POLISH FINANCIAL SUPERVISION AUTHORITY

FIVE YEARS OF ACTIVITY

Polish Financial Supervision Authority

BY THE POLISH FINANCIAL SUPERVISION AUTHORITY

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Warsaw, 2011

The years 2006-2011 have been the supervisory authority's first term of office on the financial market when no collapse of any financial institution was reported. Throughout the global crisis on financial markets, a secure and stable financial sector has remained the stronghold of the Polish economy.

Since 2006, not a single financial institution has been declared bankrupt.

In the most developed countries of the G–20 group, direct public aid for financial institutions in 2008-2009 accounted for 3.7% of the group's 2008 GDP. In Poland, this would be approximately PLN 47bn.

Potential public aid for financial institutions, amounting to PLN 47bn, was avoided.

Since the establishment of the PFSA, the condition of the Polish financial market has improved significantly despite the turmoil on global financial markets: banks' equity rose by 63%, to over PLN 100bn, the average solvency ratio in the Polish banking sector increased (from 10.8% at the end of 2008 to 13.7% at the end of 2010), in the insurance sector gross premium written soared by approximately 45%, and the number of companies listed on the Warsaw Stock Exchange went up by about 40%. The Polish market is stable and well capitalised, which has created an environment conducive to stronger growth of the banks' lending activity.

In 2006-2011, the condition of the Polish financial market has improved markedly.

KEY ACHIEVEMENTS OF INTEGRATED FINANCIAL SUPERVISION

[1]CEDUR - Education Centre for Market Participants

[2]TIFS - Training Initiative for Financial Supervision

[3]SNU - Insurance Supervision System

[4]BION - Supervisory Testing and Assessment

[5]RAU - online Register of Insurance Agents

[6]SNO - Trading Supervision System

[7]PORTAL - ITC system for secure exchange information with banks, entities conducting brokerage activities and investment fund companies

BANKRUPTCIES OF FINANCIAL INSTITUTIONS AFTER 1990

* In the case of brokerage activities, the entities concerned are whose nrokerage licenses were revoked.
** Cooperative banks have been subject to supervision since 1992.

Cooperative banks declared bankrupt
(CB - cooperative bank)

1992

CB of Śrem
(resumed opeartions in 1995)

1993

CB of Koszalin
CB of Sompolno
CB of Tuchów
CB of Szczurowa
CB of Kramsk
CB of Kolbudy, registered office in Lublew
CB of Strumień
CB of Miejsce Piastowe
CB of Raciechowice
CB of Opatowiec

1994

CB of Janowiec Kościelny
CB of Wierzchlas
CB of Bejsce
CB of Slanów
CB of Jedlnia Letnisko
CB of Grabowo on Prosna
CB of Nowogrodziec
CB of Wasilków
CB of Koszyce
CB of Czarna Białostocka
CB of Niedźwiada
CB of Wieczfnia Kościelna
CB of Borzęcin
CB of Kalisz
CB Rzemiosła of Poznań
CB of Swarzędz
CB of Szczaniec
CB of Mąkoszyce
CB of Godziesze
CB of Cisk
CB of Piekary Śląskie
CB of Tarnów
CB of Brześć Kujawski

1995

CB of Kętrzyn
CB Rzemiosła i Usług of Częstochowa
CB of Częstochowa
CB of Orneta
CB of Olkusz
CB of Ujście
CB of Trzcianka
CB of Rawicz
CB of Piła
CB of Ojrzenie
CB of Bolesławiec
CB of Sulechów
CB of Słupsk
CB of Rypin
CB of Dobra
CB of Opalenica
CB of Chęciny
CB of LuCBko
CB of Bedlno
CB of Wisła
CB of Tarnówek
CB of Wałcz
CB of Zapolice
CB of Buk
CB of Bojanów
CB of Reglmin
CB of Strzelce Opolskie
CB of Sidra
CB of Bojadły
CB of Połajewo
CB of Kluczbork
CB of Zarzecze
CB of Wieluń
CB of Biała Piska
CB of Choceń
CB of Zbrosławice
CB of Dobromierz, registered office in Roztoka
CB of Pieniężno
CB of Zbójna
CB of Woźniki Śląskie
CB of Tłuchów
CB of Jelenia Góra
CB of Skoroszyce
CB of Solec Kujawski
CB of Drużbice
CB of Gnojno
CB of Kruszyna
CB of Żerków
CB of Lutomiersk, registered office in Konstantynowo
CB of Potęgowo
CB of Lębork
CB of Postomin
CB of Zakrzew, registered office in Biłgoraj
CB of Jaraczewo
CB of Łanięty
CB of Wąwolnica
CB of Kozienice

1996

CB of Pilawa
CB of Bogdaniec
CB of Deszczno
CB of Rejowiec Fabryczny
CB of Smołdzino
CB of Granów
CB of Gryfów Śląski
CB of Ziębice
CB of Łobez
CB of Dąbrowa Górnicza
CB of Brudzew
CB of Blizanów
CB of Sępólno Krajeńskie
CB of Nowe Miasto on Pilica
CB of Jasień
CB of Wąsosz
CB of Pęczniewo
CB of Miejska Górka
CB of Krobia
CB of Piotrków Trybunalski
CB of Lądek Zdrój
CB of Serock
CB of Skwierzyn
CB of Konopnica
CB Gospodarczy of Sława
CB of Łabunie
CB of Rudnik
CB of Dębno Lubuskie
CB of Komprachcice
CB of Gorzków

1997

CB of Kamień Pomorski
CB of Przybiernów
CB of Łęczyce
CB of Dubienka
CB of Kołobrzeg
CB of Ceków Kolonia

1998

CB Pruchnik
CB Wądroże Wielkie
CB Ostrowice
CB of Resk

2001

CB of Włodowice

Situation of the banking sector

Despite the financial crisis, the sector's condition improved significantly in 2006-2010.

