services trade and turnover of direct investments, transferred to the ECB within 6 months after the end of a reporting year,
- annually – balances of direct investments, transferred to the ECB within 9 months after the end of a reporting year,
- annually – the data on the international investment position (the balance of assets and liabilities to nonresidents as of the year end), transferred to the ECB within 9 months after the end of a reporting year.

In November 2001 tests started of the transmission to the ECB of monthly data on: the balance of payments, official reserve assets and liquid assets and liabilities in foreign currencies, using the "Gesmes/CB" message format. Part of the information, specified in the form of a *Gentlemen's Agreement*, relating to the EU candidate countries, is transferred to the Eurostat, i.e. **detailed data on the balance of payments on a transaction basis and detailed annual data on the direct investment.**

Standards of international statistics, including the standards established by the EU institutions, are being changed and improved. Representatives of the NBP Department of Statistics participate in the meetings of the Committee for the Monetary, Financial and Balance of Payment Statistics (common Eurostat and ECB committee). They also participate – as observers – in the work of balance-of-payment working groups meeting twice a year in the Eurostat. In November 2000 the NBP representatives attended the first of a series of announced meetings with the candidate countries, organised by the Department of Statistics of the ECB.

The **description of Polish legal and institutional framework of the balance of payment statistics and the products and the used methodology** were submitted to the ECB in May 2001 for the insertion in the ECB publication the *"Manual on b.o.p./i.i.p. statistical method applied in accession countries"*. (*Accession Countries Balance of Payments/ International Investment Position Statistical Methods*). The manual was published by the ECB in February 2002. This publication is updated every year whereas its next edition is scheduled for May 2003.

Work on the adjustment of the balance of payment statistics to the Community requirement is connected with: the modification of IT systems used for data collection and processing; the establishment of a system integrating the source data and the implementation of the data transmission using the 'Gesmes/CB' messages format, required by the Eurostat and the ECB.

To achieve full compliance with EU requirements in the field of balance of payment and related statistics the NBP has started to implement necessary correcting changes, the most important of which are:

- the implementation of a **modified system of monthly compilation of the balance of payment** according to the ECB standard (key items), including:
 - methodological adjustments in cooperation with the ECB,
 - a new compilation and aggregation system based on ECB codification, taking into account geographical breakdown,
 - a new IT platform;

- the establishment of a **quarterly system of balance of payments compilation**, including:
 - methodological adjustments in cooperation with the ECB and the Eurostat,
 - a new compilation and aggregation system based on the ECB and Eurostat codification, taking into account geographical breakdown,
 - a new IT platform,
 - statistical estimation methods;
- the reconstruction of the current **system of the information from enterprises collection**, including:
 - the construction of a central register of reporting entities,
 - successive inclusion of the following reporting modules,
 - the modification of reporting forms,
 - a new IT platform facilitating the data integration;
- the development of a new system of collection and processing the data **on international services trade**.
- the construction of a new **system of the information on portfolio investment collection** (compliant with the ECB requirements).

7

The Adjustment of Polish Payment Systems to EU Requirements

7.1. General comments

Payment systems are one of the adjustment areas of the EU candidate countries. The main tasks connected with the adjustment of payment systems to the EU requirements include:

- the adjustment of law to the *acquis communautaire*,
- the adjustment of payment system infrastructure to the **guidelines and recommendations** not connected with the legislation, in particular the meeting of requirements indispensable from the point of view of the domestic RTGS system participation in the trans-European automated real-time settlement system for large-value payment orders – TARGET.

7.2. Legal Adjustments to the Regulations in force in the EU

The adjustment of Polish legislation connected with the payment systems operation to the European Union requirements required a number of actions taken in the recent years in order to account for the solutions arising from the below-listed EU regulations in the provisions of the Polish law:

- Directive No. 98/26/EC of 19th May 1998 relating to the finality of settlement in payment systems and in securities settlement systems,
- Directive No. 97/5/EC of 27th January 1997 relating to cross-border transfers,
- Commission Recommendation No 97/489/EC concerning transactions by electronic payment instruments and in particular the relationship between the issuer and the holder.
- Directive No. 2000/46/EC of 18 September 2000 on starting and conducting business activities by the electronic money institutions and institutions of prudential supervision over their activity.
- Directive No. 98/26/EC of the European Parliament and the European Council of 19th May 1998 relating to the finality of settlement in payment systems and in securities settlement systems.