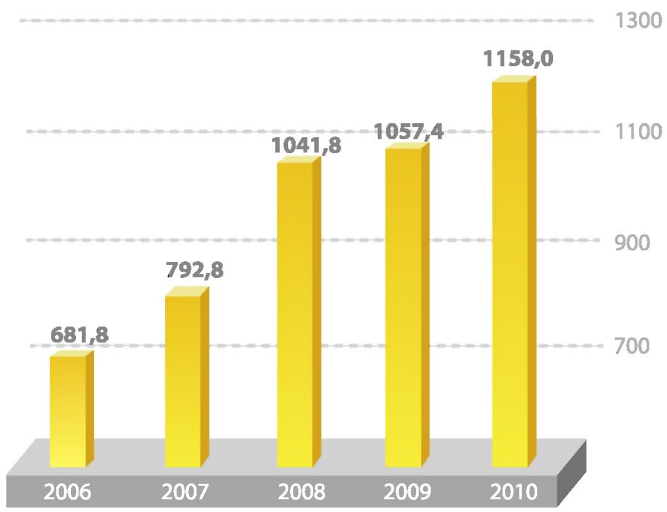


Chart 1
Banking sector's assets (PLN bn)

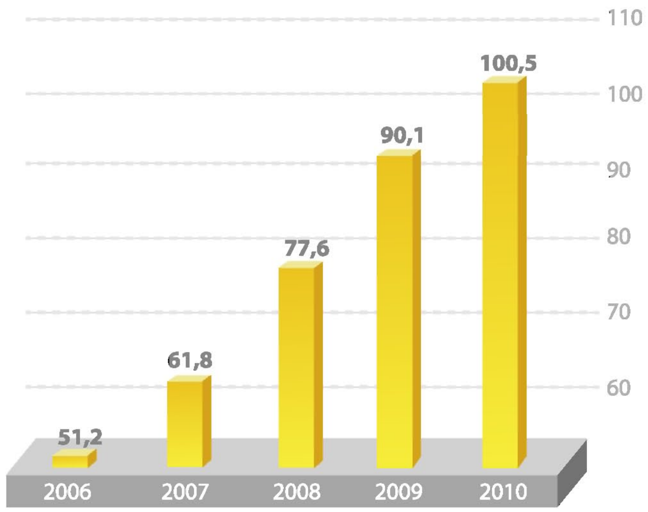


Chart 2
Banking sector's equity (PLN bn)

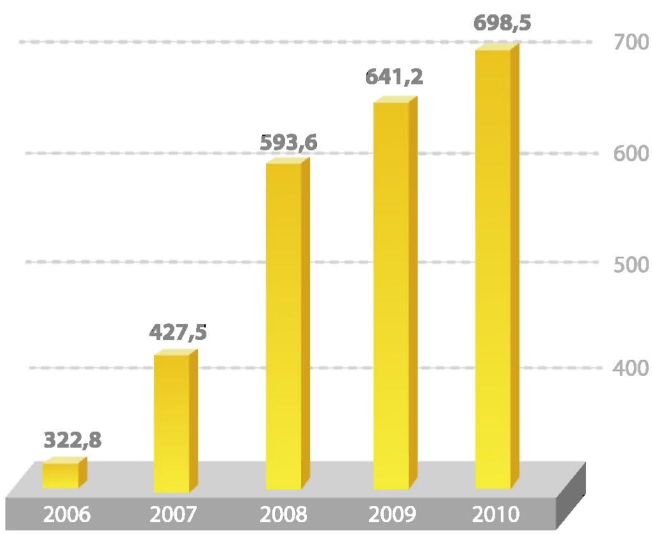


Chart 3
Amounts due from non-financial sector (PLN bn)

Chart 4
Banking sector's
net profit (PLN bn)

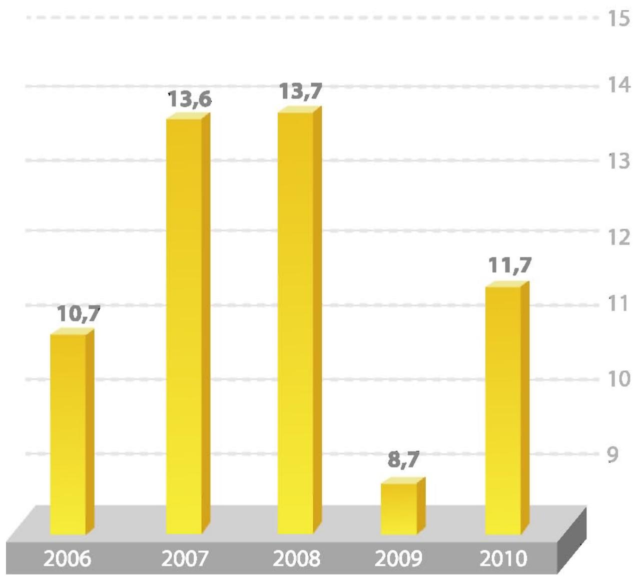


Chart 5
Banking sector's
solvency ratio (%)

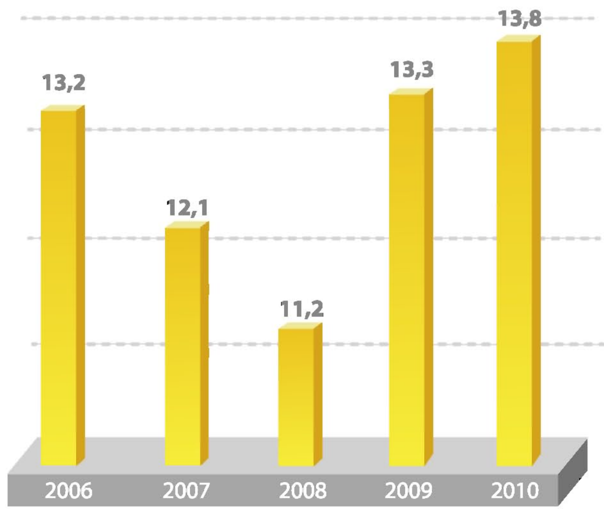
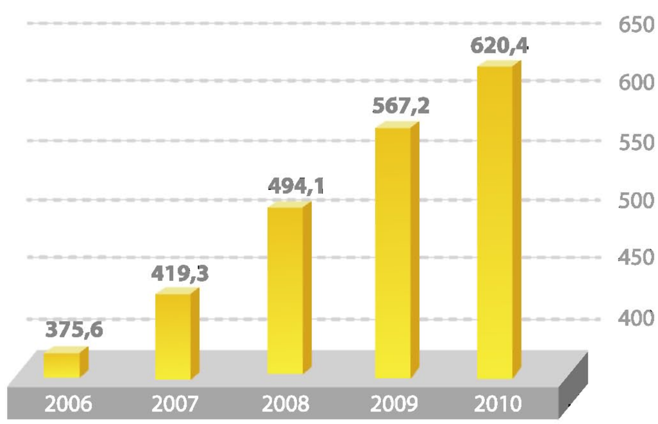


Chart 6
Amounts due to
non-financial sector (PLN bn)



Situation of the insurance market

A limit on concentration of deposits placed by life insurance undertakings with banks helped enhance banks' liquidity.