The Directive was adopted in order to limit system risk in the payment system by way of introducing rules, which guarantee that

- Netting – bilateral or multilateral – shall not be challenged or undermined in legal terms and is binding on third parties.
- System rules shall specify the moment from which transfer orders become irrevocable and must be acknowledged.
- Regulations resulting from the binding force of the “zero hour principle”, making the already executed settlements null and void in the case of a system participant insolvency, shall be repealed.
- The insolvency of a system participant will continue to be regulated by the insolvency law of the home country. The rights and obligations connected with the participation in the

system make an exception. They shall be governed by the provisions of law a given Member State of the European Union, which were chosen by system participants.

- The collateral security provided to the system in any legal technique in connection with participation in the system or accepted by the national central bank, the central bank of another Member State or the ECB in connection with performing the function of the central bank shall not be included in the bankruptcy estate in the case that a system participant or an entity performing operations even with one of the above-mentioned central bank is declared insolvent.

The implementation of Directive No. 98/26/EC of 19 May 1998 on the finality of settlement in payment systems and in securities settlement systems into Polish legislation has been effected by adopting the Act on the Settlement Finality in Payment Systems and in Securities Settlement Systems and on the Principles of Supervision over those Systems on 24th August 2001 effective since 1st January 2002. Since that day on, the provisions of the Act on Supervision over Payment Systems and Securities Settlement Systems have become final and valid. Other regulations and act shall take effect on the date of Poland's accession to the European Union. Recognising importance of legal regulations on the finality of settlement and, in particular, on limiting the impact of insolvency procedures on the payment system operation, the NBP has taken steps towards shifting some regulations from the Finality Act to the Bankruptcy and Restructuring Law Act. They shall take effect as of 1st October 2003.

- **Directive No 97/5/EC of 27th January 1997 relating to cross-border transfers**

The directive specifies the banks' obligations to the customers in a very detailed way, to ensure the latter a minimum in terms of transferring funds abroad by credit institutions that is uniform at the EU level. One of the more important duties imposed by the Directive on the Member States is the requirement to ensure the clients that any disputes with a bank regarding execution of cross-border transfers are resolved swiftly and effectively outside court.

Since the principles of liability in the bank – client relationships in Polish legislation come under the Banking Law Act, a decision was made on the transposition of the discussed Directive to Polish legislation primarily via adding to the Banking Act an article on cross-border transfers (Art. 63g). The modification was introduced by amending the Banking Act on 23rd August 2001. The article on cross-border transfers will take effect on the date of Poland's accession to the European Union.

One of the sections of the above-mentioned Article contains a delegation to a competent minister responsible for financial institution to issue a decree containing details with respect to execution of cross-border transfers by banks and financial intermediary institutions as well as indicating courts of conciliation competent to resolve disputes between banks and their clients. At present, the draft decree prepared by the NBP had been agreed by and between ministries and in mid-August 2003 was furnished to the Governmental Legislative Centre by the Ministry of Finance.

- **The Commission Recommendation No. 97/489/EC concerning transactions by electronic payment instruments and in particular the relationship between the issuer and the holder**

The above-mentioned Recommendation applies to various financial instruments which enable the client to access their bank account and make payments and payment cards in particular. Similarly to the above-discussed Directive, the regulation is aimed at protecting consumer rights with the intention to ensure that the client is given a certain minimum protection in their relation with the issuer, in particular within the scope of his liability for executed transactions.

- **Directive No. 2000/46 of the EP and EC of 19 May 1998 relating to the finality of settlement in payment systems and in securities settlement systems.**

The regulation specifies requirements for electronic money institutions which are not credit institutions (banks), chiefly in respect of their licensing and supervision. The requirements shall be uniform for all the EU member states.

Until very recently, Polish legislation lacked any provisions related to the payment-card market, excluding card definition and a few mentions in the Banking Act. In consequence, this most rapidly developing segment of the retail settlements market was based only on contractual regulations, i.e. regulations formulated and introduced by banks at their own discretion. In the Polish market, banks are the main issuers of payment cards.

In relation to the electronic money issue it should be noted that no such product is available in Poland for the time being. However, in its legislation, Poland, as an acceding country, also had to include some regulations on the institution of electronic money, which constitute an integral part of *acquis communautaire* on the payment system.

In consideration of the above, a concept was formed to transpose both the above-discussed recommendation as well as Directive No. 2000/46 into the Polish legislation in the form of a one legal act – The Electronic Payment Instruments Act.

A bill of the act was already subject to legislative work in the Polish Parliament of the previous office; however, it was referred back to the governmental party for redrafting due to inability to reach consensus on the scope of entities licensed to issue payment cards and electronic money. The final text of the Act, containing a chapter on the electronic money issuers, developed to satisfy the requirements of the Directive 2000/46 as well as other chapters, was passed by the Polish Parliament on 12th September 2002. The vast majority of regulations contained in the Act shall take effect one year after the day of promulgation, i.e. on 12th October 2003. At present, executive decrees specifying, *inter alia*, the scope and structure of the statistical data supplied by various entities to the NBP (payment card issuers, settlement agents, electronic money institutions) as well as other issues are in the final phase of the legislative process.

The above indicates that, for the time being, the process of adjusting the Polish legislation to *acquis communautaire* in the areas pertaining to the payment system has been completed. There is one remaining provision of the Business Activity Law Act to be introduced. It is connected with the Directive No. 5/97 and it extends application of the provisions contained in Art. 63g to all entities running their business activities in the form of execution of cross-border transfers.

Should any other regulations in the field of payment system be adopted by the EU bodies, the process of introducing adjustments into the Polish legislation will be continued.

7.3. The Adjustment of the SORBNET System to the EU Requirements

Report and documents of the European Monetary Institute (EMI), the European Central Bank (ECB), Bank of International Settlements (BIS) and standards of the European Committee for Banking Standards (ECBS) have a first position among extra-legal sources of the EU standards and recommendations in the field of payment systems.

The *“Report to the Committee of Governors of the Central Banks of the Member States of the European Economic Community on Minimum Common Features for Domestic Payment Systems”* was one of the first documents offering recommendations for payment systems. It contains 10 minimum principles that shall be met by the payment systems, RTGS in particular. Changes introduced in the SORBNET system were intended at adjusting the system to the principles specified in the document. The principles promoted high-volume systems and emphasised reinforcement of already existing standards.

The SORBNET system fulfils two main principles, characteristic of RTGS type systems:

1. It performs gross settlements, meaning the separate processing of every order, i.e. without netting;
2. It performs real-time settlements, meaning the continuous execution of payment orders (immediately after their receipt and formal checking), and not deferred settlements.

Enactions were taken in the NBP in connection with the development of the SORBNET system based on the principles contained in the above-mentioned report as well as on other grounds. The actions included:

- issue of acts of law defining the principles of access and system participation criteria (Resolution No. 14/2000 of the Management Board of the NBP of 31 March 2000 on the conditions of opening and operating accounts of banks by the National Bank of Poland, as amended, as Decree No. 6/2000 of the President of the NBP on 6 April 2000 on interbank settlement method),
- transfer of high-volume payment settlement to the SORBNET system (the NBP has become a settlement bank for the National Securities Deposit),
- introduction of possibility of executing clients' orders,
- adjusting the system closing time to the TARGET system requirements,
- introduction of earlier hours to service clients' orders,
- opening of a back up centre to provide technical service to the system in the case the main centre is unable to service it,
- introduction of the central queue of orders system and a queue management mechanism,
- intra-day credit, secured with T-bills, was made available to clients,
- introduction of one-day bank deposits,
- the Polish Parliament passed the Act on the Settlement Finality in Payment Systems and in Securities Settlement Systems and on the Principles of Supervision over those Systems (see p. 7.2.).

Currently, owing to the above-mentioned actions, the SORBNET system also complies with a majority of requirements applicable to important payment systems contained in another document of importance for payment systems – *“Core principles for Systemically Important Payment System”* report published in January 2001 by the Committee of Payment and Settlement Systems.

At the moment, the Polish payment system and the RTGS systems in particular are facing the major challenge, i.e. gaining access to the TARGET system. On 24th October 2002, the Managing Board of the European Central bank took a decision that had been awaited for a number of years. In accordance with the decision, the acceding countries can voluntarily access the TARGET system after they join the EU, while incorporation with the TARGET system will be only obligatory upon joining the Economic and Monetary Union. In October and November 2003, the European Central Bank defined five options of connecting an acceding country with the TARGET 1 system currently in use. Furthermore, the ECB specified two possible variants of obligatory participation in the future TARGET 2 system.