Chart 7
Investments of insurance undertakings (PLN bn)

Chart 8
Gross premium written of insurance undertakings (PLN bn)

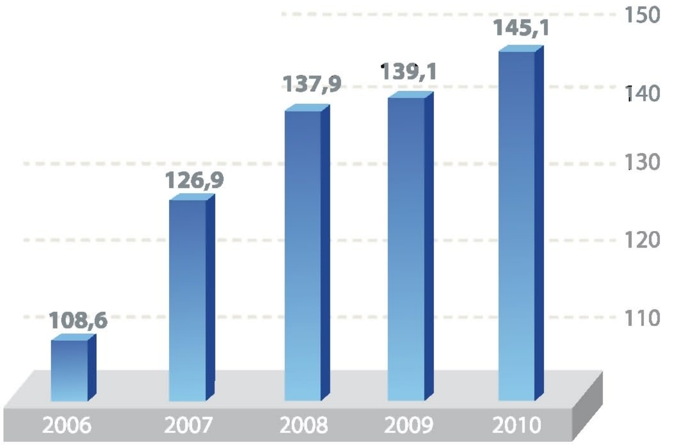


Chart 9
Total balance sheet of insurance undertakings (PLN bn)

Dynamic growth of the Polish capital market.

Chart 10
Number of entities conducting brokerage activities and providing securities accounts

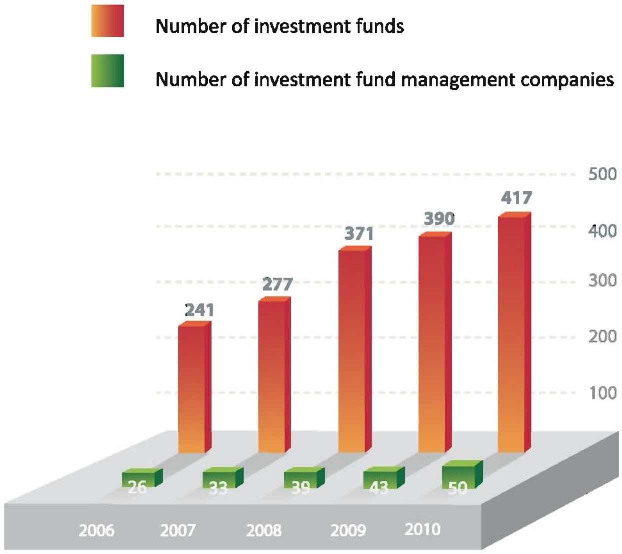


Chart 11
Number of investment fund companies and investment funds

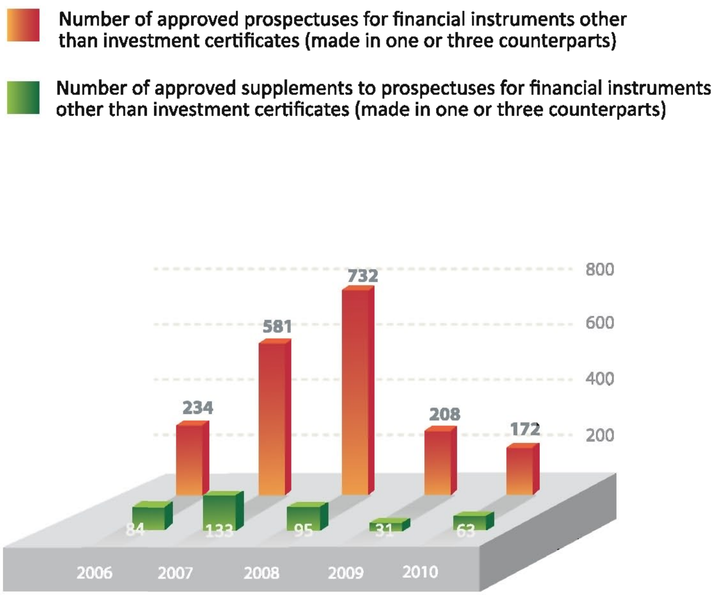


Chart 12
Number of approved supplements and prospectuses

Chart 13
Number of companies listed on WSE

Situation of the pension fund sector

In terms of the asset value, the pension fund sector remains the second largest after the banking sector.

Chart 14

Net assets of open pension funds (PLN bn)

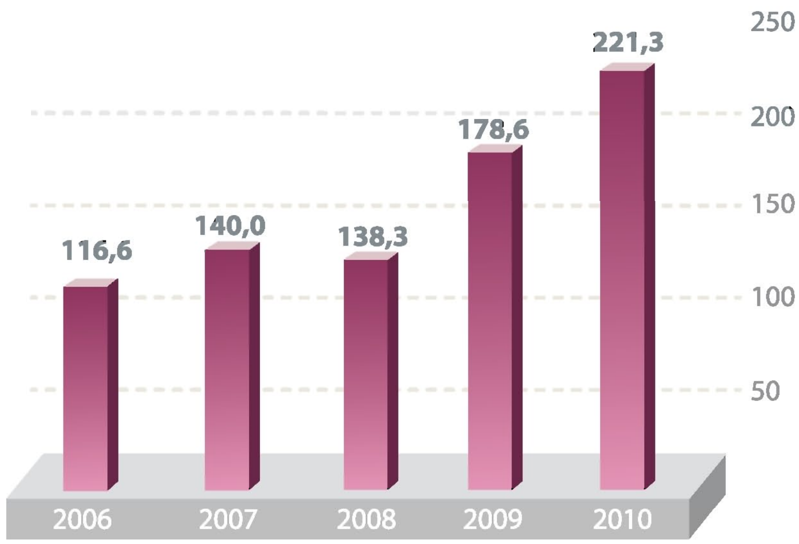
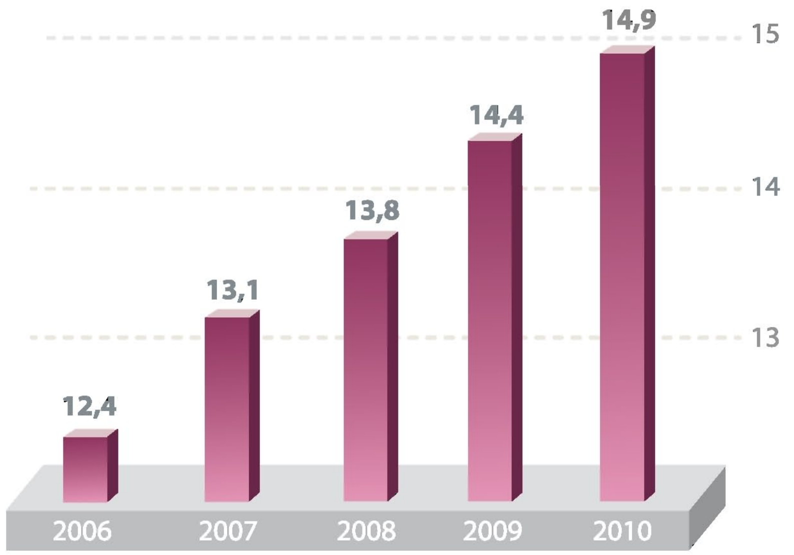


Chart 15

Number of members in open pension funds (m)



Financial supervision activities

The PFSA's mission is to ensure stability and safe development of the financial market in Poland. The PFSA issues approximately 2.5 thousand administrative decisions annually. In addition to the ongoing supervisory work, system-related aspects of the supervisor's activities are also of particular focus.