Considering possible options of connecting Poland with the TARGET 1 system and with the TARGET 2 system in the future and assuming that 2007 is the earliest possible date for Poland joining the Economic and Monetary Union and 2007 or 2008 is the earliest possible date for launching TARGET 2 system, the National Bank of Poland prepared a proposal to connect the national RTGS system (i.e. SORBNET) with the TARGET SYSTEM. Furthermore, the proposed solution accounts for the stance taken by the banking sector, which requests a prompt launch of a RTGS system in the National Bank of Poland in order to settle EUR payments. On 10th July 2003, the Management Board of the NBP approved the strategy for development of the SORBNET system. The strategy shall be implemented and it plans:

- 1) the existing SORBNET system in the Polish currency to be maintained until Poland joins the Economic and Monetary Union,
- 2) a SORBNET-EURO system to be developed on the basis of the SORBNET system and launch not later than in 2005 to settle EUR payments and taking indirect part in the TARGET 1 system via an RTGS system of a selected Eurosystem central bank,
- 3) upon launching the TARGET 2 system – to start operations on a joint platform or, as a conditional alternative solution – to build own target RTGS model.

In connection with the strategy, the National Bank of Poland plans to complete all the necessary analytical and IT works until the end of 2004. The new system connection with a central bank from the Eurosystem chosen by the National Bank of Poland should take place not later than in the first half of 2005, while the new system should be launched on 1 April 2005 at the latest. At the same time, options are analysed to launch the system at an earlier date but in a very limited version, i.e. without opening the NBP – banks connection via SWIFT or intraday liquidity support and its gradual development by adding some more advanced functions.

8

NBP Operations Connected with the Introduction of the Euro

8.1. General Comments

The effects of the introduction of the single euro currency in twelve EU countries will be noticeable not only for the EMU countries, but also for other countries (in particular those with strong economic links with the EU). The process of conversion goes beyond the euro area.

In 2000 the NBP recognised it would be advisable to carry out a questionnaire survey in the Polish banking sector on the effect of the euro introduction in the first year of the single currency operation in a transactional form only. The NBP also evaluated the banks' preparation to operate in the new conditions.

Steps were taken for the correct preparation of the Polish banking sector and a package of actions was developed, addressed both to commercial banks and other institutions, participants in the financial market, and to the public.

The establishment of the Commission for Identifying and Performing Responsibilities Associated with the Introduction of the Euro (at length in section 1.2) was one of the first steps. The work of the commission resulted in 1998 in the determination of the **Schedule of NBP Activities Connected with the Introduction of the Euro**, including *inter alia* the subjects of: foreign exchange rates, foreign exchange reserves, operation of bank accounts and the execution of banking transactions, payment systems, statistics, and accounting and legal issues. One of the tasks, established by the Commission in connection with the introduction of the euro, was the change of the composition of the basket of currencies. The Council of Minister in agreement with the Monetary Policy Council made the decision on the change of the currencies basket composition. From 1st January 1999 till 12th April 2000, i.e. the date of the floating of the zloty, the basket was comprised of two currencies: 55% euro, 45% US dollar. So the operations of the central bank, being a policy since 1995, and which have been consistently aimed at a gradual increase of the exchange rate flexibility until its full floatation, have reached their goal (detailed in section 3.3). The fixing of the Polish currency against the euro within the ERM2 will be the next step.

Further NBP operations include:

- preparation of relevant **analytical materials** on the introduction of the euro,
- creation of an appropriate legal framework: the preparation of draft *Act on the Effects of the Introduction in Certain European Union Member States of the Euro Single Currency and on the Amendment to Certain Legislation*,
- launching an **information campaign** addressed to commercial banks and to the public,
- **logistic support** to commercial banks (explaining to entities from the financial sector all the doubts connected with the conversion of money, supplying euro currency, etc.).