Banking sector

Financial crisis as a test for integrated supervision

Polish subsidiaries of foreign banks showed resilience to the problems encountered by their parents.

Inclusion of banks under PFSA's supervision just a few months before the onset of the financial crisis was a test for the sector and the supervisory policy. What made the test more difficult was the fact that a vast majority of banks operating in Poland were controlled by foreign investors. There was a real threat that problems faced by parent companies could affect their Polish subsidiaries. There was also a risk that the foreign parents would attempt to use the liquidity reserves of their local subsidiaries or discontinue financing of the subsidiaries. Given the risk factors originating outside the Polish market, including in particular reputation risk, deteriorating liquidity, and limited access to the interbank market, the PFSA attempted to strengthen the sector from inside (by issuing stricter capital recommendations and detailed liquidity standards), in order to prevent those risks from materialising. In effect, the Polish banking sector weathered that very difficult period with a solid capital base, without having to resort to state aid, and with a record-high – relative to other EU markets – ROE, amounting to 7%[1] for 2009, when the average for the EU states at 2.4%.

In 2009, the Polish banking system retained a record-breaking amount of PLN 11.2bn, representing commercial banks' profits made in 2008.

Discouraging banks from paying out any dividends out of 2008 enabled the banking sector to build up a capital buffer.

During the financial crisis, the Polish banking system maintained the operating model whereby funds for secure development of banks are sourced from the sector's earnings or from owners rather than from public aid. In Polish banking sector, almost 90% of commercial banks' profits earned in 2008 were retained. Significant part of these funds represented dividends foregone by the banks' foreign institutions.

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[1] ROE - return on equality.

In January 2009, banks were recommended to set up an additional capital buffer – a 2% surplus above the required 8% minimum solvency ratio. The focus was on ensuring that banks' equity comprised chiefly core capital. These steps were particularly important as the economic slowdown was triggering deterioration in the quality of the banks' assets.

Banks implemented a conservation buffer (minimum solvency ratio of 8% plus 2%).

Some of the banks operating in Poland received support from their foreign owners, in the form of participation in capital increase and credit facilities. Higher equity (currently in excess of PLN 100bn) helped to maintain the lending activity, offset the higher capital requirements, and consequently caused the average solvency ratio of the Polish banking sector to rise from 11.2% at the end of 2008 to 13.8% at the end of 2010.

More stringent concentration limits were introduced, whereby a bank's exposure to related parties could not exceed 100% of its equity.

No Polish subsidiary of a foreign bank provided financing to its foreign parent. It was quite the opposite – funds available to the Polish banks, expressed as the difference between the liabilities of the Polish banking sector to foreign institutions and amounts due from foreign institutions to Polish banks, rose in 2009 by an additional amount of PLN 17bn.

In 2009, PLN 17bn in foreign financing for banks was raised.

Another risk stemming from equity links within international corporate groups is the risk of exposure concentration on part of Polish banks. Pursuant to PFSA's Resolution No. 382/2008, limits applicable to Polish banks were changed with effect as of 1st January 2009. More stringent limits were also introduced with regard to exposures to foreign parent banks and to entities which are registered in Poland and have equity links with banks.

The PFSA resolved to limiting exposures allowed within a single financial group.

Liquidity standards were introduced.

In June 2008, banks were obligated to maintain specific liquidity standards. The solution implemented in Poland served as a reference point for international standards endorsed by the Basel Committee.

Poland pioneered the introduction of liquidity standards for banks.

Also, liquidity positions at banks were subject to intense scrutiny, with some of the banks placed under an obligation to file daily reports on supervisory liquidity measures. Special supervisory actions were taken with respect to banks at which irregularities had been identified (such as warning notices, lending recommendations, notifications sent to the home regulator).

None of the banks operating in Poland experienced a loss of liquidity. At the sector level, a year-on-year increase in primary liquidity reserve by nearly 23% was recorded in 2009.

Regulatory recommendations helped reduce the banking sector's risk exposures.

Recommendation T prevented banks from taking excessive risks.

The irregularities in creditworthiness assessment, discovered after banking supervision was placed within the remit of the regulator, prompted the PFSA to start work on a recommendation that would define retail lending standards. The adopted Recommendation T set out rules governing creditworthiness assessment and increased the required LTV (loan-to-value) ratio for retail loans. Qualitative standards were complemented by quantitative ones. For instance, caps were set on the loan liabilities to average net income ratio: 50% for retail clients with net incomes of less than or equal to the average income in Poland, and 65% for clients with above-average incomes. Recommendation T offers a double advantage of ensuring more effective risk management at banks and, in the social dimension, protecting individuals with low incomes against excessive borrowing.

Recommendation S was refined.

Recommendation S implemented in 2006 by the previous supervisory authority (Banking Supervision Commission) failed to halt the increase in foreign currency loans. The PFSA eliminated deficiencies in Recommendation S by precisely defining the method of determining the basis for calculating the 20% currency risk buffer and by tightening risk management standards at banks.

The revised Recommendation A helped improve the quality of risk management in transactions on derivatives markets. The revisions concerned monitoring and control of risks (notably credit risk), documents and exchange of information with the client, as well as extension of systems and procedures facilitating the flow of information at banks.

June 2011 was the date of amendment of Recommendation R, which was addressed to banks and concerned the rules of identifying depreciated balance sheet credit exposures, identifying depreciation write-downs concerning depreciation of balance sheet credit exposures and provisions for off-balance sheet credit exposures. The purpose of the amendment was to ensure conformity of Recommendation R with the practice of applying the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS).

Subsequently, in July 2011, the Financial Supervision Authority amended its Recommendation H concerning internal audit systems at banks. The purpose of the amendment was to strengthen internal audit systems at banks, implement the obligation to establish audit committees at domestic banks (other than cooperative banks) set forth in the Act on Auditors, limit the number of personal connections at key positions in banks and to include international guidelines in this regard.

The PFSA recommendations added to the stability and security of the banking sector, particularly in the context of possible external disruptions and uncertain access to foreign sources of financing. The Polish economy benefits from the inflow of external capital. However, it also faces a challenge of maintaining growth in new lending at a rate which favours economic growth but at the same time does not feed speculative bubbles or generate excessive imports.

The stability of the financing system is helped by sustainable economic growth.

A stress testing system was implemented at banks, which serves as a tool for assessing the banking sector's resilience to extreme scenarios.

As required under supervisory regulations, banks in Poland are subject to regular stress testing, which covers mainly credit risk and market risk. Stress tests are used to assess bank's resilience to extreme yet possible scenarios of shocks in the macroeconomic environment or in particular business segments (e.g. they measure sensitivity of a mortgage loan portfolio to changes in interest and exchange rates). The awareness of potential threats, which if materialised may cause major disturbances at banks, is important for the assessment of financial stability and implementation of precautionary supervisory and regulatory measures.

In 2010, to complement standard tests, an exercise was undertaken for the first time which entailed building of testing models both by banks and by the regulator independently. By comparing the models, a universal supervisory tool was arrived at, which enables ongoing monitoring of the situation at particular institutions.

Stress testing system was implemented at banks.

Protection against excessive exposure to currency risk.

In 2005–2007, the average annual growth rate in debt under foreign currency loans in Poland was 32%. The impact of Recommendation S, adopted by the Banking Supervision Commission in 2006 as a response to a growing mismatch in the banking system's financing structure, proved limited – banks adjusted their creditworthiness assessment procedures in accordance with loan applications. Two years later, the share of foreign currency loans in total housing loans reached 69.5%.

Since the banking sector's inclusion in its regulatory remit, the PFSA has issued recommendations which set standards for foreign currency lending.

Further PFSA recommendations reduced the excessive exposure to currency risk in the banking system.

Recommendation S II enhanced protection of consumers taking loans denominated in foreign currencies, including with respect to the requirement for lenders to provide information on currency spreads, extra charges and expenses, and currency risk, and provided consumers with the option to pay their liabilities directly in the loan currency.

Recommendation T, which was focused on the weak points identified in risk management frameworks, defined a more detailed creditworthiness assessment policy, lowered the permitted LTV ratio for retail loans, including those denominated in foreign currencies, and set limits on borrower's overall debt level.

At the same time, the amended Recommendation I contributed to a reduction in credit risk exposures associated with foreign-currency credit transactions executed by banks, and helped streamline currency risk management processes.

The maximum effective DTI ratio for foreign currency loans was lowered to 35%.

The amended Recommendation S, adopted in 2011, enhances protection of Poland's banking sector against disruptions such as those suffered by other economies in the CEE region, which were caused by unrestricted foreign-currency lending to households. Following the change, the maximum effective DTI ratio[2] for foreign currency loans is 35%[3].

June 2011 also saw the amendment of resolution No. 76/2010 of the Financial Supervision Authority which was addressed to banks and concerned the scope and detailed rules of determining capital adequacy requirements for different risk types. The amendment involves an increase, from the preferential 75-percent level to the base 100-percent level, of the risk weight for exposures for which the amount of payment depends on the volatility of currency exchange rates other than the currecy of the revenue generated by the debtor for retail exposures and residential real estate-backed exposures. Increasing the capital buffer helped further protect banks against the risks involved in foreign currency loans.

Capital-rich banks.

Strong capital positions at banks were promoted.

Polish banks managed to weather the difficult time of crisis with solid capital base. From the end of 2007, banks' total equity rose by 55% (PLN 41bn), to over PLN 116bn,

[2] DTI – relationship between monthly loan payments and average net income.

[3] After taking into account the recommendation concerning the maximum (monthly) loan liabilities to average net income ratio (50% or 65%) and the recommendation that creditworthiness of consumers applying for a foreign currency loan be assessed upon assumption that the principal amount of the loan is 20% higher than it would be in the case of a złoty-denominated loan.

mainly as a result of the sector's retaining the 2008 earnings. By awarding preference to long-term sources of capital and taking efforts to prevent erosion of higher-quality capital, the regulator tightened requirements on subordinated borrowing counted towards capital. During the crisis, the PFSA provided banks with an option to classify as share capital bonds issued by the banks, which offered a stable, and not merely temporary, support for their capital base.

Following its analysis of the Polish banking sector in early 2010, the Fitch rating agency concluded that banks operating in Poland were more resilient to the crisis than its peers in the region, and that the sector was better prepared to benefit from an economic recovery.

Insurance sector

During the global financial crisis, the insurance sector was a provider of liquidity to banks.

Concentration of deposits of life insurance undertakings in banks was limited. Standards imposed by the supervisor led to distribution of liquidity from the insurance sector throughout the entire banking sector. The level of diversification in bank deposits has been growing since 2009, this being particularly true about deposits made by life insurance companies at related banks.

Diversification in insurance undertakings' investment portfolios enhanced liquidity at banks.

The turmoil on financial markets did not compromise stability of insurance companies operating in Poland.

The crisis had no direct impact on the Polish companies nor Polish subsidiaries of international companies, which were under much pressure on their respective home markets. At the time of crisis, maintaining financial liquidity is critical. Therefore, the regulator examined whether insurance companies held any assets issued by foreign financial institutions threatened with insolvency. Additionally, insurance companies were requested to report regularly on their basic solvency indicators and placements.

Additional reporting added to the insurance sector's transparency.

Steps were also taken to raise standards in the area of concentration and credit risk management. These included monitoring of investment policies pursued by particular insurance undertakings, assessment of investment structures and the ability to absorb risk, and monitoring of actions taken by insurance companies to reduce risk exposures associated with investment activities. As for life insurance companies, ongoing monitoring was undertaken to determine the level of concentration of investments in

Standards of concentration and credit risk management were raised.

structured products and bank deposits, as a proportion of equity. Moreover, a review of structured products offered by insurance undertakings (key features, general terms and conditions of insurance contracts) and their investments in bank deposits was performed.

Insurance Supervision System (SNU) was implemented.

Since December 2009, the exchange of information between the supervisor and insurance companies has been carried out through the electronic Insurance Supervision System (SNU).

The participants of the insurance market have been included in the internal stress testing system.

The results of stress testing facilitate identification of key risks which the entire sector and individual insurance undertakings are exposed to. As a result, supervisory activities in these areas are intensified.

Preparing the market for Solvency II.

Stress tests and the pre-application process help insurance undertakings prepare for the implementation of Solvency II regime.

In the coming years, insurance operations in the European Union will be governed by the Solvency II directive, which, among other things, introduces considerable changes with respect to financial management at insurance companies. An important new solution will be the possibility to calculate capital requirements with the use of internal models which will be developed by insurance undertakings and subject to approval by the regulator. In January 2011, the pre-application process was initiated, designed to facilitate the preparation of approvable internal models.