8.2. Analytical Activity

The *"Analysis of the Introduction of the Euro Influence on Polish Banking System"*¹² was connected primarily with the identification of problems that originated during the first year

¹² K.Szeląg, R.Żak, S.Jakubiec, M.Glibowska: *Analysis of the Introduction of the Euro Influence on the Polish Banking System*, Materials and Studies, NBP, No 107, Warsaw, August 2000.

of the single currency operation. The first step of the analysis was completed in June 2000. It comprised the preparation of a report based on the results of the questionnaire returned by the 15 main commercial banks, the representative sample for the entire Polish banking sector (because of their significant share in the assets and equity of the banking sector and in the deposits and loans for the non-financial sector). The questionnaire designed by the NBP referred to the introduced and planned changes in the banking sector, resulting from the introduction of the euro, so as to facilitate the assessment of commercial banks' preparation for operation under the new conditions. The analysis was split into two parts. The first dealt with matters connected with legal issues, banking products and services adjusted to the provision in the euro, organisational-technical issues originated in relation to its introduction, and methods and conditions of payments settlement in the euro. The second part presented the NBP role in the process of the euro adoption by Poland and the issues connected with the fulfilment of the economic convergence criteria by Poland, the floating of the zloty exchange rate, the necessity of drafting an Act on the Euro and the changeover to the euro of bank notes and coins from the hitherto national currencies of the EMU countries. The final part was devoted to the prospects of Poland's accession to the EMU and the zloty replacement with the euro. The NBP is going to perform the analysis once a year, on the basis of a revisable questionnaire (in accordance with the changing conditions within the single EU financial market).

The second edition of the *"Analysis of the Introduction of the Euro Influence on Polish Banking System"*¹³ – in the section relating to the Polish banking sector – discusses changes that occurred in 2000 as compared with the 1999 situation. This analysis (like the first edition) was addressed to a dozen or so of the largest Polish banks, being a representative sample for the entire Polish banking sector. It was split into three parts. The first part is connected with the effect of the euro introduction in the EMU countries and covers the issues of banks' preparation to the operation of national currency changeover to the euro, the degree of euro use in the EMU countries, and actions aimed at the establishment of a uniform payment area. The second part, relating to the influence of the introduction of the euro to the Polish banking sector, presents the issues deduced out on the basis of information obtained from the surveyed banks; the analysis included formal-legal issues, changes in banks' services, organisational-technical issues, and payment systems. The NBP role in preparation for the operation of changeover of national currencies of the EMU countries is described in the third part. The preparatory actions of a legislative, information and logistic nature have been mainly presented. The analysis was annexed with statistical materials, containing the data on the degree of the euro use in the EMU member states and the information on the euro share in the currency structure of payments executed in Poland in 2000 on behalf of exports and imports of goods and services.

In December 2002 the third edition of the *"Analysis of the Introduction of the Euro Influence on Polish Banking System"*¹⁴ – came out specifically covering the issue of introducing euro notes and coins to the circulation. The publication is split into three parts. The first part describes the effect of the euro introduction in both the EMU and third countries, specially in the context of arrangements for the introduction of the euro they have undertaken and developments associated with this process. The second and the main part is based on the survey addressed to the twelve major Polish banks, and analyses the influence of the introduction of the euro on the Polish banking sector. A particular emphasis was laid on formal-legal issues, organisational-technical issues, changes in banks' services, and the operation of changeover of national currencies of the EMU countries, including the carrying out of information campaign related to the introduction of the euro and the logistic activities.

In 2001 the NBP International Department analysed the preparation of the EU member states and candidate countries to the introduction of the euro as a cash currency. This study was prepared in the first half of 2001 on the basis of materials obtained from the central banks of

¹³ K.Szeląg, R.Żak, M.Glibowska, B.Pawelczyk: *Analysis of the Introduction of the Euro Influence on the Polish Banking System (2nd edition)*, Materials and Studies, NBP, No 128, Warsaw, July 2001.

¹⁴ H. Glibowska, A. Górska, B. Pawelczyk, R. Żak: *Analysis of the Introduction of the Euro Influence On the Polish Banking System (3rd edition)*. Materials and Studies, NBP, No 153, Warsaw, 2002.

European Union member states and the candidate countries. The available documents, reports, bulletins, and leaflets of member states, the data provided online and the information obtained due to a healthy working relationships with representatives of those banks, the ECB and the European Commission have been used. The '*Analysis of the EU Member States and the Candidate Countries' Preparation to the Introduction of the Euro Cash*'¹⁵ is complex in nature and presents the action taken by the discussed states in the process of the introduction of the circulation of the euro. It aimed at the presentation of the state of preparations at the Community level as well as of individual EMU countries, the EU countries outside the euro area and selected candidate countries for EU membership (Bulgaria, Czech Republic, Hungary, Slovenia, Turkey, as well as Poland). The analysis demonstrates differences resulting from the different status of countries ("ins" and "outs", member and candidate states), the effect of which could be seen in their various preparatory actions.