Pension funds sector

The pension fund sector remained second-largest market segment, after the banking sector, in terms of asset value.

The PFSA reiterated its earlier proposals for the necessary changes in the operation of open pension funds and was involved, through the performance of appropriate analyses, in all the legislative work relating to the pension market. As at the end of 2010, the total net asset value of open pension funds was PLN 221.5bn, and open pension funds had 14.9m members. In 2010, the number of members of all funds active in the market grew by 570 thousand, including over 360 thousand new members acquired by three mid-sized open pension funds, which were most active in member acquisition.

Capital adequacy requirements for pension fund companies should be implemented.

Currently, minimum equity levels are the same for all pension fund companies, irrespective of the value of assets of the pension funds managed by them. At the same time, if a pension fund incurs a deficit, such deficit is covered with, inter alia, the pension fund company's own funds.

The minimum equity requirement for universal pension fund companies should depend on the assets held by open pension funds.

As a result of an assessment of the validity of introducing capital adequacy requirements for the pension fund market, a model for evaluating the effect of capital adequacy requirements on the value of pension fund companies was developed and a proposal was formulated to strengthen the security of the pension system by linking the minimum capital requirement for pension fund companies with the value of assets held by open pension funds.

The problem with the methods of acquiring new open pension fund members was solved.

Open pension funds should compete on their investment performance rather than clever tactics of their agents. Lowering acquisition costs will reduce open pension funds' operating expenses.

In response to the irregularities found in the operation of agents of open pension funds, and assuming that competing on investment performance of funds rather than on the agents' persuasion skills would be more desirable, a proposal was made to abandon the system where new fund members are acquired by agents. The changes will help to reduce the costs of operation of the open pension fund system – acquisition costs currently account for over one third of the pension fund companies' overall operating expenses. Lower costs of operation may offer an opportunity to reduce the charges collected from members of open pension funds.

Improved security of the investments of open pension funds.

Steps were also taken to implement regulations promoting greater security of the investments of open pension funds by adjusting the range of permissible investments to the stage of development of the financial market. The PFSA, upon request from the Minister of Labour and Social Policy, arranged for a working group project seeking to legislate the rules under which pension funds could engage in securities lending. The conclusions and results of work of the working group were presented to the Minister of Labour and Social Policy acting as the regulator of the pension fund market.

Investment policy changes will increase the effectiveness of open pension funds.

Capital market

Supervisory powers over the public offering market.

Since the establishment of the PFSA, the number of companies listed on the WSE has increased by approx. 40%. In May 2008, the prospectus approval procedure was changed. Prior to May 2008, the supervisor would thoroughly review prospectuses and present often numerous comments and proposals aimed at producing, jointly with the issuer and advisors, a prospectus which would be free from any errors and compliant with the applicable laws and regulations. Under the new approval procedure, it is assumed that full responsibility for contents of an offering prospectus rests with the issuer and the entities drafting the prospectus. The changes have helped improve the quality of work of advisors and halved the time required to approve a prospectus in the PFSA.

Quicker approval of prospectuses stimulated the capital market.

Lists of most common errors and irregularities found in issue prospectuses were updated and published on a regular basis, which allowed companies drafting prospectuses to better review the documents prior to their filing with the PFSA and improve the quality of the documentation.

The investment fund licensing procedure was optimised.

The investment fund licensing procedure has a shorter duration.

In the area of investment fund supervision:

- ✓ changes were proposed in the legislation related to the supervision of closed-end investment funds investing in non-public assets,
- ✓ investment fund licensing procedure was enhanced by committing additional human resources to the process (the resources grew from approx. 10 staff in 2006 to approx. 20 staff in 2011) and forming a separate team to handle share purchase notifications from investment fund companies, applications for management of securitised claims, and extension of the scope of activities of investment fund management companies.

Implementation of the Markets in Financial Instruments Directive has provided better protection for investors.

Implementation of the Markets in Financial Instruments Directive (MiFID)

Following the implementation of the MiFID into the Polish legal system, the range of brokerage activities was extended and several additional obligations were imposed on investment firms. As a consequence, amendments to the existing legislation improved the legal situation of a client. The MiFID offered the clients a higher standard of customer service and better protection of their interests.

The new obligations imposed on investment firms require such firms to assess the knowledge and experience of their clients, making sure that a given investment service or financial instrument is appropriate for the client, and in particular that the client understands the risks related to the product.

A number of interpretations to the amended regulations were made public by the PFSA and training courses related to the MiFID were offered to professional participants of the capital market. A number of inspections were carried out into the adjustment of the regulated entities to the new legal framework.

Measures for increased protection of capital market participants

February 2011 saw the publication of the PFSA policy paper "Measures for increased protection of capital market participants", containing recommendations on measures, including legislative changes, to be taken to enhance transparency of the capital market, or indirectly ensure better protection of investors' interests.

Enhanced transparency of listed companies means better protection of investors.

The proposed changes cover such matters as:

- ✓ greater responsibility of management boards of listed companies for any breach of disclosure requirements by the companies,
- ✓ regulating the relationship between statutory confidential information and the regulation on current and periodic information,
- ✓ reporting by listed companies on any closed meetings with analysts and selected investors,
- ✓ greater clarity of financial forecasts published by listed companies,
- ✓ increased transparency of the companies listed on the NewConnect market,
- ✓ valuations of in-kind contributions and related-party transactions in listed companies,
- ✓ clarification by issuers of any false or incorrect information circulated publicly,
- ✓ reporting by listed companies on proceedings of the General Shareholders Meetings,
- ✓ payments for subscriptions and leveraging during public offerings,
- ✓ supervisor's increased emphasis on preventive measures (formulation of warnings, presentation of opinions, interpretations and explanations).

Supervision based on risk assessment was introduced.

The intensity of supervisory measures is termined by the risk generated by supervised entities.

Due to the number of regulated entities and the scale of their operations, there was a need to clarify the manner in which financial supervision is exercised so as to ensure that the supervision measures are adequate to the level of risk.

Therefore, a supervisory system based on risk assessment was launched at the PFSA. Regulated financial institutions are continuously assessed based on the risk involved, using the BION methodology[4]. The result of the BION evaluation determines the intensity of supervisory activities, in particular inspections. This enables a more efficient allocation of the PFSA resources, which are assigned to areas and entities with high risk profiles.

All financial institutions are evaluated based on the BION methodology.

The BION evaluation uses all the information obtained by the supervisor during, for instance, inspections, visits and supervisory meetings, licensing procedures, communication with owners, reviews of periodic reports or sourced from the responses to the PFSA's additional enquiries (questionnaires, supervisory requests, surveys, etc.). The BION process is supported by the PFSA's IT systems designed to handle the exchange of supervisory information with financial institutions.