8.3. Legislative Activity

The preparations, from a formal-legal point of view, for the correct operation of contractual relationships in the territory of the Republic of Poland in connection with the introduction of the single euro currency in the EMU area appeared to be widely accepted by the banking environment as being necessary, when the banks in question expressed their views in what has been loosely termed as a questionnaire (of 15 asked, only one did not perceive the need for passing such regulations). The NBP prepared a bill of the Act, to set out the Polish legislation the issues of the euro's introduction into circulation. From the beginning the prepared bill had the clause of urgency, resulting from the need for a quick and broad campaign of information and education. The bulk of the **Act of 25th May 2001 on the Effects of the Introduction in Certain European Union Member States of the Single Euro Currency and on Amendments to Certain Legislation** passed by the Sejm took effect on 1st January 2001. The Act settled numerous key issues connected with the introduction of the new currency to circulation, i.e.:

- period of dual circulation,
- irrevocable conversion rates for the euro,
- conversion and rounding rules,
- continuity of contracts,
- principles, places and periods of notes and coins changeover,
- banking charges for conversion to the euro.

The above issues are generally regulated in a similar way to that in the Community regulations (Council Regulations (EC) No 1103/97, 974/98 and 2866/98). Provisions of the Act ratify the fact that from the beginning of 2002 the currencies of EMU countries will have been replaced with the euro. This will result in the fact that pecuniary transactions shall be made in the euro. However, in the initial phase, i.e. from 1st January 2002 to 28th February 2002, the pecuniary performances may be made in the national currencies of EMU states (both in cash and in cashless form). The above principle applies also to the realisation of the collateral of a pecuniary performance, if it was established in a national currency of an EMU member state.

The above two-months period is what is called the phase of parallel operation of national currencies and the euro. The "no ban, no order" Community principle is used during that time, allowing a free selection of the currency of transaction and settlement. This principle does not apply to banks that are obliged to make the pecuniary performance in the euro. They have also been obliged to convert national currencies held on bank accounts into the euro without additional charges and according to the exchange rates given in the Act (i.e. the irrevocable conversion rates

¹⁵ K.Szeląg, M.Glibowska, S.Jakubiec, B.Pawelczyk: "*Analysis of the EU Member States and the Candidate Countries Preparation to the Introduction of the Euro Cash*", "Materials and Studies", NBP, No 122, Warsaw, May 2001.

that were transferred to the Polish legislation – in an identical form – from the Commission Regulations (EC) No 2866/98 and 1478/2000, which aimed at ensuring the uniformity of Polish and Community regulations in that respect). Conversions were made automatically on 1st January 2002 and on the balance of that day. All other liabilities and claims, which do not apply to banks, were also converted according to the tabled rates, rounded off to two decimal places. After 28th February 2002 no payment may be made in a national currency; for Polish citizens commercial banks with foreign exchange permissions will first convert notes and coins in national currencies into the euro during 2002. The costs of such a conversion will be born by the customer and banks are authorised to levy an appropriate charge.

According to the principle of continuity of contracts, the obligation to pay in euro and the conversion of national currencies into the euro cannot be used to terminate or amend a contract. That also applies to interest rates (on loans, advances, securities), except for deposit rates for bank customers. However, in this case changes resulting in the diminution of effective conditions of deposit rates for bank customers were forbidden. The implementation of the principle of contract continuity aimed both at the guaranteeing of business reliability and at consumer interest protection.

The conversion of EMU national currencies (both notes and coins) is carried out equally by commercial banks and the NBP. The conversion is planned for Polish citizens only and will last till 31st December 2002 (after that date national currencies of EMU countries may be given for collection only, which means that the conversion into the euro will not be equivalent).

8.4. Information Activity

Within the preparation of the Polish banking system for the introduction of the euro the NBP has been running an **information campaign** propagating the knowledge of the new currency among the public and the banking sector. This campaign has also been presenting the positive aspects of Poland's membership of the EU and later on of the EMU. Initially this task was carried out by a team established specifically for the purpose of organising an information campaign on Poland's accession to the EU and the EMU. This function has now been taken over by the Department of Information and Public Relations, co-operating in this area with other departments.