Under the BION process, the supervisor evaluates:

- ✓ level of risk at the financial institution,
- ✓ quality of the significant risk management process implemented by the financial institution,
- ✓ amount of capital covering risk at the financial institution, and
- ✓ financial institution's compliance with laws and internal regulations.

The benefit offered by BION is that it provides a mechanism for applying adequate supervisory measures to a given institution, aiming at improving the institution's position in areas of excessive risk. The key criterion for determining the priority and frequency of regulatory measures is the actual level of risk incurred.

[4] BION (Supervisory Review and Assesment) - one of the supervisory tools supporting prudential supervision based on risk assesment

Sanction activities were strengthened.

Table 1
Number and value of penalties imposed by the PFSA

Year	Number of penalties imposed	Value of penalties imposed (PLNm)
2006*	12	0.70
2007	30	2.08
2008	55	4.03
2009	50	2.61
2010	51	5.40

The value of penalties for violation of regulations imposed by the PFSA increases.

Any party not satisfied with PFSA's decisions may file an appeal with administrative court. In 2006–2011, the PFSA was involved in approximately 300 court and administrative proceedings.

Table 2
Number of notifications of alleged offence filed by the PFSA with public prosecutors

Year	Number of notofications
2006*	10
2007	47
2008	42
2009	42
2010	53

Coalition of host countries of the European Union

There are two groups of markets in the EU. The first group comprises countries which are home markets for the parents of international financial groups. The second group, which includes Poland, comprises countries which host subsidiaries of such international financial groups. Home countries want to exercise financial supervision in as integrated manner as possible. The host countries are concerned that with such an

Hosting countries jointly protect their interests in the European Union.

*Since September 19th 2006

*Since September 19th 2006

approach, elements of the central liquidity or capital management system of the financial groups may not be sufficient to meet the expectations of the local market. In order to better coordinate the activities of supervisory authorities from hosting countries and jointly protect their interests in the European Union, the Forum of Host Supervisors, comprising the supervisory authorities from ten Central and Eastern Europe countries, has been established at the initiative of the PFSA.

The crisis sweeping across the global financial markets sparked a discussion on how to reform the regulatory architecture at the EU level. The European Supervisory Authorities (ESAs) have been in operation since 2011. The objectives of the new system is to ensure uniform application of the EU laws by the national financial supervisors and facilitate coordination of regulatory and supervisory activities. In crisis situations and in an event of any dispute between national supervisors, ESAs will be able to make decisions binding for the national authorities. In special circumstances, to ensure compliance with the EU laws, ESAs will also issue individual decisions addressed directly to financial institutions.

Host countries appointed their representatives to the governing bodies of ESAs.

Participation in the work of the management board of an European authority at the stage of its establishment offers a unique opportunity to influence the process of forming new authorities and their operations. Thanks to the creation of the Forum of Host Supervisors, the authorities from Central and Eastern Europe have managed to form a coalition which appointed their joint candidates to the management boards of all three ESAs[5].

Protection of non-professional market participants.

Complaints submitted by clients help to identify and eliminate irregular market practices of financial institutions.

Ambiguous information on products offered, marketing tricks, asterisks, hidden disadvantages, and fine print in contract documents are among the most common problems faced by clients of financial institutions. Apart from its duty to ensure proper functioning of the financial market and to promote its stability, security and transparency, the PFSA is responsible for protecting the interests of market participants.

Client complaints are reviewed by the supervisor in a three-stage process:

- ✓ A complaint is subject to initial assessment which allows to eliminate complaints in respect of which no indication of violation of law or interests of non-professional financial market participants was found.

[5] EIOPA – Damian Jaworski of Poland, ESMA – Raul Malmstein of Estonia, EBA – David Rozumek of the Czech Republic and Károly Szász of Hungary

- ✓ At the next stage, a complaint is assessed to determine whether it pertains to an isolated case or to a potentially detrimental practice occurring at a regulated entity or in a financial market segment, and whether such practice constitutes violation of the law or interests of market participants.
- ✓ Based on the findings of the assessment, a decision is made whether further actions should be taken to investigate the identified irregularities (intervention correspondence with the regulated entity, petition to impose a sanction, instructions, etc.).

Such complaint handling system helped resolve the following issues:

- ✓ use of substitute vehicles under motor TPL insurance,
- ✓ a practice employed by banks and insurance companies to refuse the return of an unused portion of insurance premium in the case of earlier loan repayment,
- ✓ inclusion of VAT in compensation amounts paid by insurance companies based on repair estimates,
- ✓ payment by an insurance company of benefits to the aggrieved spouse of the offending party in an accident due to their being married in community of property,
- ✓ debt collection practices employed by banks.

Other consumer protection activities conducted by the PFSA included monitoring of advertising content to eliminate that which may be misleading for users of financial services. In July 2007, the PFSA defined rules for investment fund advertising, and in October 2008 – rules for banking and insurance services advertising. In past two years, the PFSA made over 20 interventions concerning advertising-related irregularities.

Reliability of financial services advertising was enhanced.

In May 2011, the PFSA issued complaint handling guidelines whose purpose is to harmonise the process across all regulated financial institutions.

Complaint review procedures were implemented.

Accelerated registration process for financial intermediaries.

In December 2010, the Register of Insurance Agents (RAU) was launched as an electronic-only channel through which insurance undertakings may send applications to register, modify the data of or deregister an insurance agent. The launch of the RAU eliminated the need for paperwork in the registration process, which in turn helped reduce costs incurred by insurance companies and the PFSA.

As a result, the average time for registration of insurance agents has been shortened from approximately 1-2 months (from the date of filing of a registration application) in 2007 to approximately two days at present.

The registration process for insurance agents is thirty times faster.

The time for registration of financial intermediaries was also shortened:

- ✓ for distributors of investment fund units – on average, from 6-7 months in 2007 to two months in 2010 and 2011,
- ✓ for investment firm agents – on average, from four months in 2007 to 1-2 months in 2011,
- ✓ for investment advisers – on average, from 22 days in 2007 to seven days in 2010 (no new entries have been made in the register in 2011),
- ✓ for securities brokers – on average, from 15 days in 2007 to eight days in 2011,
- ✓ for commodities brokers – on average, from 22 days in 2007 to six days in 2011.

Over eight thousand people took part in the CEDUR programme.

The PFSA's statutory task is to educate the public in financial matters, and it fulfils its role by promoting and disseminating financial literacy and understanding of how the financial market operates.