The basic objective of the campaign consists of the dissemination of the information on the conversion of national currencies of twelve EU countries into the euro, the process of the conversion in Poland, images of euro notes and coins, and the security features in place against counterfeiting. To this end various forms of social communication have been used, *inter alia* the **mass media** (TV, radio, billboards), **information materials** (leaflets, posters, CD-ROMs), **public relations activity** (press conferences, TV and radio broadcasts, papers in national, local and professional press), the **Internet** (a euro page on the NBP website: www.nbp.pl/euro/index.html; Internet portals), **publications, seminars and training courses** (for bankers, journalists, teachers), **scientific conferences, knowledge quiz competitions and internal action** (addressed to the NBP staff – Intranet, databases). The information campaign has been planned so as to cover as wide a group of people as possible. It was broken down into four basic stages:

- **stage I (May – August 2001)** – the provision of **general information** on the EMU and euro to **commercial banks** and to other institutions directly involved in the process of national currencies conversion into the euro (**enterprises, exchange offices**) and also to **the media**;
- **stage II (September – October 2001)** – the delivery, apart from previously started information and promotional activities, of **specialised training courses** for the **personnel of commercial banks** and other interested **institutions** (including for disabled persons' organisations) on the security features of the euro banknotes;

- **stage III (October 2001 – January 2002) – an intensive campaign**, addressed primarily to the **public**, via **the mass media**, providing detailed information on the conversion of EMU national currencies into the euro;
- **stage IV (February - December 2002)** – activities reminding about the withdrawal from circulation of EMU national currencies and the introduction of the euro and providing information on the methods and dates of the conversion.

8.5. Logistic Activity

The NBP, as the central bank, bears the responsibility for the **preparation of the conversion operation** of EMU countries' currencies into the euro. In accordance with the NBP Management Board decision the NBP will not perform the conversion of EMU national currencies into the euro nationwide or in the banking sector. However, that does not mean that the NBP is not going to perform such operations at all. The **responsibility for the conversion** of national notes and coins of EMU countries into the euro notes and coins is **born equally by commercial banks and the central bank**. To this end the schedule of activities was adopted:

– **from October 2001** the NBP was gradually reducing – by selling to foreign banks – its reserves of EMU national currencies;

– **in December 2001** the NBP started purchasing euro cash, as to be prepared after 1st January 2002 for counter service to customers and for euro supply to those commercial banks with which agreements were made on the supply of foreign currencies;

– **1st January – 31st December 2002** – a period of conversion of national currencies of EMU countries into euro notes and coins to be performed by the NBP and commercial banks – pursuant to the provisions of the Act on the Euro – to the order of natural persons, being citizens of Poland;

– **by 31st December 2003** the NBP will be purchasing EMU national currencies only from those commercial banks with which it has made agreements on the supply of foreign currencies (however, it will not purchase currency from natural persons).

Apart from the supply of commercial banks with the euro currency the NBP is also going to provide **logistic support**. It shall be confined to the explanation to entities from the financial sector of all concerns connected with the currency changeover and with the procurement of the euro currency, etc.

9 Summary

In the process of European integration the NBP has been actively participating in three areas: together with the Government it participates in negotiations, adjusts the central bank structure and operation to the ESCB and prepares the banking sector to EU standards. The direction and pace of work carried out by the NBP were determined by the European Commission and by the ministries and central offices responsible for the conduct of negotiations in the areas of the NBP interest (e.g. the Ministry of Finance, Ministry of Economy, Office for Competition and Consumer Protection, Office of the Committee for European Integration).

The NBP participation in the negotiations refers now in particular to areas: the "Free movement of capital" and the "Finance and budget". Also the process of the central bank adjustment to the operation within the ESCB structures has not been entirely completed and is carried out in cooperation with the ECB. So far it was based on formal contacts with the ESCB countries (mainly with bank governors) and on working relationships (initiated both by the NBP and the ECB or NCBs), connected mainly with the provision of technical assistance by the ESCB experts.

The NBP aims at a closer cooperation with the ECB and the national central banks – members of the ESCB. During **working meetings**, apart from issues related to the economic and banking sector development, detailed issues are being discussed the balance of payments, foreign exchange rate, and banking statistic issues. For a precise identification of the areas that might be the subject of consultations with the ECB, the NBP departments have prepared a list of detailed issues and a schedule of technical cooperation between the banks.

The NBP suggests the following areas of technical co-operation between the ECB and the NBP:

- **legal aspects** (adjustment of the financial legislation to the EU directives – general issues, within which consultations will be necessary on individual subjects – e.g. regulations on the collateral legislation, cross-border transfers, payment and settlement systems, the banking supervision, cross-border insolvency, the system of foreign exchange rates fixing and foreign exchange reserves management);
- **monetary and credit policy** (the definition of required reserve problems, securities trading monitoring and control, the lending operations security, and banking sector liquidity);
- **monetary and banking statistics** (the co-operation at the updating of the MFI list, the reconstruction of monetary and banking statistics system and the collection and processing of the information on interest rates);
- **payment systems** (terms and conditions of the participation in the TARGET system, the security of the payment systems in the context of electronic payment instruments and electronic money development);
- **accounting and reporting** (principles of grouping economic events in the ECB chart of accounts, principles of central bank operations budgeting);
- **co-operation in subjects of research** (the nominal and real convergence of the Polish economy vis-à-vis accession to the EU and EMU, models of imports and exports forecasting, the technological progress and its influence on the banking sector, integration processes within the EMU and the globalisation of financial markets);
- **issue of currency, including withdrawal from circulation of counterfeit notes and coins** (cooperation in the establishment of the Counterfeits Monitoring System and the Counterfeit Analysis Centre, access to the Counterfeit Currency Database);

- **information technology and telecommunication** (the two-way communication between the NBP and the ECB, participation in working out the technical specification in the field of including Polish RTGS to the TARGET);
- **co-operation in the field of prudential regulations influence** on the financial standing of credit institutions;
- **training assistance and exchange of experience: conferences, seminars, training at the ECB** (e.g. legal issues, the inflation forecasting and mechanisms of monetary policy, financial system, co-operation between central banks within the ESCB, operation of the euro, statistics, accounting, banking supervision, etc.).

At present, the ECB co-operation with the NBP has been significantly deepened because Poland will become entitled to the following even before obtaining the UE membership, i.e. by or before May 1st 2004:

– participation of the NBP President in the work of the ECB General Council with the **status of the active observer**.

– participation of the NBP representatives in the operations of the **committees and working groups**¹⁶ functioning within the ECB, also with the status of the **active observers**.

The **status of the active observer** involves active participation in the work of those bodies, yet with no right to vote, with the view to **supporting the introduction to general rules and internal procedures of operations** of the ESCB. Ultimately, it is also to secure effective participation of new Member States in the work of numerous experts' bodies.

Apart from working in the above mentioned committees, the **NBP experts participate in the working groups operating within each of the ESCB committees**. The newly established Working Group for Monetary Policy of Acceding Countries is the one whose operations will be of special interest for the NBP.

The NBP has been attaching importance not only to the co-operation with the ECB, but also to contacts with other central banks, also from outside the ESCB. **Central bank workshops** are used for the exchange of experience, attended by representatives of the ESCB, the EU institutions and central banks of EU candidate countries. The second meeting of this type (the first was held in Malta in 1999) was organised by the NBP on 11–12 October 2000. Papers suggested by the NBP (legal aspects of integration, the monetary policy, payment systems, and the euro introduction) were connected with the most important issues of central banking, with particular focus on the aspects of harmonisation with the ESCB standards. After a successful third meeting organised by the central bank of Cyprus in October 2001, it may be presumed that such meetings will be continued.

Conferences with the participation of the central banks' representatives are another form of the information exchange and co-operation initiation. On 22–23 October 2000 in Falenty, the NBP organised a conference on **"The Polish way to the euro"**, attended *inter alia* by representatives of the ECB, central banks of Germany, Austria, Denmark, Hungary as well as from government offices and academic circles. The subject of the conference was connected with the strategy of the accession to the EMU. It referred to the future of the zloty and the problem of so-called *euroisation*, the adequacy of monetary criteria for the accession countries as well as benefits and costs of the accession to the euro area and the effects of that for the Polish labour market.

¹⁶ Present ESCB's Committees (12): Accounting and Monetary Income Committee, Banknote Committee, Banking Supervision Committee, External Communications Committee, Internal Auditors Committee, International Relations Committee, Information Technology Committee, Legal Committee, Market Operations Committee, Monetary Policy Committee, Payment and Settlement Systems Committee, Statistics Committee.