Eight thousand people with interest in the financial market took part in the CEDUR programme.

Due to the cyclical nature of the PFSA's educational activities, in particular training seminars, the PFSA launched the CEDUR brand (Education Centre for Market Participants).

Under the CEDUR initiative, five target professional groups were identified:

- ✓ professional financial market participants (representatives of the supervised entities),
- ✓ the judiciary, prosecutors and law enforcement officers,
- ✓ local and regional consumer ombudsmen,
- ✓ media representatives,
- ✓ scholar and academic communities.

Groups with **the greatest potential** to influence other market participants were selected in pursuit of the following goals:

- ✓ Promotion of understanding financial market mechanisms among professional market participants.
- ✓ Promotion of financial literacy and building confidence in the financial market among prospective consumers of financial services.

- ✓ Improvement of professional qualifications of teachers in the fields related to economics and finance.

Over eight thousand individuals took part in the CEDUR programme.

Moreover, a training centre for foreign financial supervisors (TIFS) was set up[6]. Attendees and speakers representing 26 foreign authorities participated in TIFS events in 2010.

Foreign regulators exchange experience through the TIFS platform.

Debureaucratisation of the financial market.

In 2010, the "Measures for financial market debureaucratisation" were developed. Their goal was to facilitate operations on the financial market and improve the effectiveness of state financial supervision. An initial draft of the Measures was presented to market organisations, along with an invitation to submit their own proposals on how to de-bureaucratize the financial market. The proposals were included in the Measures if they pertained to the existing bureaucratic burdens on the part of the market and the supervisor which brought no regulatory advantage.

"Measures for financial market debureaucratisation" helped eliminate bureaucratic burdens which brought no regulatory advantage.

As part of implementing the Measures, the PFSA:

- ✓ developed IT systems facilitating communication with the supervised entities (SNU, RAU, PORTAL, SNO),
- ✓ established an inspection division within its structure, which enabled a more comprehensive analysis of risks at corporate groups, further standardisation and optimisation of inspection procedures across financial market segments, accelerated information flow and reduced the average length of inspection time,
- ✓ reduced the number of supplements to prospectuses,
- ✓ streamlined registration of employee pension schemes,
- ✓ launched application "Requests and applications" on its website at www.knf.gov.pl, containing forms of requests and applications filed with the PFSA and a list of documents to be attached to them,
- ✓ launched electronic monitoring of duration of administrative proceedings.

Furthermore, proposals for improvements in the legal framework were drafted and submitted to supervisors. These were aimed at:

- ✓ undertaking adequate supervision over closed-end investment funds issuing non-public investment certificates,

The law should keep pace with market development.

[6]TIFS – *Training Initiative for Financial Supervision.*

- ✓ abandoning state licensing exams for brokers and investment advisers,
- ✓ replacement of reporting on outsourcing of banking and insurance services with records of outsourcing contracts kept by banks and insurance companies,
- ✓ removal of the requirement to obtain authorisation to maintain commodity accounts and registers,
- ✓ removal of the obligation to hold administrative proceedings prior to imposition of fines by the PFSA,
- ✓ introduction of mandatory consumer arbitration.

Independence of financial supervision authorities.

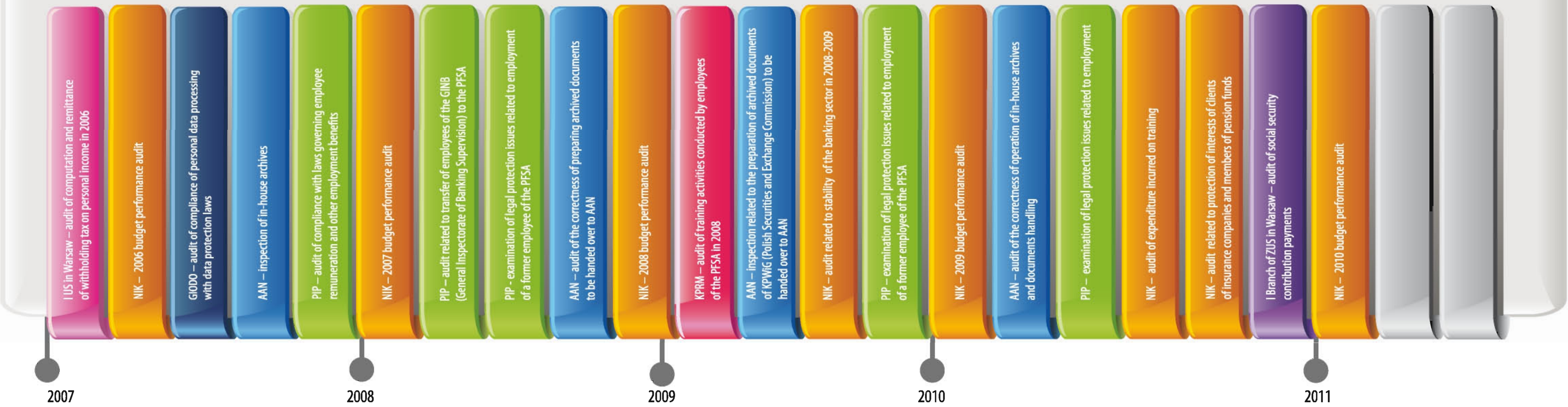
In June 2011, the Constitutional Tribunal found that Article 10.3 and Article 74.2 and 74.3 of the Financial Market Supervision Act are in line with the Polish Constitution, in particular, stating that the Polish Financial Supervision Authority is a public administration body with a great deal of independence and it is not part of the civil service corps (ref. K 2/09).

S u m m a r y

If done properly, supervisory work is strenuous and hardly spectacular but if done defectively it may lead to spectacular bankruptcies or crises. The key supervisory tasks undertaken by the supervisor included: implementation of stress testing system at banks and insurance companies, introduction of liquidity standards for banks, strengthening of banks' capital base, tightening of concentration limits, clarifying rules governing creditworthiness assessment, reducing foreign-currency lending, changing the prospectus approval procedure, and development of the pension fund companies capital adequacy model.

The purpose of financial supervision is to ensure that the financial sector properly performs its role as an intermediary in economic activity, while maintaining risk exposure at an acceptable level.

INSPECTIONS AND AUDITS PERFORMED AT THE PFSA



AAN – Central Archives of Modern Records
GIODO – Inspector General for Personal Data Protection
KPRM – Chancellery of the Prime Minister
NIK – Supreme Audit Office
PIP – National Labour Inspectorate
US – Tax Office
ZUS – Social Insurance Institution

Overall, twenty-one inspections and audits were carried out at the PFSA.
The outcome of all of them was favourable to the PFSA no material irregularities were discovered.

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